

“Economic integration in East Asia: Implications for the Cross-Strait Relationship”

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The paper argues that the recent accelerated pace of economic integration in East Asian provides the opportunity to improve the stalled cross-Strait relationship and reap more economic gains for both side of the Strait.

Asian free trade movement has accelerated recently

Most countries in Asia are engaging into free trade negotiations of one kind or another. In spite of this activism, the Asian “regionism” is a relative new phenomenon. According to Asian Development Bank², only three bilateral trade packs existed in Asia prior to 1995. By 2005, the trade packs swelled to 27, with a much bigger number under consideration, compared with as many as 300 bilateral trade agreements estimated to be in force by the end of 2006 worldwide. ASEAN is the oldest free trade agreement (FTA) in East Asia, which has later been expanded into a ten-country Asian Free Trade Area (AFTA), ASEAN-10. In October 2003, ASEAN-10 agreed to progress toward an ASEAN Economic Community (AEC) by 2020 to cope with the challenge posed by China and FTAs in Europe and America.

China also has undertaken a number of bilateral trade initiatives on her own. In November 2002, China signed a Framework Agreement on Comprehensive Economic Cooperation with ASEAN, ASEAN + 1. Under this agreement, the parties agreed to establish a Free Trade Area (CAFTA) within ten years. To help prop up the Hong Kong economy, China has also signed the Closer Economic Partnership Agreements (CEPAs) with Hong Kong, effective January 2004, to allow the latter enjoy the above-WTO privileges in entering China’s service market. In the Northeast Asia corridor, China, South Korea, and Japan agreed at the 1999 Manila Summit to promote joint research to reinforce their economic cooperation.

CAFTA has hastened the pace of other countries in the region to seek bilateral economic cooperation arrangements with ASEAN as well. In 2002, Japan proposed an ASEAN-Japan Comprehensive Economic Partnership. Korea is also entering

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² Asian Development Outlook 2006, Asian Development Bank, 2006

discussions with ASEAN. Austria and New Zealand intends to enter negotiations for a free-trade agreement (FTA) with ASEAN. Thus, ASEAN+1(China) is shaping into ASEAN+3 (with the addition of Japan, and Korea) and even ASEAN+5 (with the further addition of Austria and New Zealand). Proceeding in parallel to the pan-ASEAN FTAs are a number of bilateral negotiations with individual members in ASEAN. Australian has concluded bilateral FTAs with Singapore and Thailand. Japan has concluded a FTA with Singapore. China negotiates a bilateral FTA with Thailand and Singapore.

In addition to FTAs, the central banks of a number of countries in the region have strengthened monetary cooperation through currency swap arrangements to counter the potential destabilizing cross-border capital flows.

Four factors have propelled the recent proliferation of FTA negotiations in East Asia.

First, the devastating 1997-98 Asian financial crises has taught Asian economies a dear lesson that they share a common fate before the vagaries of international capital flows, which will only aggravate over time as the globalization of financial markets deepens. Second, bilateral trade packs by their very nature tend to divert trade and investment away from the excluded parties to detriment their welfare. Thirdly, the global trade talks under the auspices of the WTO have progressed little since the Cancun meetings, thus diverting the effort toward negotiating regional/bilateral trade agreements. Finally, China, with its dynamic economic growth and growing impact on the region, wishes to use regional FTAs to better manage the process by which its huge economy integrates with the region, as a supplement to the WTO; i.e., to mitigate potential economic frictions and better still expand business opportunities within the region.

The integration of China into the global economy has hastened the pace of Asian economic integration.

Lack of Asian regionism notwithstanding, Asian economic integration has proceeded apace. As a result, Asia has commanded the most rapid growth in foreign trade in the world. The pace of East Asian economic integration has further accelerated since the early 1990s when China adopted the market economy and opened its economy wider to global competition, culminating in her entry into WTO in 2001. As a result, foreign direct investment has poured into China. In the case China serves as a production platform to export to the world market, multinational firms continue to import the needed capital goods, raw materials, and technology from for the lack of domestic supply. The result has been a fast economic growth in China's foreign

trade, ranging 30-40% per annum since 2003. Cross-border intra-industry trade has followed and intra-regional trade boomed. According to the World Bank, the share of intra-regional trade in total Asian trade nearly doubled over the last two decades to about 41%. The intra-industry trade growth, in turn, accounted to 75% of the total intra-regional trade growth in 1996-2000, up from 42% in 1986-90. The “vertical integration” of China with the rest of Asia has turned China into a growth engine for Asia. World Bank estimates that China contributed to 53% of Asian growth over 2003-04

The dynamic growth in China’s trade has also been accompanied by a bulging US bilateral trade deficit with China, which bears the brunt of US protectionist pressure, while many countries in the region run large trade surpluses with China.

Taiwan’s integration with China reflects the broader trend in East Asian integration

Taiwan’s enterprising firms have taken part in these broad economic trends in Asia and often helped to shape them. Overtime, as more and more Taiwanese firms move their businesses to the offshore China to take advantage of low cost, Taiwan’s economy has become more and more integrated with the mainland economy. At the same time, its traditional trade links with its largest trading partner US has gradually weakened. During the ten years between 1992 and 2001, the share of exports destined to China to total exports nearly doubled, from 7.1% to 13.0% (and it further rose to 17.1% in 2003). During the same period, imports from China as a share of total imports experienced even a greater increase, from 1.6% to 7.1% due to a low base. However, Taiwan is not an exception. The Korean trade and Japanese trade with China have also exhibited a similar trend. In the same period, Korea’s export share destined to China nearly quadrupled, from 3.5% to 12.1%, and Japan’s doubled from 3.5% to 7.7%³. Their import shares with China more than doubled in this period; Korea from 4.6% to 9.4% and Japan from 7.3% to 16.6%.

Foreign direct investment has driven the regional trade with China. China-bound foreign direct investment (FDI) has surged ever since China had determined to embark on a socialist market economy path since the early 1990s. During the period: 1992-2003, China’s inward investment from Taiwan rose from \$105.3 billion to \$337.7(3.2 times); Japan from \$74.8 to \$505.4(6.7 times); US from \$51.9 to \$419.8(8.1 times); and Korea from a negligible \$12.0 billion to \$448.8 billion (37.3 time).

³ Foreign trade is reported in Sarah Chan and Chun Chien Kuo (2005).

The above analysis suggests Taiwan's rising economic integration with China is not a unique phenomenon but part of a broader economic trend in East Asia toward a greater economic integration with China. In 2003, Korea and Japan both invested even more in China than Taiwan did. Despite the grave concern of certain quarters in Taiwan about Taiwan's economic "over dependence" on China, Taiwan's economic integration with the mainland economy is distinctively less than the integration of Japan and the US with the latter (Cheung, Chinn and Fujii (2003)).

Deepening cross-strait economic relationship benefits all and politics needs to catch up

Taiwan has benefited from trading with the mainland by exporting high-end immediate and capital goods – thus helping out on industrial upgrading (Alan G. Aheame 2003, Wang 2003) -- while taking advantage of China's efficient production platform as the springboard for exporting the final goods to the worldwide markets – thereby raising its international competitiveness. In contrast, western multinationals, often armed with their brand name advantage, tend to set their minds on the Chinese home market. But there is no reason why the Taiwanese firms should forever give up the potentially lucrative opportunities in the fast growing Chinese market. In fact, Taiwanese firms have the great advantage of cultural affinity with the mainland; even this entails a fundamental change in their mainland business strategy. Other opportunities abound; for instance, they can cooperate with the mainland firms to set up industry standards in telecom and other fields to enhance their competitiveness as advocated by Liu (2005).

Westerners often observe that China's economic renaissance has a unique advantage when compared with other emerging economies in that it has the support of Chinese diaspora with their rich endowment of knowledge, capital, and extensive overseas business networks. Taiwan, with her rich development experience and extensive global trade networks, has provided exactly this type of assistance to the mainland. Taiwan's investment in China has matched each and every step of its industrial upgrading, as well as China's open-door policy. It began from investing in labor-intensive manufacturing in Southern China – the pearl delta region-- in the 1980s, gradually upgraded to information technology products in the Yangtze delta region in the 1990s, and to the capital intensive semi-conductor industry at the present.

No doubt, both parties will benefit from a further deepening in their economic relationships by dismantling existing artificial investment and trade barriers. This

may require some form of a formalistic trade pact between the two sides such as a cross-strait FTA or the like. However, to move forward, political consensus is a prerequisite, which is conspicuously lacking. History also demonstrates that political considerations often motivate the formation of FTAs. European economic integration is seen as an instrument for an eventual pan-European political union to equalize with the US power. The US push for NAFTA was motivated more by the potential geopolitical benefits than economic benefits (Joseph E. Stigitz, 2004). China's active interest in CAFTA may also be partly influenced by her interest in nourishing amicable relations with her small neighbors, beyond economic ones. The latest is that even Gorge Bush had to sell the six Central American free trade deal CATFA in the congress on national security grounds, in lieu of benefits from free trade.

Yes, politics often takes precedence over good economics. But good economics may also sway politics around to its good cause. In the case of cross-strait relationship, the long-standing political standoff across the Taiwan Strait is an unstable one that in the minds of many war strategists only serves to increase the war risks overtime that neither side could afford. It is to the best interest of both parties to find a way to defuse this potential time bomb. Since the deepening economic relationship has benefited both sides, it has already helped to ameliorate the cross-strait tensions, even gradually and inconspicuously. Our analysis argues that the deepening in the cross-Strait economic integration has been a by-product of three dynamic forces: the great transformation of the Chinese economy under autarky into a global economic force, the larger forces of globalization, and Taiwan's own economic upgrading. Now it is the job of politicians to recognize the big, evolving trend and to further consolidate the cross-Strait economic ties. Pursuing an alterative course is futile. Once both sides come together, the winners would not be limited to them alone, but the world economy at large (Liu, 2005).

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