Taiwan Takes On China ... and Wins
By Shalendra D. Sharma

The landmark trade agreement forged by China and Taiwan this year promises to have a profound impact on Taiwan’s domestic economy. But that is only its most immediate importance.

Longer term, the agreement could lead to major economic and political changes in China itself and in the troubled cross-strait relationship, writes political scientist Shalendra D. Sharma.

ON JUNE 29, TAIWAN and China signed a landmark preferential trade agreement. Painstakingly negotiated, it is designed to institutionalize cross-strait economic relations and dramatically enhance trade between the two parties by reducing and streamlining a range of tariff and commercial barriers. On August 17, the deal passed Taiwan’s Legislative Yuan after an acrimonious debate that saw tense standoffs between the ruling and opposition parties. The outcome, however, was never in question, because the ruling Kuomintang (KMT) controls an absolute majority in the legislature. With that act of democratic consent, the relationship between Taiwan and China entered a new era. The deal comes into effect on Jan. 1, 2011.

For Taiwan’s President Ma Ying-jeou and the KMT the pact had particular poignancy as it was signed, whether by design or accident, in the historic city of Chongqing, which served as Generalissimo Chiang Kai-shek’s provisional capital during the Japanese invasion in World War II (1937-1945). It was also the city from which the KMT government so ignominiously fled in 1949 to self-exile in Formosa, now Taiwan.

A WIN FOR THE TAIWAN MODEL
Two generations later, the KMT has made a triumphant return — although there is no hint of this irony in any of the official narratives. The solicitous official statements fail to note that it is the most
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important agreement the two sides have signed since the end of the Chinese civil war in 1949. In fact, the agreement is so conspicuously purged of any political references that Beijing ambivalently refers to the deal as being between “two shores” without ever mentioning the official names for either China or Taiwan. As if to further politically sanitize the agreement—formally known as the Economic Cooperation Framework Agreement, or ECFA—it was signed by “semi-official representatives,” not government officials. Yet ECFA, in a fundamental sense, is a tribute to the Taiwan model of development. Even though leaders in Beijing held the major bargaining chips in the negotiations, including controlling an economy more than 20 times the size of Taiwan’s, they nevertheless made indulgent concessions to seal the deal. Perhaps most importantly, China, which until recently used threats and its formidable economic leverage to prevent other countries having formal relations with Taiwan, was the first to relent and pursue an FTA. Why did it sign an agreement with a regime it considers illegitimate and a renegade, and give generous concessions in the process?

Perhaps Beijing wanted to reward (or even “bribe”) Ma, a judicious and cosmopolitan man who since winning the presidency in March 2008 has defied the pro-independence side of Taiwanese politics by working tirelessly to diffuse the decades-old antagonism between the two sides. His strategy has been one of “replacing confrontation with negotiation” and “replacing conflict with reconciliation.” Or perhaps, as the opposition Democratic Progressive Party (DPP) claims, the deal is a seductive way for Beijing to tighten its embrace over Taiwan. Through economic subjugation, Beijing can discreetly impose its chilling rules of political quiescence and conformity, the DPP argues.

DPP Chairwoman Tsai Ing-wen has even accused Ma and the KMT of political malfeasance, sternly warning that Taipei is unwittingly contributing to China’s hegemony in East Asia by signing the trade deal. The DPP, along with a number of other pro-independence groups such as the People’s Sovereignty Action Network, predict an imminent, if indirect, mainland takeover as cheap Chinese-made goods and labor flood Taiwan. They claim this will decimate the island’s manufacturing and industrial base, putting at risk some 2.5 million jobs, undercutting wages and emasculating the freedoms the Taiwanese now enjoy. Former President Lee Teng-hui has criticized ECFA as a “Chinese scheme,” saying that “when China has siphoned all of Taiwan’s capital and technology with the ECFA, then it will be the end of Taiwan ... What Ma is doing is helping China to absorb Taiwan.” See, Editorial, “A new era of negotiation dawns with the ECFA,” The China Post, Tuesday, July 20, 2010. www.ChinaPost.com.tw

1 ECFA was signed by the heads of the Straits Exchange Foundation (SEF), a private non-profit organization established in February 1991, and the Association for Relations Across the Taiwan Straits, (ARATS), an unofficial organization set up by China. Both were established to handle cross-strait negotiations in the absence of official ties. Their first formal meeting was in Singapore in April 1993. 2 How did Taiwan transform itself from a resource-poor, low-income country into a member of the developed world? More specifically, what explains its ability to promote sustained economic growth, expand employment opportunities, raise average incomes, provide social benefits such as universal health care and education and dramatically reduce the poverty level, which a generation ago was over 40 percent? While several related factors contributed to the island’s success, an important aspect of the Taiwan development model included investment in human capital, the building of a competitive export-oriented manufacturing sector, incentives for high rates of saving and investment, and the use of foreign investment to finance new businesses, including new technologies. 3 As president, Ma has been instrumental in starting direct flights and cargo links to China for the first time in more than six decades. 4 Former President Lee Teng-hui has criticized ECFA as a “Chinese scheme,” saying that “when China has siphoned all of Taiwan’s capital and technology with the ECFA, then it will be the end of Taiwan ... What Ma is doing is helping China to absorb Taiwan.” See, Editorial, “A new era of negotiation dawns with the ECFA,” The China Post, Tuesday, July 20, 2010. www.ChinaPost.com.tw

THE BALANCE SHEET
Chinese-made goods, especially agricultural products, will hardly enjoy unfettered access to the Taiwanese market under the agreement. On
the other hand, among the so-called early harvest list, 18 agricultural products from Taiwan will immediately enjoy zero-tariff access to the mainland. This will give a huge boost to Taiwan’s agricultural sector. In contrast, there are no mainland agricultural products on the early harvest list for export to Taiwan — mainly to protect Taiwanese farmers from the huge economies of scale enjoyed by Chinese farmers, and to appease Taiwanese consumers who might be worried about the safety of Chinese agricultural products. Moreover, processed foods from the mainland will be subjected to mandatory surveillance and oversight and continue to face strict environmental, health and safety standards in line with World Trade Organization (WTO) rules. Although Ma’s claim that ECFA will create some 260,000 new jobs and add 1.72 percentage points to Taiwan’s gross domestic product sounds rather optimistic, the opposition’s claim that it will destroy Taiwan’s labor market is untrue, because free movement of both skilled or unskilled labor is not part of the agreement.5

Arguably, what Beijing most covets, and will get, under ECFA is unhindered access to Taiwan’s exemplary human and financial capital, including its technological and managerial endowments.

Nevertheless, research on existing bilateral and regional free trade agreements around the world does show that the gains and losses they cause are seldom evenly distributed. Rather, the losses are generally concentrated in certain sectors, while the gains are spread across the economy. In the case of Taiwan, some sectors, in particular traditional labor-intensive industries, will be adversely impacted, although to what extent is uncertain. Regardless, Taiwan’s labor-intensive sectors are already doomed, with or without ECFA, because of growing competition from low-wage countries in Asia and elsewhere. The government has announced the creation of a NT$95 billion (US$3 billion) 10-year fund to assist these sectors.

At its core, ECFA is the result of cold strategic calculation on both sides. It is a victory of dispassionate pragmatism over the convulsive mix of clashing ideologies and the bitter historical grievances that continue to poison cross-strait relations. Overall, ECFA, as its proponents argue, is a “win-win” because it has the potential to generate real and substantive benefits on both sides of the Taiwan Strait. Official estimates suggest ECFA could boost the current $110 billion cross-strait trade by 15-20 percent.6 Indeed, in its review of ECFA, the WTO praised the agreement as “vital” to Taiwan’s future economic growth. In particular, the WTO notes that it is essential for heavily export-dependent economies such as Taiwan to improve business competitiveness and expand the services sector and high-tech manufacturing, including green technologies, as new engines of economic growth. This is just what ECFA facilitates.7

The lead negotiators, Chiang Pin-kung, the chairman of Taiwan’s Straits Exchange Foundation (SEF), and Chen Yunlin, the president of China’s Association for Relations Across the Taiwan Straits (ARATS), have gone on record stating that Taiwan will receive a disproportionate share of the benefits from ECFA.8 According to research by Rosen and Wang, ECFA will increase Taiwan’s GDP by 2020 by about 4.5 percent, or $21 billion, from the current level. The study also notes that without ECFA, Taiwan’s overall growth would shrink by 0.8 percent.9

5 I am not aware of a single trade agreement (either bilateral or multilateral) that allows unrestricted cross-border flow of labor.
8 In 2008, after 10 years of inactivity, the SEF and ARATS reopened consultations. They have held four top-level meetings (also referred to as the “Chiang-Chen talks”), and signed a number of landmark agreements, including the “Cross-Strait Agreement on Cooperation of Agricultural Product Quarantine and Inspection,” “Cross-Strait Agreement on Cooperation in Respect of Standards, Metrology, Inspection and Accreditation,” and “Cross-Strait Agreement on Cooperation in Respect of Fishing Crew Affairs.”
This is not surprising, because in addition to enjoying zero tariffs for its agricultural exports, Taiwan will also receive preferential tariffs on manufactured goods and the opportunity to enter the booming mainland market ahead of its competitors. Allowing Taiwanese manufacturers priority access to the mainland has the potential to make Taiwan a key regional hub, as foreign companies will have a greater incentive to invest directly in Taiwan. Also, it will encourage domestic businesses to expand their operations in Taiwan to take advantage of special access to the mainland.

In addition, the early harvest list covers 539 Taiwanese products, but only 267 from China. According to the agreement, the trade gains made by Taiwan would be substantial $13.8 billion, while estimated net gains for China are a modest $2.86 billion. China also agreed to open markets in 11 service sectors, including highly sensitive ones such as banking, securities and insurance, while Taiwan only agreed to offer more access to these sectors. Following implementation of the early harvest list on Jan. 1, both parties have agreed to hold further talks every six months to reduce trade barriers in services, intellectual property and investment guarantees—areas where Taiwan enjoys a huge competitive advantage over the mainland. Anticipating this, a number of Taiwanese banks have already filed applications with the central bank to provide yuan cash settlement services to Taiwan’s financial institutions operating on the mainland. This would be a significant improvement over the prevailing rather chaotic and costly practice that requires Taiwanese banks to buy, at a much higher cost, yuan in Hong Kong from HSBC and Bank of America. Just as significant, the Taiwanese authorities have prudently refused to compare ECFA with the Closer Economic Partnership Arrangements (CEPA) that China has signed with Hong Kong and Macau. Taipei calls CEPA an economic arrangement between China and its special administrative regions, but ECFA an agreement between two equal partners. This wisely underscores Taiwan’s insistence that it is no mere appendage of China. Taipei also hopes that ECFA will make it easier for the island to sign more FTAs without interference from China.

Ma has vowed to vigorously expand free trade agreements with other countries and has indicated that his administration is eyeing an agreement with Japan, Taiwan’s second largest trading partner after China. Ma’s overtures have, to date, received no objections from the mainland.

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**How Taiwan Will Come Out on Top With ECFA:**

- **Taiwan’s estimated rise in GDP growth by 2020:**
  - with ECFA: 4.5%
  - without ECFA: -0.8%

- **Export items to enjoy reduced tariffs:**
  - Taiwan: 539
  - China: 267

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10 According to Taiwan’s Constitution, since Taiwan and China were not viewed as separate nations, it is not clear how they could sign a treaty. President Ma has argued that ECFA should be regarded as a treaty, but has reiterated that this has nothing to do with the independence versus unification issue. Rather, it is aimed at maintaining the status quo across the Taiwan Strait. However, there is also a domestic political dimension to seeing ECFA as a treaty. According to Ma, since ECFA is a treaty, it should be directly submitted to the Legislative Yuan for a second reading with lawmakers either “approving” or “opposing” the deal in its entirety. On the other hand, to the DPP, ECFA is not an official treaty because it was not signed by the president or the foreign minister, but by the chairman of the quasi-official Straits Exchange Foundation. As a result, the DPP has demanded that ECFA be treated as a bill and that its provisions should be chronologically screened on a one-by-one basis in an extra legislative meeting, with lawmakers having the right to amend particular clauses. On July 8, 2010, disagreements over the proper process soon degenerated into open clashes between the KMT and DPP lawmakers, during which KMT legislator, Wu Yu-sheng, was inelegantly hit on the forehead by an object thrown at him by a DPP lawmaker. Wu received cuts on his forehead that required seven stitches. The following day, the DPP walked out of the session in vehement protest. The session was then adjourned until August.
also economically. China is Taiwan’s top export market, accounting for some 39 percent of total exports in 2008. Together, China, the United States, ASEAN and the EU account for more than 80 percent of Taiwan’s exports and more than 60 percent of its imports. Given this, without ECFA, Taiwan would have experienced declining investment and a rapid loss of market share in exports because China and the 10 member countries of ASEAN, for all practical purposes, are already operating under a single free-trade zone. Over 92 percent of goods enjoy tariff-free status between China and ASEAN. More unsettlingly, Japan and South Korea are engaged in intensive talks with China that would expand that zone to include these two economic giants. Without ECFA, Taiwan would have become economically marginalized because its exports would be subject to much higher tariffs in the region — anywhere from 5 to 15 percent more. Countries such as South Korea would have filled the vacuum — particularly in areas such as electronics, which account for a significant proportion of Taiwan’s GDP and export earnings. Taiwan’s trade surplus with the mainland, which stood at $42.9 billion in 2008, would erode sharply, and the Taiwanese companies that have invested some $75.5 billion in the mainland between 1991 and 2008 would become less competitive.

It is important to note that ECFA also calls for the establishment of a “cross-strait economic cooperation committee” to handle negotiations, including the implementation and interpretation of the pact or disputes arising from it. Moreover, since both parties agree that ECFA was negotiated “under the spirit of the WTO,” both have recourse to the WTO’s dispute settlement framework.

WHAT’S IN IT FOR CHINA?
So why did the hard-nosed practitioners of power politics in Beijing make these concessions with what they consider a seditious and treacherous regime in Taipei? Arguably, what Beijing most covets, and will get, under ECFA is unhindered access to Taiwan’s exemplary human and financial capital, including its sophisticated technological and managerial endowments. China’s lumbering and inefficient state-owned enterprises face extinction without radical reform, while its unwieldy and opaque financial and banking sectors are abysmally uncompetitive, inefficient and burdened with non-performing loans. Beijing is also aware that relying excessively on exports to promote growth is no longer sustainable and needs to be rebalanced by more domestic demand.

However, rebalancing will require the politically wrenching process of withdrawing the implicit subsidies to exports (in particular, its undervalued exchange rate) and explicit subsidies to exporters, including cheap credit, land and energy. Encouraging domestic consumption will require an incremental shift of income toward households, which in turn will require a more competitive and productive domestic-oriented production sector to meet demand. This is where Taiwan’s vibrant entrepreneurial capitalism can help reinvigorate the mainland’s economy. Indeed, Beijing hopes to tap the rich intangible “software” that helped trans-
form Taiwan from a pre-industrial economy into a modern economy in less than a generation to transform its own static, “hardware” economy into a more supple and competitive one.

AUTOCRACY VERSUS DEMOCRACY
In the 1960s and 1970s, the economic success of Taiwan and East Asia was synonymous with the “hard authoritarian state” similar to the “developmental autocracy” now associated with China’s growth. Unlike China, however, Taiwan has moved away from dictatorship to a system based on the rule of law, individual rights, democracy and accountability. Like much of the rest of the region, over the past two decades, Taiwan has become a thriving democracy, debunking the idea that authoritarianism is better at promoting economic growth than democracy.

With its political pluralism, empowered constituencies, robust and myriad array of civic associations, protected civil liberties, sustainable social-safety nets (including access to universal health care), worker rights, free press and relatively equitable income distribution, Taiwan has overcome the extreme pathologies inherent in autocracies. Indeed, even Singapore, that quintessentially “benevolent” autocracy created by Lee Kuan Yew, cannot boast such a vibrant social contract that has evolved between the state and civil society.

To be sure, China has hardly abandoned its willingness to use force where necessary to prevent Taiwan from declaring independence. It has an estimated 1,300 ballistic missiles positioned opposite Taiwan’s western coast should Taiwan ever try to secede. For this reason alone, ECFA is important for having brought the two sides to the table to engage in meaningful dialogue. In human terms too, ECFA also provides for between 300 and 500 independent travelers from the mainland daily to Taiwan, and the number is expected to increase over time. This will not only give a boost to Taiwan’s tourism industry, it will also introduce a new generation of compatriots from opposite sides of the strait to each other, helping to chip away at decades of mistrust.

NEXT STEPS
Will ECFA pave the way for a more enduring dialogue on sensitive political, military and security issues? Could it serve as the catalyst to end six decades of acrimony? Could deeper trade and human linkages help reduce tensions and start the long overdue process of political normalization and reconciliation? This remains to be seen, but the potential cannot be ruled out. After all, the European Union and ASEAN also had clumsy beginnings, with only very modest aims to promote trade and dialogue before familiarity, self-interest and shifts in the international system led them to move beyond narrow economic trade-offs to establish robust and stable security communities.

If the “two shores” continue their dialogue and collaboration in good faith and exercise restraint, there is no reason these adversaries, who share a common language, kinship and culture, cannot amicably overcome their long alienation and estrangement. Of course, it is not unreasonable to envision a future where China itself adopts a more representative system of government. It will not have to sign an agreement with Taiwan for that. The People’s Republic would have become like the Republic of China by then.

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