Taiwan’s Reaction to the Global Financial Crisis

Elizabeth Freund Larus
with James Wu

University of Mary Washington
elarus@umw.edU

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Abstract

This paper evaluates Taiwan's attempts to surmount the global financial crisis. Specifically, it focuses on Taiwan's adjustments and positioning to meet the global economic crisis, particularly its political approach and strategies. The paper analyzes how Taiwan is faring not simply at home, but in terms of its economic relations in Asia. The paper addresses the following questions: How has Taiwan's foreign policy evolved? Are new political and economic strategies being formed? How has Taiwan positioned itself vis-a-vis the broader Asian region? What about beyond Asia?

Introduction

Regionalism is a growing phenomenon in today's global economy, and particularly in East Asia. Before the late 1990s, there were few free trade agreements (FTAs) and regional economic institutions in East Asia. In the last decade, however, there has been a wave of regionalism in East Asia.[1] Since 2000, alone, East Asia has formalized more than 75 free trade agreements (FTAs)[2] with many others under negotiation or study. For instance, Taiwan in 2004 formalized a cross-regional trade agreement (CRTA) with Panama, is currently pursuing an FTA with Singapore, and has proposed a CRTA with the United States. Historically, the nature of East Asian trade has been cross-regional because security and diplomatic factors -- and fears -- prevented the creation of regional trade governance institutions. Due to these factors,[3] many East Asian countries sought trade and investment agreements outside the region, particularly with the West. As a result, the United States became one of the largest foreign investors in East Asia and in China, and many countries in the region became heavily dependent on outside markets, especially the US, as buyers for their exports and for sources of investment dollars.

Taiwan is no exception. After transitioning from import-substitution industrialization (ISI) to an export-oriented economy in the 1960s, the island experienced the "Taiwan miracle." Taiwan's governments channeled this economic growth into education, health care and technology. Taiwan has befitted from export-oriented industrialization under the framework of

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[1] For a comprehensive discussion of Asian regionalism and cross-regionalism, see *Cross Regional Trade Agreements: Understanding Permeated Regionalism in East Asia*, Saori N. Katada and Mireya Solis, eds. Berlin: Springer-Verlag 2008.

[2] The paper uses the generic term Free Trade Agreement (FTA) to include both regional trade agreements (RTA) and cross-regional trade agreements (CRTA).

[3] These factors and fears include security arrangements and security cleavages, historical animosities, territorial disputes and wars and lack of formal diplomatic relations, among others.

GATT/WTO, and Taiwan's active promotion of its exports enabled Taiwan to participate in the global economy. Until the late 1990s, Taiwan's was one of the world's fastest growing economies. Political and economic uncertainties slowed this growth in the early 2000s. Just as the economy was beginning to recover, however, it was hit by the 2008 financial crisis. This paper argues that the financial crisis presented Taiwan with the conditions for signing an official trade agreement with China. This article employs theories of regionalism and cross-regionalism to explain Taiwan's efforts to formulate FTA with China and other trade partners. This paper[4] evaluates Taiwan's attempts to surmount the global financial crisis. The paper is organized into four sections. The first section examines economic relations between Taiwan and China before and after the global financial crisis. The second section examines changes to the global economic structure after the 2008 financial crisis. The third section analyzes Taiwan's policy measures to cope with the global financial crisis. The final section assesses Taiwan's strategy adjustment in response to the new global economic structure.

Economic Relations between Taiwan and China pre- and post-Global Financial Crisis

In the past decade, Taiwan businesses invested nearly $70 billion in mainland China.[5] Investment in China as a percentage Taiwan's total overseas investment climbed from 19 percent in 1999 to 62 percent in 2006. Hammered by the global financial crisis and the deceleration of economic activities, however, Taiwan's annual investment in China slid to $7.1 billion last year from a peak of $10.69 billion in 2008 (Table 1).

According to official PRC statistics, Taiwan was China's largest source of FDI from 1978 to 2002. From Table 2, we can see that the sources of FDI included Viking Islands (Finland), Cayman Islands, and Hong Kong, which are major indirect channels for Taiwanese investment in China. Many Taiwan businesses and investors used these channels to bypass government limits on investment to China.[6] By compiling the investments from all of these channels, it is clear that

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[4] The author thanks James Wu of Franklin/Templeton Securities, Taipei, Taiwan for his assistance in researching this topic.

[5] The total amount is estimated to be two to three times that amount if one were to include indirect investment to China.

[6] Former ROC President Lee Teng-hui implemented limits on mainland bound investment in the "be patient, go slow" policy (*jieji yongren*).

Taiwan was the largest investor nation in China from 1978 to 2008. In the last decade, China has become the most important investment target for Taiwanese enterprises. Taiwan's increased investment on the mainland reflects the relaxation of government policy toward China, as well as China's emerging role as the global manufacturing base after its ascension to WTO in December 2001.

Table 1.

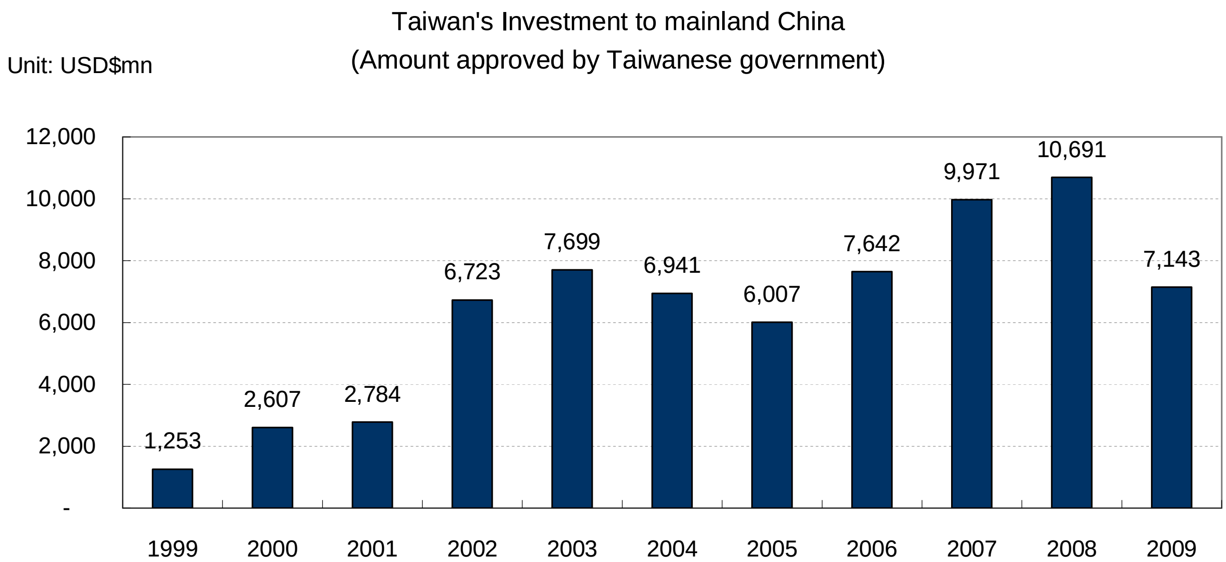


Table 2.

Source of FDI to China

	1978-2002 USD $bn	2002 US$bn
HK	204.88	89.31
Viking Islands	24.39	30.59
USA	39.89	27.12
Japan	36.34	20.95
Taiwan	33.11	19.86
Korea	15.20	13.61
Singapore	21.47	11.69
Cayman Islands	3.80	5.90
German	8.00	4.62
UK	10.70	4.48

Source: Department of Commerce, PRC

Looking at Figures 1 and 2, we can see the enhancement of economic relations between China and Taiwan. China (including HK SAR) represented 42 percent of Taiwan's exports in 2009, followed by ASEAN (15 percent), and NAFTA (13 percent). (Figure 1). By comparison, Taiwan's exports to China (including HK) in 1996 represented only 0.5 percent of Taiwan's total exports.

Concerning imports, Japan and not China, is Taiwan's largest source of imports. While Japan represents 21 percent of Taiwan's imports (providing key components, machinery and manufacture facilities), China accounts for only 15 percent of total imports to Taiwan. In fact, Taiwan consistently runs a trade surplus with China. Although China has contributed greatly to Taiwan's economic growth in recent years, given Taiwan's trade surplus with China, it would be a mistake to conclude that Taiwan should alter its trade and investment policies in response to the emergence of China. Merely looking at China's contribution to Taiwan's economic growth oversimplifies the picture, and can lead to the wrong conclusion.

Figure 1.

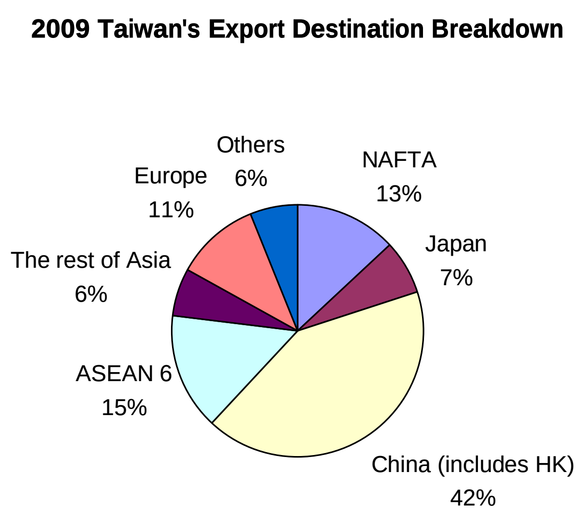
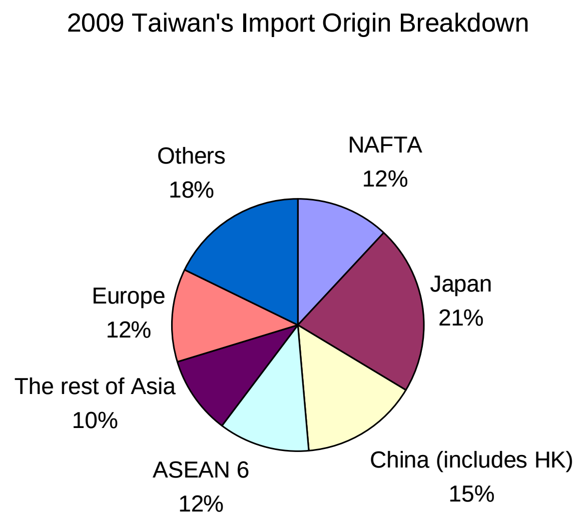


Figure 2.



If we consider the global supply chain, however, we realize that China, Taiwan, Japan, the United States and other countries each play a different but critical role in the chain, and any change on the part of one country affects the entire chain. We may describe the current chain as follows: upstream component providers (Japan and Germany), mid-stream processing (Taiwan), down stream assembling (China), and the end market of consumption (the US and Europe). Understanding the supply chain gives us a better understanding of the structural export/import breakdown, and a clearer picture of the significance of Taiwan's surplus with China. Taiwan's surplus with China provides the necessary components to China's factories, which assemble final products and ship them to overseas markets. China-Taiwan economic relations can be described as complementary: both parties do business together to play their role in the supply chain. During the process, Taiwan makes investments in China and generates a trade surplus with China. In that case, any reshaping of Taiwan's future strategies or policies should take this supply chain picture into account, instead of simply attempting to loosen control. Specifically, either tighter control or looser control should be part of a broader strategy, and should be adjusted in response to changes in China's policies, the impact on the Taiwan people or the competitiveness of Taiwan's domestic economy.

The question of whether one country should increase economic ties with any one of the other players should be put under the consideration of global strategy position. If the move can improve the country’s position, it benefits the country; otherwise, it may weaken its role in the value chain. For example, if Taiwan over-emphasizes any one of its trade partners (such as China), it would likely miss the key point. In other words, it is not a game of bilateral trade competition or cooperation, but is a game of global strategic layout and self-positioning.

Figure 3.

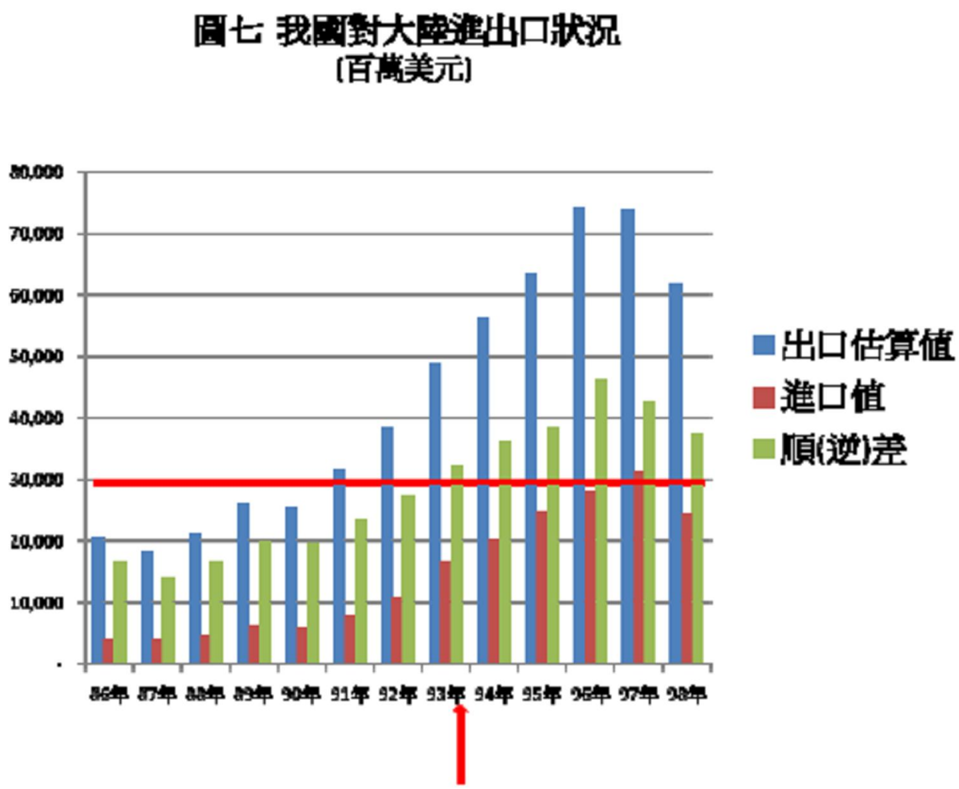
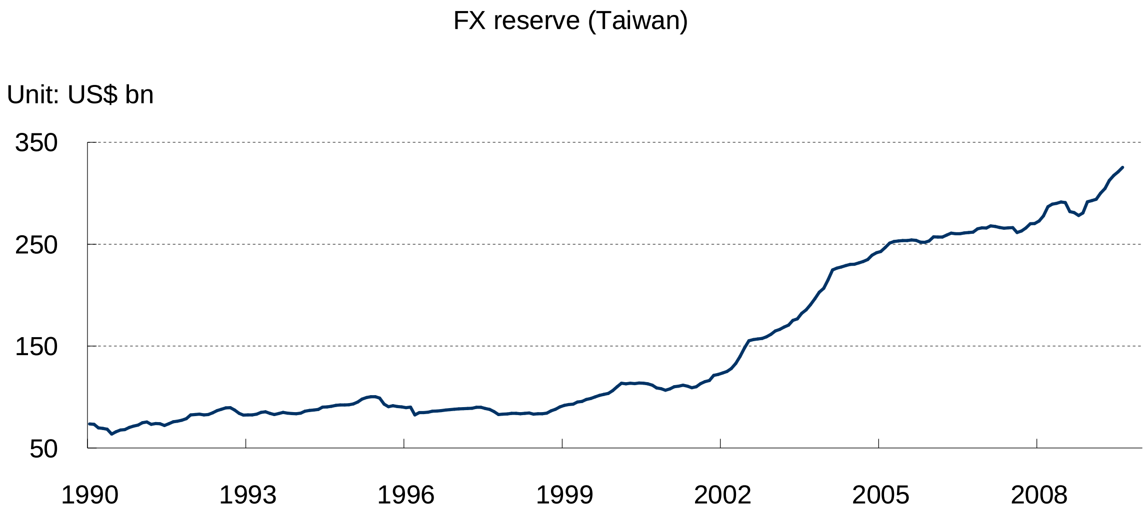


Figure 3 illustrates Taiwan’s exports to China (blue bar), imports from China (green bar), and its trade surplus with China (red bar). All of the numbers exhibited an upward trend, peaking in 2008 and then dropping in 2009 due to the global financial crisis. The increases reflected the greater integration of China and Taiwan into the global supply chain.

Taiwan’s integration made Taiwan the world’s third largest holder of foreign exchange reserves (FX). Taiwan’s foreign exchange reserves climbed from \$74 billion in early 1990 to \$84 billion in 1996 and to a whopping \$325 billion in 2009 (Figure 4).

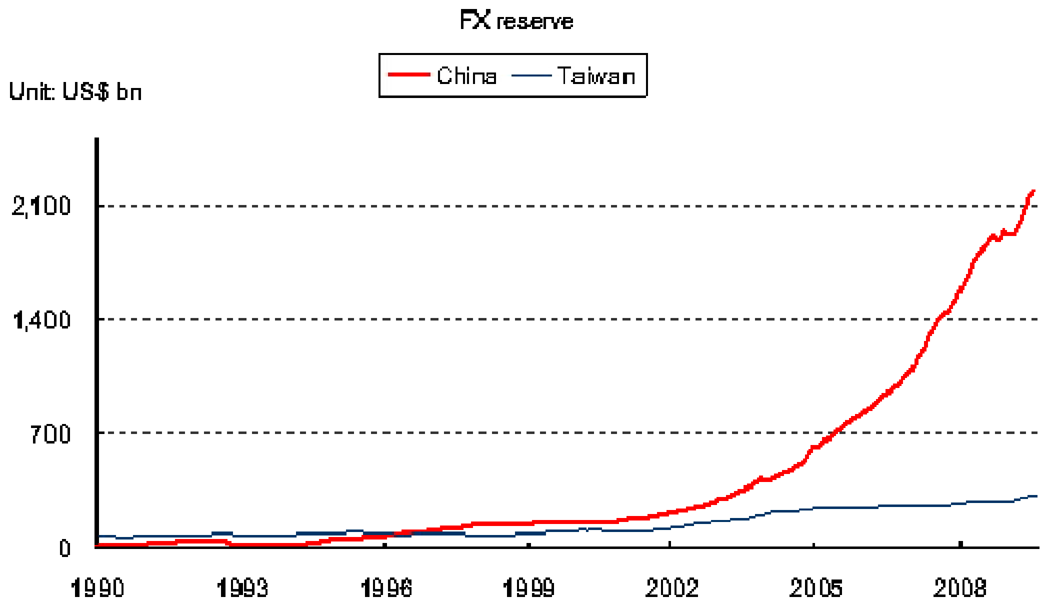
Figure 4.



The accumulation of Taiwan's FX reserve demonstrates the economic growth of Taiwan. Beginning in the 1960s, Taiwan adopted an export-oriented development strategy to drive economic growth, ultimately thrusting Taiwan into the ranks of the developed countries. Taiwan's development was described as an economic miracle. Until recently, Taiwan was one of the world's fasting growing economies. Looking at Taiwan's FX reserve numbers (or foreign trade surplus), we would rightly conclude that Taiwan's growth model was quite successful. We would also conclude that Taiwan benefited from globalization and integration into the world economy.

Although Taiwan benefited globalization and integration into the world economy, it appears that China benefited more. After 1996, China accumulated FX at a faster rate than did Taiwan (Figure 5). In fact, the dramatic speed of China's accumulation easily overshadows that of Taiwan's. China's FX reserves increased from a mere \$19 billion in 1990, to \$87 billion in 1996 and \$159 billion in 2000, to a whopping \$2.2 trillion in July 2009. We can see that Taiwan's FX reserves exceeded that of China until May 1996, but the dramatic growth of China outpaced Taiwan in the following years. With more than \$2.5 trillion in FX reserves, China is by far the world's largest holder of FX. Taiwan is ranked third, with \$355 billion. Clearly, both Taiwan and China have benefitted from participation in globalization.

Figure 5.



Despite Taiwan's economic miracle, the Taiwan economic growth slowed considerably earlier this decade. The slowdown can be attributed to four factors. First, China's economy grew much faster than Taiwan's, and China's emerging economic clout made many Taiwanese feel insecure. Second, although moving Taiwan's manufacturing base to China increased Taiwan's GDP and trade surpluses, many people in Taiwan did not benefit from the move. Many people complained of a hollowing-out of Taiwan's industry, while others grumbled about problems of rising inequity. Third, China's economic and military rise put China in a stronger position in its relations with Taiwan, creating a sense of uncertainty on the island.

If Taiwan's economy was stagnant before 2008, what then of Taiwan's economy after the financial crisis? To answer that question, we need to look at how the global economic structure changed after 2008.

Global Economic Structure after the Financial Crisis

The global economic growth engine has been shifting gradually from the West to the East since the beginning of the 21st century, the latest stage of the globalization process of the last twenty to thirty years. Consistent with Deng Xiaoping's economic reform policies that began in 1978, China liberalized its low-cost labor force, its land and natural resources. These changes allowed Chinese manufacturing to participate in the global manufacturing process. The twin phenomena of liberalization and globalization fueled China's spectacular economic rise. China's share of the global economy has been increasing significantly since the 1990s (Figures 6 and 7).

Figure 6.

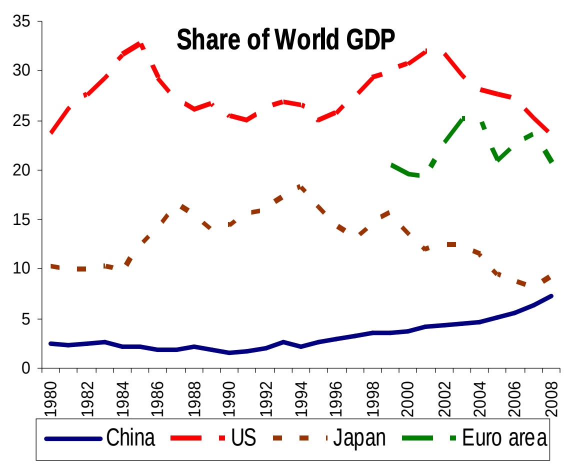
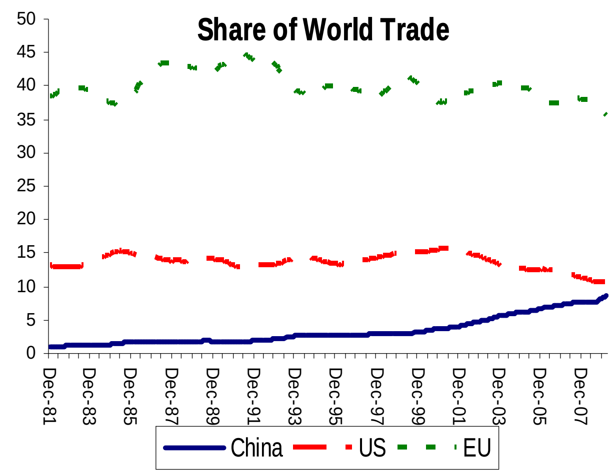


Figure 7.



China's opening offered new opportunities for Western businesses. Many MNEs moved their production lines to low-cost countries such as China and Vietnam. With this development model benefited both China and the West. Western companies provide jobs, and helped fuel China's economic rise. Made-in China products shipped all over the world satisfied the fast-growing consumption need of the West at low prices. The result was a great wave of consumption for the West, a great economic leap for China, and great loosening of liquidity for the global financial market. This global economic development model functioned very well for more than a decade and both producers (such as China) and consumers (such as the US) enjoyed a long period of low-inflation and high-growth. Ben Bernanke described this era as the "Great Moderation."

The model had a fatal shortcoming, however. The model ignored the fact that this "Goldilocks economy,"[7] was unsustainable. The longer it lasted, the bigger the problem it created. Western countries failed to pay for cheap products made in China (and in the other Asian countries), with goods of the same value. To pay for the increasing consumption, they either borrowed more and more money from the next generation or increased their debt (either household or government, or both) year after year. Uber-consumption coupled with uber-debt caused a global imbalance. The huge trade surpluses China racked up was the causality of the huge U.S. trade deficit (as well as household debt and government deficit). The greater China's surplus, the greater the U.S. deficit, creating a greater imbalance of the global economy. The imbalance could be sustained for many years, but not eternally. Over the years, the US has borrowed too much from creditors and eventually the US has to pay back its debt.[8]

Looking for New World Economic Order

The global financial crisis uncovered the fragility of the global economic development model. The crisis was not an accident, but was the unavoidable result of structural instability. In 2008, the export-oriented development model premised on over-consumption and over-borrowing faced a fatal challenge from the global financial crisis. While both China and the US benefited from the model, the US incurred an extraordinarily heavy debt burden. At some point, the debt needs to be repaid. An attempt to immediately pay off debt is called deleveraging.[9] Figures 8 and 9 demonstrate the impact of deleveraging. The process is akin to a self-strengthening downward spiral. As more people reduce their leverage, the economy shrinks (or grows at a slower pace), which in turn makes people less willing to borrow and consume.

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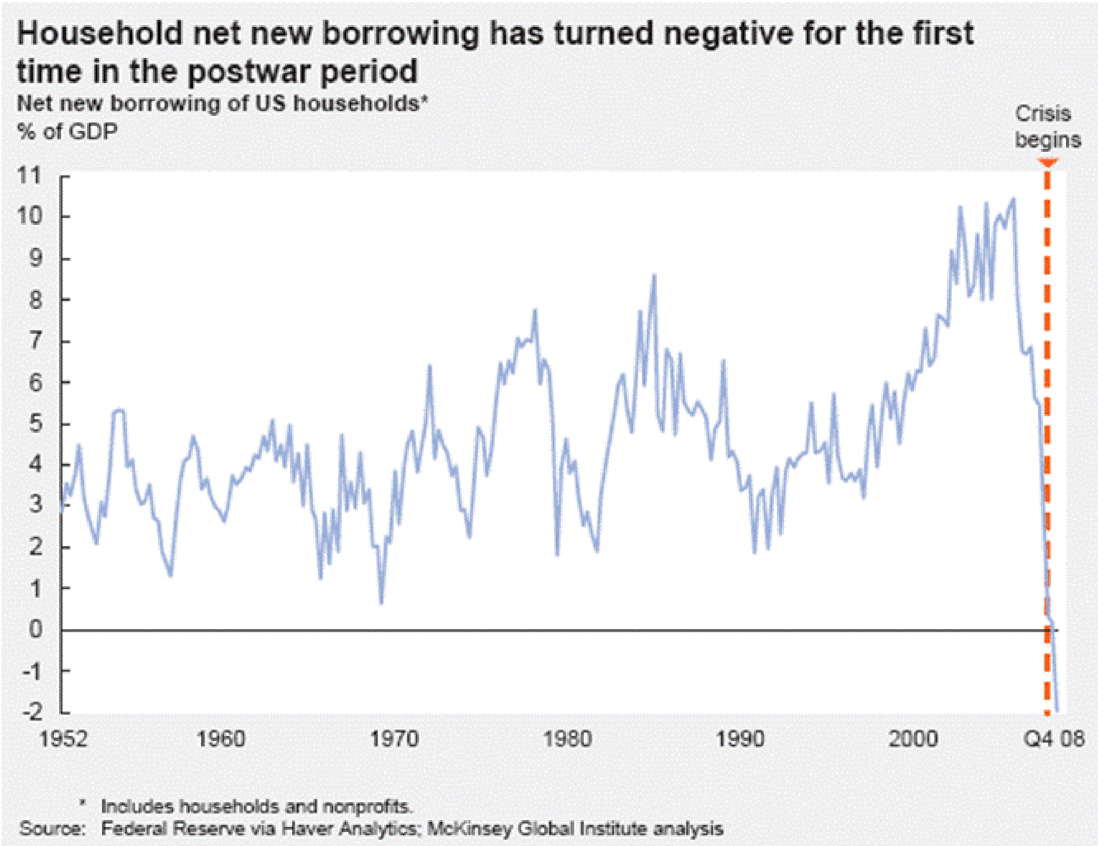
[7] The term "Goldilocks economy" connotes a desirable level of economic growth without inflation. It describes the U.S. economy of the mid- and late-1990s when economic growth and inflation were around 3 and 2 percent, respectively. It is called "Goldilocks" economy because, like the fairytale porridge, it is neither too hot (inflation) nor too cold (recession). Some economists consider this optimal and in such situations the government usually decides not to undertake any policy measures to improve macroeconomic performance.

[8] Another option would be to inflate the value of the US dollar or to cause financial crisis to write off the huge debt.

[9] The term deleverage usually refers to a company's attempt to immediately pay off any existing debt on its balance sheet. If the company is unable to do this, it risks defaulting. Households and countries can deleverage as well. Households typically tighten belts to bring liabilities in line with income. Countries reduce their total debt to GDP ratios.

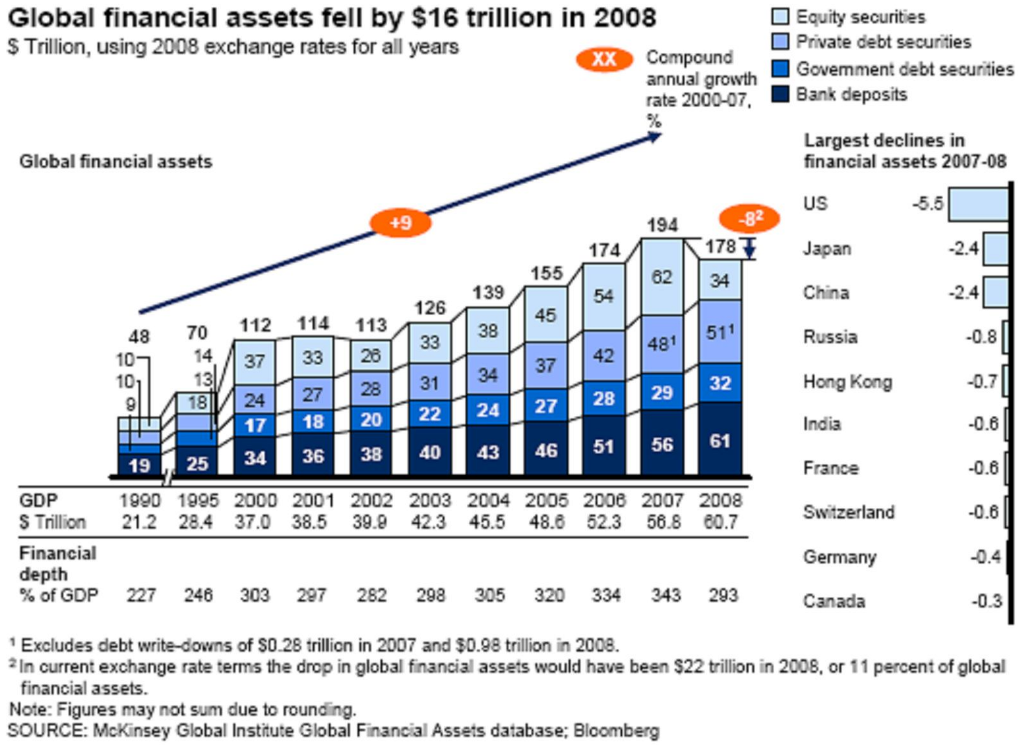
Figure 8.



No longer able to access cheap credit, the Western countries can no longer consume cheap products as much as they wanted, and the turnaround pushes them into the difficult deleverage process which is expected to take several years.[10] The deleverage process has slowed consumption in the West. In other words, global demand growth will rely less and less on the West.

[10] Historically, deleveraging began about two years after the beginning of the financial crisis and lasted for six to seven years. "We've only just begun to deleverage," *Economist*, January 14, 2010.

Figure 9.



It is interesting to note, however, that while the global financial crisis drastically hurt Western economies, it hurt Asia-Pacific economies far less. When the growth model had been damaged, the old growth engine of the West also shifted to Asia. Thus, the impulse of the global financial crisis not only shook the global development structure, but also shifted the global economic balance of power.

As domestic demand in the West withered, domestic demand in China emerged as the new global growth driver. China, which for the past three decades had used the export-oriented growth model, is standing at the crossroads of a new development model. There are three reasons for the change in the model. First, foreign demand can no longer sustain China's strong growth and the domestic demand inside China is finally taking off. Second, rising labor costs in China have begun to erode China's cost advantage. Third, wealth accumulation in China is approaching a critical point, driving huge consumption growth as China urbanizes its rural areas. China's 2008 Labor Law seeks to increase the standard of living standard for workers, while pressuring manufacturers to raise wages for their employees. Wages are rising due to a growing labor shortage (felt particularly in China's coastal regions). Even before promulgation of the 2008

Labor Law, China's per capita GDP had risen to more than $3,000 and the per capita GDP of China's coastal regions had risen to more than $10,000. China's wealth accumulation provides a solid foundation for strong consumption growth in the next decades. In that sense, the global growth engine looks to further shift its weight to the Asia-Pacific, at least to the foreseeable future.

Although the old structure has collapsed, the new one still under construction and is incomplete. Although these new consumption patterns provide new business opportunities after the global financial crisis, the trend has not been as promising as it appears absent some necessary conditions. Then, the question becomes "What are the further conditions for China to become the next end market and global growth driver"? Conditions that may limit China's ability to become the next end market and global growth driver are: increases in the cost of labor, depletion of natural resources (such as coal for energy), higher food prices, natural disasters and possibly the threat of climate change. Therefore, attempts to increase living standards in China to levels seen in the West may generate a lot of business opportunities, but can cause disaster if the huge demand is constrained by the resource limitation without agile policy arrangement.

In short, the global economic structure has been altered drastically after the global financial crisis. The West is waking up to the fact that it will one day need to deleverage. At the same time, China is emerging as the next consumer market. The Taiwan government needs to respond to this new environment with a comprehensive strategy. The next two sections discuss short-term policy measures that Taiwan's government has already adopted to face the global financial crisis and Taiwan's new national strategy, respectively.

Taiwan's Policy Measures to Cope with the Global Financial Crisis

In response to the financial crisis and the sudden shock of demand shrink simultaneously, Taiwan government adopted several policy measures.[11] The impact of global financial turmoil resulted in downside risks to the local economy in the second half of 2008. To alleviate the impact of the financial crisis, Taiwan's government in September 2008 launched the Economic Vitalization Package and implemented a succession of monetary policies, financial stability measures and fiscal policies to increase domestic demand, stabilize the financial system and maintain the momentum of economic growth. The package is summarized as follows.

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[11] Financial Stability Report, the Central Bank of China, ROC, May 2009.

Loosening Monetary Policy

To increase domestic demand and provide a sufficient injection of liquidity into the market, the Central Bank of China adopted an easy monetary stance. Key changes included:

- *Lowering the discount rate*

The CBC lowered the discount rate from 3.5 percent in September 2008 to 1.25 in February 2009. Lower interest rates helped to reduce individual and corporate funding costs, encourage private consumption and investment, and stimulate domestic economic growth.

- *Lowering the required reserve ratios*

The CBC also lowered the required reserve ratios on demand deposits and time deposits by 1.25 and 0.75 percentage points, respectively, releasing around NT$200 billion of funds with a view to increasing the momentum of bank lending.

Stabilizing the Financial System

To stabilize the financial markets, improve market confidence, as well as assist individual and corporate funding, the government also implemented a number of measures to stabilize the financial system. Key measures include the following.

- *Adopting an interim blanket deposit guarantee*

The government moved to guarantee all deposits in insured financial institutions (both banks and community financial institutions) by their full amount until the end of 2009, thereby effectively stabilizing the market and restoring the confidence of depositors.

- *Initiating approaches for stabilizing stock markets*

The government tried to stabilize the stock markets by temporarily resuming the ban on some short-sales, encouraging companies to buy back their own stocks as treasury stocks or company directors to purchase their companies' stocks, encouraging state-owned financial institutions and the four government-managed funds to purchase low-priced stocks of well-performing companies.

- *Increasing securities market momentum and expanding capital market size*

To increase market momentum, the government permitted the short-selling of borrowed and margin stocks at or above the closing price on the previous trading day. As a result, the trading volume in the stock market increased substantially in December 2008. Moreover, in early January 2009, the government resumed the short-selling of 150 listed shares below the closing price on the previous trading day and lifted the limits on the total volume of short-selling for borrowed and margin stocks. Market liquidity increased as a result. In addition, in late April the FSC released a new regulation which gave the green light to Qualified Domestic Institutional Investors (QDIIs) from China wishing to invest in Taiwan's securities and futures. It was expected to expand the scale of the local capital market in order to promote its internationalization and competitiveness.

- *Coordinating corporate financing support*

The government also introduced several initiatives to facilitate corporate financing. These efforts include organizing a special task force to help small and medium enterprises (SMEs) and large corporations find financing support, extending loan and interest payments by six months for corporations that face financial difficulties but still operate normally, extending the settlement period for dishonored checks, initiating a program (formally, the Program to Encourage Lending by Domestic Banks to Small and Medium Enterprises), and increasing SMEs' lending by NT$300 billion by the end of 2009, providing NT$600 billion in loans to large corporations.

To help corporations raise funds from capital markets, the government also relaxed the lower limit of offering prices for equity offerings, allowed issuers of convertible bonds which are due before the end of 2009 to set additional conversion price reset provisions or modify terms, such as extending the due date, after reaching the final decision at shareholders' meetings and negotiating with bondholders, allowed companies to issue new corporate bonds to pay off previous bond indentures; and allowed public-issuing companies to repay corporate bonds using the residual funds of previous bond issues.

- *Assisting individuals to get loans from banks*

The government also introduced several measures to assist individuals in getting loans from banks and reducing the interest burden for homebuyers. These measures include providing a total of NT$400 billion in preferential mortgage loans in September 2008 and April 2009, respectively, allowing borrowers of preferential mortgage loans to extend the expiration date or defer principal repayment of loans if applicable, and allowing involuntarily unemployed workers to defer principal payments of their mortgage loans.

Fiscal policies

Finally, the government altered its fiscal policies to promote domestic demand and maintain the momentum of domestic economic growth. These measures include the following.

- *Expanding investment in public works*

The government adopted a NT$500 billion four year project of expanding investment in public works schemes. Its objectives are to create a comprehensive and rapid transit network, strengthen infrastructure to enhance national competitiveness, improve transportation facilities on outlying islands, and to foster education and employment. The government anticipates that the project will increase real GDP by 0.68 percentage points in 2009.

- *Encouraging consumption*

The government issued consumption vouchers valued at NT$3,600 per person starting in January 2009, totaling around NT$80 billion, to stimulate private consumption and boost the domestic economy.

- *Lowering the estate and gift tax rates*

The government lowered the ceiling on the estate and gift tax from 50 percent to 10 percent. The move is expected to attract capital remitted abroad to flow back and revitalize domestic markets.

- *Promoting employment*

To create employment opportunities, the government introduced the 2008-2009 Short-Term Employment Promotion Program, which aims to provide approximately 46,000 job openings in 2008 and 56,000 job openings in 2009. Moreover, the 2009-2012 Employment Promotion

Program is expected to add 50,000 employment opportunities per year from 2009 to 2012, thereby reducing Taiwan's unemployment rate.

Taiwan's Strategy Revision in Response to the New Global Economic Structure

The most important strategy change of Taiwanese government is its mainland China policies. Since his inauguration as president, Ma Ying-Jeou has maintained an atmosphere of reconciliation with mainland China. Cross-Strait relations have warmed up since the ice-breaking visit of the then KMT's chairman Lien Chan to mainland China in 2004, and the historical bilateral talk between the chairman Lien of KMT and the chairman Hu of the CCP. Since 2008, both the governments of Taiwan and China have sought measures to improve Cross-Strait relations. The most significant of these efforts has been signature of Economic Cooperation Framework Agreement (ECFA) between Taiwan and mainland China. On its face, ECFA is a free trade agreement (FTA) that promotes economic cooperation and trade facilitation. Looking a bit closer, however, one can see that ECFA implies some element of political reconciliation. While the agreement is designed to enhance economic ties between China and Taiwan, it may also have the effect of diluting the pressure of the pro-independence power in Taiwan. Thus, while the impact is primarily economic, it also has political implications.

The Taiwan government positions ECFA as a strategic turning point to enhance Taiwan's economic development. While the strategy may not be planned specifically in response to global financial crisis, it can be used to cope with the new world structure. Taiwan's government had two major aims in pursuing ECFA. The first aim was to improve the economic relationship with China and benefit from China's economic rise. The second aim was to improve Taiwan's political relationship with China so that the ROC could augment economic ties with the rest of the world without interference from China. These two aims require some elaboration.

First, Taiwan wants to improve economic relations with China to benefit from China's economic rise. China's economic rise, coupled with its ability to weather the financial crisis relatively unscathed, has earned China a more important role in the global market. In light of China's rising economic clout, Taiwan may have more chances to join the construction of the new global economic chain if Taiwan can enhance its economic ties with China. For example, development of China's interior, urbanization of rural areas, emergence of domestic consumption, and liberalization of industries such as financial service, infrastructure, retailing and transportation all provide huge business opportunities for Taiwan investors. Tighter economic ties with China may also strengthen Taiwan's strategic position in the region. Many people on Taiwan think that the island can play a more aggressive role in the regional or even global value chain. They claim that, given Taiwan's location in Asia, the island can serve as a critical point in the supply chain. Specifically, Taiwan may position itself as the regional headquarters for MNCs in the Asia Pacific and as the regional capital raising center. Reaching this goal would require a massive effort on the part of the Taiwan's government, financial and lending institutions and entrepreneurs. Furthermore, Taiwan would face competition from other AP countries. Although ECFA is a starting point, Taiwan still has a long way to go to achieve the above mentioned goals.

Taiwan's Council For Economic Planning And Development (CEPD)[12] recently announced plans for a global road show to promote Taiwan's strategic position. The CEPD claims that Taiwan is the best choice for multinational enterprises that want to set up Asian regional headquarters or find alliance partners. Following the signing of ECFA, international enterprises that cooperate with Taiwan in deploying in the Asian market can enter the Chinese market under preferential conditions and be protected by an investment protection agreement. In addition, the better understanding that Taiwanese enterprises (relative to companies in other countries) have of China's operating environment, and the comparative advantage provided by Taiwan's 17 percent business income tax, can bring rich rewards to foreign companies that invest in Taiwan. Under the favorable conditions provided by ECFA, foreign investors in Taiwan not only will be able to draw on Taiwan's existing industrial strengths, but also will enjoy a very promising business environment that enables them to secure more sustainable benefits.[13]

ECFA's second goal is to improve Taiwan's political relationship with China, thereby increasing Taiwan's economic ties with the rest of the world with less interference from China. FTAs are inter-governmental negotiations, and as such reflect not just economic goals of policy makers but also non-economic priorities of the state.[14] One of the motives for formalizing FTAs

[12] The CEPD is a central government bureau responsible for economic strategy and policy planning.

[13] CEPD, July 16, 1010. Online, http://www.cepd.gov.tw/encontent/m1.aspx?sNo=0013968.

[14] For a discussion of the security and diplomacy motives of formalizing FTAs, see Solis and Katada, "Permeated Regionalism in East Asia: Cross-Regional Trade Agreements in Theory and

is to improve a country's status by gaining international recognition. The World Bank notes that many countries engage in FTAs to be noticed.[15] Thus, signing FTAs with major trade partners would enhance Taiwan's strategic position, both economically and politically. In other words, signing FTAs with other countries would help Taiwan expand its diplomatic space.

Hence, negotiations imply sovereignty, and China does not want its diplomatic partners to recognize (the ROC on) Taiwan. Taiwan, because the international pariah status imposed on it by China, has been largely shut out of the free trade regime. For many years, China has put political pressure on countries *not* to formalize or discuss FTAs with Taiwan. Although Taiwan does have trade agreements with other countries, they are mostly with their diplomatic allies. For instance, Taiwan has trade agreements with Panama, Guatemala, Nicaragua, Honduras and El Salvador, and is in negotiation with the Dominican Republic. The Taiwan government believes that signing ECFA will improve cross-Strait relations and trade, enabling foreign governments to enter into FTA talks with Taiwan. In particular, it believes that China would be more willing to allow its diplomatic and trade partners to sign FTAs with Taiwan.[16] Also, Taiwan will be able to better align its economy with global markets, up more development space for its businesses, and build up profit niches from global positioning, and to attract more foreign investment in Taiwan. The government believes that these benefits will enable Taiwan to play a central role in the Asia-Pacific economy and trade and further develop Taiwan's domestic economy.[17]

Unfortunately for Taiwan, it appears that regional and cross-regional FTAs with China's diplomatic partners only come through China. Taiwan's economy is export-oriented, and Taiwan's export competitiveness being threatened in global markets, with exports account for more than 70 percent of Taiwan's GDP. Exports and a trade surplus are the driving forces of economic growth. In recent years, the wave of regionalism has generated more than 230 RTAs and bilateral FTAs in which the signatories grant each other tariff-free market access. If Taiwan is unable to participate in this trend, its export competitiveness will be greatly weakened.

Practice," in *Cross Regional Trade Agreements: Understanding Permeated Regionalism in East Asia*, Saori N. Katada and Mireya Solis, eds. Berlin: Springer-Verlag 2008, 1-26. 2008.

[15] World Bank, *Trade Blocs*, 19.

[16] Visit to Mainland Affairs Council, Taipei, Taiwan, June 2009.

[17] Mainland Affairs Council, *ECFA: Cross-Strait Economic Cooperation Framework Agreement, Policy Explanation* (Taipei, Taiwan: The Executive Yuan, Republic of China, 2009).

In Asia, the ASEAN countries have taken the initiative in seeking FTA partners. ASEAN has formalized or negotiated ten bilateral CFTAs and promoted the idea of ASEAN plus N (i.e., China, Japan, Korea and India among others) RFAs. Starting this year, the successive establishment of the ASEAN-China, ASEAN-Japan, and ASEAN+3 free trade areas will further threaten Taiwan's exports. The petrochemical, machine and auto parts industries will be among those that will be most affected. With the wave of regionalization and cross-regionalization, Taiwan is at risk of being left out of the game. In other words, the greater the number of countries that engage in FTA, the greater the threat put on those countries that fail to engage. The formalization of FTA on the part of ASEAN and other Asian countries put pressure on Taiwan to join the game to avoid the threat of marginalization. Without ECFA, Taiwan believes that China would continue to obstruct Taiwan's efforts to enter into FTAs with trade partners, essentially isolating Taiwan at a time of growing regionalism and cross-regionalism.

There is no guarantee that China will allow other countries to enter into FTAs with Taiwan. Negotiating and finalizing an FTA is always a highly controversial issue even among states that don't have a bug bear influencing their trade partners. In the case of other countries, different industries, constituencies and other actors may support or reject the proposed FTA. The conflict and negotiations between two countries usually takes years to work out an FTA. Taiwan has the added complication of China putting pressure on diplomatic and trade partners not to engage in FTA with Taiwan. In July, however, Taiwan officials indicated that China was finally willing to let Taiwan negotiate trade pacts with other countries.[18] For example, Taiwan and Singapore will pursue a free trade-style deal under the WTO framework. Both Taiwan and Singapore are avoiding the use of the term FTA to describe the deal. Although Taiwan broached the topic of FTAs with other ASEAN nations, Malaysia and Thailand both indicated that they were satisfied with the existing trade agreements with Taiwan and did not need to sign an FTA with Taiwan. Taiwan is now eyeing Vietnam and Indonesia as potential FTA partners.

Even after signing ECFA, China will strongly influence any potential FTA that Taiwan seeks with any of China's diplomatic or trade partners. China's strategy will be to find the point which balances economic benefit (what it can give to Taiwan) and political goal (what it wants to take from Taiwan). All parties involved in the FTA concept (Taiwan, China, and the potential

[18] "Taiwan, Singapore to Pursue Trade Pact," Reuters, august 5, 2010. Online, www.reuters.com.

FTA partner) will be looking out for their best interest. Taiwan's strategy will be to improve relations with China in hopes of getting positive feedback from China, which will enable Taiwan to extend its economic influence to other countries (through FTA). Taiwan's motive will be to strengthen political ties with the FTA partner, enhancing Taiwan's international posture. Thus, the signing of ECFA benefits both Taiwan and China. Through ECFA, China gains greater access to the Taiwan market, while Taiwan gets more control to engage in negotiations with other countries. ECFA, which on its face appears to be merely an economic arrangement, is actually a dilemma for Taiwan and touches the critical point of cross-Strait relations.

But what if China puts pressure on its partners *not* to sign FTA with Taiwan? In that case, Taiwan companies may shift their headquarters or move more manufacturing facilities to China in order to take the advantage of the FTA between China and other trade partners, such as lower tariffs. In the worst case scenario, this hollowing out of Taiwan's economy would damage Taiwan's economy and further shake its strategic position in the region. A strategically weakened Taiwan might be the ideal solution for China, but would impair Taiwan's ability to determine its own future.

Conclusion

The most likely solution may be neither of the above. As of August, ECFA is just a framework agreement. China and Taiwan still need to negotiate detailed agreements on mutual investment and openness of the trade service sectors. Because of these outstanding issues, Taiwan still has some bargaining power to deflect China's potential objections to Taiwan's signing of FTA with other countries. The next stage of the process will certainly be more complicated than the first stage of reaching the ECFA framework. Taiwan's negotiating skills will certainly be tested as China and Taiwan finesse the details of ECFA.

Currently, Taiwan's most important strategic goal after the global financial crisis is to reposition itself in the new global economic structure and use the incumbent resources and market conditions to create an indispensable status in the global economic value chain. The Taiwan government has already taken some important measures to cope with the global financial crisis, such as loosening monetary policy, stabilizing the financial system, and altering fiscal policies. While some of these were one-time measures or temporary measures designed to have an immediate impact, others, particularly loosening monetary policy, will have more effect in the medium to long run. Positioning Taiwan as the regional headquarters for MNCs in the Asia and as the regional capital raising center is a longer term strategy, and one that does not seem to have the consensus of policy makers. Implementation of ECFA is a long term strategic initiative. While negotiating a free trade framework with China, Taiwan hopes to be able to enter into FTA with other countries, thereby expanding its international space. These negotiations will reveal China's true colors. One day, ECFA may be judged less on its merits as an economic agreement than on its ability to enhance Taiwan's international position and thereby safeguard Taiwan's security.