

TAIWAN-CHINA RELATIONS FROM AN ECONOMIC PERSPECTIVE

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I. INTRODUCTION

After he was elected president in March 2000, President Chen Shui-bian adopted many open measures with respect to economic relations between Taiwan and China. Indeed, cross-Strait economic policy became a major initiative of the Chen Shui-bian administration's China policy and cross-Strait economic exchange was the only issue on which both sides could "interact" and "negotiate" through appropriate channels accepted by both. Therefore, despite continuous political confrontation between Taiwan and China, economic relations across the Taiwan Strait have developed very rapidly and could serve as a catalyst for future bilateral political interaction.

From an economic perspective, this paper analyzes dynamic Taiwan-China relations during the Chen Shui-bian administration period. First, it sets out the basic statistics of the growing economic exchange across the Taiwan Strait from 2000 to 2005. Second, it elaborates how cross-Strait economic relations bring opportunities for cross-Strait interaction. Third, it discusses China's new approach of economic inducements against Taiwan on cross-Strait economic exchanges. Fourth, with rapid regional economic integration, it analyzes how Taiwan, the United States, and Japan can advance cooperation for a win-win solution of economic prosperity and regional stability. It concludes with some policy suggestions for three parties concerned.

II. STATUS OF CROSS-STRAIT ECONOMIC EXCHANGE

A. TRADE RELATIONS BETWEEN TAIWAN AND CHINA

Taiwan's Mainland Affairs Council (MAC) of the Executive Yuan estimates that the island's exports to China are equal to transit trade plus the difference between Taiwan's exports to Hong Kong and Hong Kong's imports from Taiwan. This estimate is likely to be more reliable than the figures from customs services of Taiwan and China because the latter data do not take different types of Taiwan exports to China into account and thus underestimate the total amount.

Based on the MAC's estimates, Taiwan's indirect trade with China via Hong Kong was US\$31.2 billion in 2000 and US\$76.4 billion in 2005, recording an increase of 145 percent in five years. In addition, Taiwan enjoyed a continuous and large trade surplus with China. In 2000, Taiwan ran a trade surplus of US\$18.8 billion, with US\$25.0 billion of exports to, and US\$6.2 billion of imports from, China. In 2005, it enjoyed a trade surplus of US\$36.2 billion, with US\$56.3 billion of exports to, and US\$20.1 billion of imports from, China. (See Table 1)

Table 1. Taiwan's Trade Relations with China

Unit: US\$ billion

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Exports	20.7	22.5	19.8	21.3	25.0	24.0	31.5	38.3	48.9	56.3
Imports	3.1	3.9	4.1	4.5	6.2	5.9	8.0	11.0	16.8	20.1
Trade	23.8	26.4	24.0	25.8	31.2	30.0	39.5	49.3	65.7	76.4

Source: Mainland Affairs Council (Taiwan), <http://www.mac.gov.tw>, accessed on May 17, 2006.

Since 1993 China had already been Taiwan's third largest trading partner, after the United States and Japan. After 2002, China became Taiwan's largest trading partner. In 2003, Taiwan's trade with China, Japan, and the United States was US\$46.3 billion, US\$44.6 billion, and US\$42.8 billion, respectively. In addition, since 1993 China has been Taiwan's second largest export market, following the United States. After 2001, China became Taiwan's largest export market. In 2002, Taiwan's exports to China, the United States, and Japan were US\$29.4 billion, US\$26.7 billion, and US\$12 billion, respectively.

In comparison, between 1990 and 1999 Taiwan was China's fourth largest trading partner, following Japan, the United States, and Hong Kong. Between 2000 and 2005 Taiwan became China's fifth largest trading partner, following Japan, the

United States, Hong Kong, and Korea. In 2005, China's trade with the United States, Japan, Hong Kong, Korea, and Taiwan was US\$211.6 billion, US\$184.4 billion, US\$136.7 billion, US\$111.9 billion, and US\$91.2 billion, respectively. In addition, since 1993 Taiwan has become China's second largest source of imports (Japan has been its largest source) and after 2005 Taiwan was the third. In 2005, China's imports from Japan, Korea and Taiwan were US\$100.5 billion and US\$76.8 billion, and US\$74.7 billion respectively.

B. FINANCIAL RELATIONS BETWEEN TAIWAN AND CHINA

According to Taiwan's official figures, in 1991 the island's foreign direct investment (FDI) into China was only US\$17 million. After 1992, however, China became the largest recipient of Taiwan's outward investment. By the end of 2000, Taiwan's cumulative FDI in China was US\$17.1 billion; by the end of 2005, Taiwan's cumulative FDI in China reached US\$47.3 billion, or 51.5 percent of total Taiwan's outward FDI. Note that the figure for 2005 includes retroactive registration of Taiwan's previously unregistered investments to China. Between 2002 and 2003, there were 12,218 cases of such registration.

In comparison, according to official Chinese sources, by the end of 2000, Taiwan's realized FDI in China was US\$26.2 billion; by the end of 2005, Taiwan's realized FDI in China was US\$41.8 billion, or 6.7 percent of total realized FDI received by China. Taiwan was the fifth largest source of FDI in China, next to Hong Kong (41.7 percent), Japan (8.6 percent), the United States (8.2 percent), and British Virgin Islands (7.4 percent). (See Table 2)

Table 2. Taiwan's Annual FDI in China

Unit: US\$ million								
	1999	2000	2001	2002	2003	2004	2005	Cumulative
Taiwan's statistics	1,253	2,607	2,784	3,859 (2,864)	4,595 (3,104)	6,941	6,007	47,256
China's statistics	2,599	2,296	2,980	3,971	3,377	3,117	2,152	41,775

Note: Figures in parenthesis are retroactive registration of Taiwan's previously unregistered investments to China.

Source: Mainland Affairs Council (Taiwan), <http://www.mac.gov.tw>, accessed on May 17, 2006.

However, both Taiwan's and China's official figures considerably underestimate

the extent of Taiwan's "real" investment in China because many Taiwan businesspeople began in the mid-1990s to invest in China through their holding companies in tax-exempt third countries such as the Virgin Islands and the Cayman Islands (British Central America, BCA).¹ Perng Fai-nan, Governor of Taiwan's Central Bank, estimated that by the end of 2002 the real figure of Taiwan's cumulative investment in China was about US\$66.8 billion, including investment through tax-haven countries.²

III. A NEW NEGOTIATION MODEL: THE MACAU MODEL

The crux of the current deadlock between Taiwan and China is the insistence of China on one-China principle (1992 consensus) as the precondition for the holding of official negotiations on both functional and political issues; however, Taiwan is unwilling to accept the one-China principle and "1992 consensus." As a result, the cross-Straits political deadlock has remained from 1999 to the present. A side effect of this has been that cross-Straits economic issue negotiation has not been able to go ahead, seriously affecting cross-Straits economic opening.

At the end of 2001, Taiwan suggested that negotiations be held on the issue of opening up Taiwan to tourists from China. In 2004, Taiwan put forward 18 issues for negotiations with China, including direct transport links, tourist visits to Taiwan, currency settlement, financial supervision mechanism, fishing boat worker agreement and business mediation, but China failed to respond positively. The progress of cross-Straits negotiations has always been restricted by the "one China" political obstacle set up by China and Taiwan's insistence on an official negotiation model.

Nevertheless, cross-Straits Lunar New Year charter flight negotiations have gradually opened up a window of opportunity to break the deadlock. Because of the burgeoning demand for charter flights from China-based Taiwan business people, at the end of October 2002, the two sides across the Taiwan Strait began to consider and plan Lunar New Year charter flights. With respect to this issue, China's response was that the charter flights should see participation of airlines from both sides; Taiwan, for its part, thought that, if the airlines were from both sides, then suitable arrangement had to be reached by officials from both sides. With Taiwan insistent, in

¹ Chen-yuan Tung, *China's Economic Leverage and Taiwan's Security Concerns With Respect to Cross-Straits Economic Relations*, PhD Dissertation (Baltimore, M.D.: Johns Hopkins University, 2002), pp. 25-26.

² Ming-cheng Lin, "Perng Fai-nan: Capital Remitted to Mainland Amounted \$66.8 Billion," *Zhongguo Shibao* [China Times], January 17, 2003.

the end China allowed Taiwan airlines to fly one-way to China area but retained the right for its airlines to fly to Taiwan the next year. However, because China insisted that it would not allow direct negotiation between officials from both sides of the Taiwan Strait, arrangements for Lunar New Year charter flights in 2004 broke down.

In October 2004, Taiwan adjusted its strategy and, with the precondition that the government was able to guide and participate to an ample degree, used a flexible negotiation model to actively promote cross-Strait Lunar New Year charter flights. Particularly, Taiwan also accepted the “two-way, reciprocity, non-stop” principle originally put forward by China. However, China added another political obstacle to negotiations, that is, Taiwan must follow the “domestic affairs” principle, also criticizing Taiwan for not following this principle. Regardless of the political obstacle set up by China, Taiwan put forward the Taiwan-Hong Kong navigation right model, in which Taiwan government officials guided talks, with private bodies acting on their behalf, for cross-Strait Lunar New Year charter flight negotiations.

Under the insistence of Taiwan, early last year China at last expressed a willingness, with the participations of government departments from both sides, to promote negotiation on Lunar New Year charter flights through private organizations. In only 11 days, the two sides of the Taiwan Strait, using a private organization method, completed negotiations on the Lunar New Year charter flights, with negotiations carried out by Chang Kuo-cheng, director of Taiwan’s Civil Aeronautics Administration, and Pu Zhaozhou, director of the Taiwan-Hong Kong-Macao Office of the Civil Aviation Administration of China. Because negotiations were carried out in Macao, they were called the “Macao model” for short. The chief characteristics were “setting aside of disputes, no setting of preconditions; mutual respect, seeking truth from facts; government leadership, private sector assistance”. On the same basis, this year’s Lunar New Year charter flight negotiations were completed smoothly.

After the smooth completion of cross-Strait flights during Lunar New Year last year, China put forward a request for negotiations on the normalization of cross-Strait cargo and passenger charter flights, agricultural produce to be imported tariff-free from Taiwan, export of fishing boat workers and tourist visits to Taiwan by its citizens etc. On June 13, Taipei appointed the Taipei Airlines Association to contact its Chinese counterpart for the purpose of arranging talks on cargo charter flights and also named the Taiwan External Trade Development Council to begin talks regarding Taiwan’s export of fruit to China. On August 2, it further authorized Taiwan’s Travel Agent Association to negotiate with its Chinese counterpart on the

issue of Chinese tourism. Despite its preference for the prioritization of negotiations on cargo charter flights across the Taiwan Strait, on August 4, Taiwan agreed to open talks with China simultaneously on cargo and passenger charter flights due to China's insistence.

Parenthetically, Taipei referred to the Macau model for the negotiation of all the three issues and China expressed no opposition. However, for issues including import of agricultural produce into China from Taiwan and export of Chinese fishing boat workers to Taiwan, China designated Taiwan's private groups to represent Taiwan in negotiations, attempting to exclude the involvement and guidance of the government of Taiwan. As a result, there was no negotiation consensus reached by the two governments with regards to agricultural produce and fishing worker issues.

The main negotiation points of the charter flight issue were normalization and "weekendization". The main dispute was: China insisted that holiday passenger charter flights first be agreed, otherwise there would be no conclusion reached on cargo flights and tourism. Taiwan insisted that, if the negotiations on the tourism issue could not reach a satisfactory result, then holiday charter flights would not be opened. However, China was very cold on the tourism issue and was continually reluctant to negotiate. Also, China was only willing to open up a very limited number of airports for cargo charter flights, was not willing to include Shanghai, and insisted that Taiwan first agree to holiday and weekend passenger charter flights.

Up to the start of this year, China had not actively negotiated the tourism issue with Taiwan, with the result that negotiations on cargo and passenger charter flights had also stopped. However, through the "Cross-Strait Economic Forum" hosted by the Chinese Nationalist Party (KMT) and the Chinese Communist Party (CCP) in April, China put pressure on the government of Taiwan to make concessions on the one-China principle (1992 consensus). While China was not actively negotiating with Taiwan, China attributed the responsibility of delayed negotiations and thus exerted the pressure of actively engaging negotiations to Taiwan, which was implicitly based upon the precondition of the one-China principle. Chinese real intention is to use Taiwan's opposition parties to isolate and pressure the Democratic Progressive Party (DPP) government to make political concessions to China on the one-China principle.

In order to clarify that China should be responsible for the delay of the negotiations, on April 12, Taiwan asked China again to engage in negotiations on the tourism issue, also saying that if negotiations could not be completed within six months, Taiwan would not rule out unilaterally announcing the opening of

cross-Strait passenger and cargo charter flights and tourist visits to Taiwan by Chinese citizens. In the face of pressure from Taiwan, China responded by demanding that Taiwan quickly authorize a private body (Taiwan has done so in August 2005!!) to engage in negotiations with it and, on April 16, announced “Rules Managing Tourist Visits to Taiwan by Mainland Citizen”.

After the two sides expressed their positions, charter flight and tourism issue negotiation gradually gained momentum. On April 26, a report given to the Legislative Yuan by the MAC mentioned that the two sides were discussing a third route to shorten the cross-Strait charter flight route. At the same time, China called on Taiwan to quickly begin negotiations and it was reported that the date which its citizens would be allowed to travel to Taiwan was set as July 1. Although we are not clear about the progress of official cross-Strait negotiations, both sides shown an intention to achieve concrete opening around this year’s summer vacation

From the end of 2003 to early 2005, the two sides reached a consensus on a negotiation model of economic issues, the “Macao model”, under which private bodies carry out negotiation guided by government. Taiwan no longer insisted on calling negotiations official, but insisted that an official representative control negotiations, with a private body in a support role only. China also did not refuse contact between official cross-Strait representatives; however, the contact could not be called official.

On the Macao model basis, if the two sides can achieve concrete results on negotiations on cross-Strait passenger and cargo charter flights and tourist visits to Taiwan by Chinese citizens, in the near future, it is very likely that negotiation consensus can be achieved on other economic issues. It can be said that cross-Strait charter flight and tourism negotiations will be likely to bring a new opportunity for the normalization of bilateral relations and build a bridge for peaceful and stable cross-Strait interaction.

IV. CHINA’S NEW APPROACH: ECONOMIC INDUCEMENTS

Since early 2005 China has adopted a new approach of cross-Strait economic exchanges toward Taiwan: economic inducements. Economic inducements involve commercial concessions, technology transfers, and other economic carrots that are offered by the initiator(s) in exchange for political compliance by the target.³ China

³ Tung, *China’s Economic Leverage and Taiwan’s Security Concerns*, pp. 97-98.

has played down the importance of using cross-Strait economic exchanges to boost China's economy. Instead, Beijing has gradually demonstrated its economic strength and is using economic allurements to force Taipei to make political concessions.

Following the promulgation of the anti-secession law on March 14, 2005, Beijing unilaterally offered preferential treatment to Taiwan in several areas: It removed import tariffs on several kinds of Taiwanese fruit, provided RMB 30 billion (US\$3.7 billion) in preferential loans to Taiwanese businesspeople, established several cross-Strait agricultural cooperative projects and Taiwanese agricultural parks, allowed fishermen to work in Taiwan, significantly lowered tuition fees for Taiwanese students in China, allowed Taiwanese students to take-up employment in China, offered local expenses for Taiwanese students and other scholars engaging in cross-Strait academic exchanges in China, and tried to give Taiwan two pandas.

On April 15, 2006, before the economic and trade forum between the KMT and the CCP ended, Chen Yunlin, director of China's Taiwan Affairs Office, announced a package of 15 policy measures to promote economic and trade relations across the Taiwan Strait. Following on from last year's preferential trade measures for Taiwan, China declared policies highlighting principles of expanded preferential treatment, mutually beneficial cooperation, facilitation of cross-Strait exchanges and the avoidance of negotiations.

Particularly, China has proposed sending agricultural procurement delegations to Taiwan to buy goods, and offered to facilitate more marketing advantages for Taiwanese agricultural produce. Furthermore, China has expanded the channels through which Taiwanese people can find employment in China by recognizing Taiwanese academic degrees, allowing Taiwanese to sit for China's Customs Declarer qualification examination and allowing Taiwanese physicians who obtain Chinese permission to practice medicine in China. Beijing has also added more entry points where Taiwanese people can obtain landing visas and has made it easier for Taiwanese to obtain medical treatment in China.

The most significant measures Beijing offered in its recent announcement were the plan to allow Chinese tourists to travel to Taiwan, as well as permitting Taiwanese healthcare institutions to set up jointly invested and managed hospitals in China. While tourist visits will be subject to quota restrictions and investments in hospitals by Taiwanese shareholders will be capped at 70 percent, it is still a significant gift from China, aimed at winning the support of Taiwan's tourist and healthcare industries.

The 15 measures show Beijing using its economic strength as a bargaining chip against Taipei. Obviously, the Chinese government is pursuing deregulation unilaterally. It is appealing directly to the economic interests of the Taiwanese people, and, particularly, co-opting Taiwanese farmers and fishermen in order to divide the DPP grassroots support. Moreover, China is using the cooperation of Taiwan's opposition parties as leverage to squeeze concessions from the Taiwanese government on the one-China principle.

V. EAST ASIAN ECONOMIC INTEGRATION

Over the past few years, East Asian countries have signed many regional trading agreements and quickened the pace of economic integration. Unfortunately, Taiwan has been excluded from this process. Taiwan, of course, hopes to play a leading role in the integration rather than merely being a spectator. As a matter of fact, cross-Strait economic exchange is a part of the global production chain and East Asian further economic integration with Taiwan will be vital to regional prosperity in the Asia-Pacific area. Nevertheless, the obstacle to this comes from China's political obstruction.

Through the competitive advantage of labor division, Taiwanese investments in China have been beneficial to Taiwan's export of intermediate products and capital goods (for example, raw materials, semi-finished products, machinery and equipment) to China. Most of the finished goods are exported to advanced countries, such as the United States and Japan, after being processed in China. Furthermore, Taiwan has been importing equipments and services from the United States and Japan. Not only did Taiwan's early shoe, plastics and textile industries follow this path but its current electronics industry is also doing so.

Over the past two decades, Taiwan's information technology (IT) industry⁴ has grown very rapidly. In 1986, the value of its IT industry was only US\$2.1 billion; in 1992, it increased to US\$9.4 billion; in 2000, it reached as high as US\$47 billion. From 1986 to 2000, the average growth rate was 26 percent. This decreased slightly to US\$42.7 billion in 2001, due to the international economic downturn, but picked up to US\$48.4 billion in 2002 and US\$57.1 billion in 2003.

⁴ According to Taiwan's Institute for Information Industry, IT products include PCs, CD/DVD/CD RW drivers, scanners, monitors, digital cameras, game machines, multimedia, servers, notebook computers, printers, motherboards, graphics cards, sound cards, video cards, PCMCIA cards, CPUs, memories, palm computers, radios, printed circuit board, projectors, and hard disks.

Consequently, the global market share of Taiwan's IT industry has been expanding dramatically. In 1986, Taiwan's share in the world market was only 1.5 percent; by 2000, its market share among the world's ten largest producers increased significantly to 18.7 percent. These figures demonstrate clearly that the industry has been very competitive in the global market over the past two decades.

Nevertheless, after 1990 Taiwan's IT industry began to invest abroad on a large scale. As a result, a huge share of Taiwan's IT products were manufactured abroad. In 1992, 90 percent were made in Taiwan, while 10 percent were made abroad. In comparison, in 2003 only 21 percent were made in Taiwan, while 79 percent were made abroad. In other words, nearly four-fifths of output was created by overseas production bases.

Moreover, a significant portion of the overseas production bases were established in China. In 1995, only 14 percent of Taiwan's IT products were produced in China, by 2003, 63.3 percent were being produced in China. That is, the overseas production bases were located primarily in China. This trend characterized the fact that although Taiwan's IT products were mostly made by Taiwanese business people, the majority of the products were increasingly being made in China.

In addition, China's IT industry grew at an amazing pace in the 1990s. The global market share of Chinese high-tech products ⁵ (including telecommunication equipment, automatic data processing machines, parts and accessories of computers) increased from 0.4 percent in 1985 to 6 percent in 2000.⁶ This result indicates that China is quite competitive in high-tech products in the global market.

In fact, Taiwan's direct investment in China has clearly played a vital role in the rapid expansion of China's IT industry. Between 1996 and 2003, the average annual growth rate of Taiwanese businesspeople's IT products that were made in China was 39.4 percent. In 2003, 63.6 per cent of Taiwanese businesspeople's IT products were already produced in China. During the period of 1999–2001, Taiwan-invested enterprises contributed to around 60–70 percent of China's IT hardware products

⁵ According to China's official definition, the hi-tech industry includes eight categories of technologies: biological technology, life science technology, optoelectronic technology, computer and telecommunication, electronic technology, computer integrated manufacturing technology, materials technology, and aerospace technology.

⁶ United Nations Conference on Trade and Development, *World Investment Report 2002: Transnational Corporations and Export Competitiveness* (New York: United Nations, 2002), pp. 161-162.

and exports.⁷

Within the global production chain of the IT industry, a large proportion of American and Japanese multinational enterprises have operations and partnerships on both sides of the Taiwan Strait. Further economic integration among East Asian countries, particularly Taiwan, China, the United States, and Japan, would bring synergistic business opportunities and enormous advantages for their enterprises in the severe global competition. Especially, Taiwan has been a business gateway and partner for the United States and Japan in this region for decades. Closer economic integration will cement East Asian economic relationship and thus enhance prospects of prosperity and peace in the region.

With this backdrop of China's political obstruction and regional economic co-prosperity, Taiwan should push for free trade agreements (FTAs) with its four major trading partners: China, Japan, the United States and Hong Kong. The United States should be Taiwan's primary target for signing a FTA. The United States is Taiwan's third-largest trading partner, and an FTA with the United States would serve as a political example, making other countries more willing to follow. It would also undermine the legitimacy of China's obstructionism. Furthermore, Taiwan could use the process of negotiating an FTA with the United States and Japan to apply pressure on China and Hong Kong to sign an FTA with Taiwan, or at least undermine Chinese leverage against Taiwan on political concessions.

In addition, Taiwan, the United States and Japan should even sign Strategic Economic Partnership Agreements (SEPAs) with each other. The integration ushered in by a SEPA is far more comprehensive than an FTA, and it would better address the needs of current regional economic integration. Advanced countries currently levy less than 5 percent of their import tariffs on imported industrial products, which is why lowering these tariff rates will not be of great importance to these countries. Such partnerships would deal with global economic competition, emphasize integration in the service sector and production factors, promote further economic integration in multilateral economic organizations, and advance economic policy cooperation with each other.

VI. CONCLUSION

⁷ Chen-yuan Tung, "Made by Taiwan but Made in Mainland China: The Case of the IT Industry," in Kevin H. L. Zhang (ed.), *China as a World Workshop* (London: Routledge, forthcoming).

In the past four years it can be said that negotiations over cross-Strait Lunar New Year charter flights have opened a window of opportunity for the cross-Strait interaction impasse. On the Macao model basis of “setting aside of disputes, no setting of preconditions; mutual respect, seeking truth from facts; government leadership, private sector assistance”, the Taiwanese government and the Chinese government are currently actively engaging in negotiations on cargo and passenger flights and tourist visits by Chinese citizens to Taiwan. If both sides can reach concrete agreements on these two issues it will inevitably be a new opportunity for the normalization of cross-Strait relations, gradually pointing relations between the two sides in a win-win direction towards prosperity and peace.

Nevertheless, China’s new approach of economic inducements against Taiwan aimed at forcing Taiwan to make political concessions on the one-China principle would seriously undermine the prospects of prosperity and peace between Taiwan and China laid out by economic negotiations through the Macau model. Moreover, China’s political obstruction against Taiwan’s participation in East Asian economic integration would further undermine the prospects of prosperity and peace in the region at stake.

This trend could be reversed through trilateral cooperation among Taiwan, the United States and Japan. First, based upon the Macau model, Taiwan should continue to aggressively advocate negotiations on cross-Strait charter flights, tourist visits of Chinese citizens to Taiwan, and other economic issues. Second, Taiwan should push for FTAs with China, Japan, the United States and Hong Kong. Third, Taiwan, the United States and Japan should even sign SEPA with each other to advance economic integration and policy cooperation.