

A Review of Cross-Strait Trade Development

Yuh-jiun Nancy Lin

Associate Research Fellow
Chung-Hua Institution for Economic Research

This paper studies the development of cross-Strait trade relations since 1978. Before the mid-1980s, relations were mainly initiated by Beijing; afterwards, changes in both domestic and international economic conditions forced Taipei to take a more active role in the two-way trade. Nevertheless, both the Taipei government and scholars have urged local enterprises to cooperate with those of other countries for investment in mainland China to avoid political risks during the current uncertainties in cross-Strait relations.

Keywords: cross-Strait trade, reexport, mainland China, Taiwan, Hong Kong

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Over the past two decades, the Republic of China (ROC) on Taiwan has enjoyed rapid economic growth. This growth, like that of other progressing industrial Asian countries, has been mainly due to prosperous foreign trade. Between 1978 and 1994, the value of ROC exports comprised 39 percent or above of its gross domestic product (GDP), reaching a height of nearly 50 percent between 1984 and 1986, in which almost every one percent of growth was linked to nearly 0.5 percent of growth in the GDP.¹ Likewise, the value of imports has also accounted for approximately 30 percent or above of the GDP. The highest import percentage was reached between 1979 and 1981, during which the ROC's trade surplus was relatively low, with a mere US\$78 million in 1980. Nevertheless, after 1985, the surplus began to surge over US\$10 billion. Faced with the rapid

¹Yuh-jiun Nancy Lin, "Comparative Analysis of Taiwan's Intra-Industry Trade with Mainland China and Other Trading Partners," Chung-Hua Institution for Economic Research, *Economic Papers*, no. 151 (1994): 2.

increase of foreign exchange reserves and monetary provisions, and unprecedented pressure for the appreciation of the NT dollar, the government began to liberalize its foreign exchange controls. By July 1987, businessmen were permitted to keep foreign exchange earnings from their transactions. This policy change proved of great importance to the development of Taiwan's foreign relations, particularly cross-Strait investment.

Cross-Strait economic and trade relations were initiated in 1978 with Beijing's reform and opening-up policies. Before the mid-1980s, however, Taipei's official prohibition of trade with mainland China restricted cross-Strait trade to transactions conducted via a third country. In July 1985, the ROC government finally formulated three principles to the two-way trade in accordance with its "three no's" policy (no contacts, no negotiations, no compromise): (1) no direct trade, (2) no contacts with Beijing's organizations or officials, and (3) no intervention with the entrepôt trade between the two sides. The principles marked the foundation of a more relaxed policy toward cross-Strait economic and trade relations.

By the late 1980s, Taiwan's economic conditions had become increasingly difficult. At home, the aforementioned pressures to increase foreign exchange reserves and inflation hit hard; in the international market, Taiwanese products were losing their competitive edge and faced the threat of rising protectionism. All these called for an upgrading of industrial structure, and some traditional industries made efforts to relocate overseas. At this time, mainland China, with its burgeoning economy and low-cost labor, was attracting investment from all over the world. If Taipei continued its ban on the cross-Strait economic interactions, it would only stymie the drive for industrial upgrading.

In November 1987, Taipei lifted the ban on visits to family members on mainland China. Many local businessmen used the chance to make "disguised" trips in which they pursued investment opportunities and were attracted by a series of preferential measures offered by Beijing. With the added advantage of the two sides' similar cultural background, a new fervor for mainland China investment was aroused among local businessmen. Thereafter, cross-Strait relations entered a new stage, and the role of mainland China's market in Taiwan's foreign trade structure became increasingly complex. Since 1988, Taiwan has transformed from a capital-importing nation into a capital-exporting one. Another phenomenon beginning at this time, the statistics of the direct investment approved by the Invest-

ment Commission of the Ministry of Economic Affairs (MOEA) and the statistics of the international balance of payments made by the Central Bank of China have widened considerably.

For years, many private Taiwan overseas investments were made with a registration to the MOEA, especially since the deregulation of foreign exchange controls in 1987. As a result, the difference between the figures given by the commission and its counterparts in other countries has increasingly widened. For instance, according to a study made by the scholars of the Chung-Hua Institution for Economic Research, official statistics for the value of Taiwanese investment in East Asian countries like Malaysia, Thailand, Indonesia, and the Philippines, generally account for less than 15 percent of the data released by those countries.² This indicates that most local businessmen are disinclined to make registrations for overseas investment, thus hindering the government from a complete view of the situation. Such a phenomenon is much more serious when it comes to investment in mainland China, which is much more sensitive matter.

In short, both Taiwan and mainland China are members of the international community. Neither Beijing nor Taipei can formulate cross-strait policy solely according to its domestic needs. Both sides have to take into consideration changes in international political and economic conditions which inevitably affects their interactions. Thus, in order to obtain a full understanding of the impact of mainland China's market on Taiwan's economy, one should not confine the study to mainland China. Instead, a comparative approach which can provide a much broader view should be adopted.

The Development of Indirect Cross-Strait Trade

Cross-strait economic relations between 1978 and 1987 developed mainly through indirect trade between the two sides via Hong Kong. The development of these relations can be divided roughly into three periods.

1978 to 1980. After Beijing implemented its reform and opening-up policies in 1978 to reduce the antagonism between the two sides

²Kuo Wen-cheng, Liu Ta-nien, and Jin Ke-yi, *Changshang duiwai touzi dui woguo jingji fazhan zhi yingxiang—Dongnanya diqu diaocha yanjiu* (The impact of local businessmen's overseas investment on the economic development of our country—A case study of Southeast Asia) (Taipei: Chung-Hua Institution for Economic Research, 1991), 14.

Table 1

Statistics of Cross-Strait Entrepôt Trade via Hong Kong, 1978-86

Unit: US\$ million, %

| Year | Taiwan Exports | | X_1 | Y_1 | Mainland China's Exports | | | |
|------|----------------|-------------|-------|-------|--------------------------|-------------|-------|-------|
| | Value | Growth rate | | | Value | Growth rate | X_2 | Y_2 |
| 1978 | 0.05 | — | 0.00 | 0.14 | 45.58 | — | — | — |
| 1979 | 21.47 | 1031.8 | 0.13 | 0.38 | 56.29 | 39.86 | — | — |
| 1980 | 234.97 | 81.8 | 1.19 | 0.39 | 76.21 | 9.35 | — | — |
| 1981 | 384.15 | -42.08 | 1.70 | 0.35 | 75.18 | 27.89 | 0.34 | 1.74 |
| 1982 | 194.45 | -2.84 | 0.88 | 0.44 | 84.02 | 28.00 | 0.38 | 1.01 |
| 1983 | 157.84 | 170.73 | 0.63 | 0.44 | 89.85 | 42.92 | 0.40 | 0.74 |
| 1984 | 425.45 | 131.36 | 1.40 | 0.58 | 127.75 | -9.51 | 0.49 | 1.55 |
| 1985 | 986.83 | -17.78 | 3.21 | 0.58 | 115.90 | 24.43 | 0.42 | 2.34 |
| 1986 | 811.33 | 51.17 | 2.04 | 0.60 | 144.22 | 100.35 | 0.47 | 1.89 |

Notes:

1. X_1 and X_2 represent respectively the ratio of indirect exports through Hong Kong to the total values of the ROC's exports and the PRC's exports.
2. Y_1 and Y_2 represent respectively the ratio of indirect imports through Hong Kong to the total values of the ROC's imports and the PRC's imports.

Sources:

1. The Statistic Department of the Ministry of Finance, ed., *Zhonghua minguo Taiwan diqu jinchukou maoyi tongji yuebao* (Monthly Statistics of Exports and Imports, Taiwan Area, ROC), December 1993, 10.
2. General Administration of Customs of the People's Republic of China, *China's Customs Statistics* (Hong Kong: Economic Information & Agency, 1993), 5.
3. Mainland Affairs Council of the Executive Yuan, ed. *Gang-Ao yuebao* (Hong Kong and Macau Monthly), no. 18 (April 15, 1993): 36-37.

of the Taiwan Strait and facilitate its final goal of "unification," it encouraged cross-Strait trade, mail, and tourism with various preferential measures.³ Although Taipei prohibited direct trade between the two sides, it turned a blind eye to Taiwan's exports to mainland China via Hong Kong or other areas. The volume of Taiwan's indirect exports to mainland China increased more than four hundred times from 1978 to 1979, and ten times in 1980, or US\$234.97 million (see table 1).

1981 to 1983. Beijing made efforts to take control of cross-Strait trade. For one thing, many imports from South Korea were disguised as Taiwan products. In addition, by this time, two-way cross-Strait

³Chang Rong-feng, "A Study of the Cross-Strait Indirect Trade via Hong Kong," Chung-Hua Institution for Economic Research, *Economic Papers*, no. 12 (1985): 29.

trade had begun to make headway; there seemed no further need of encouragement through administrative measures. Therefore, in May 1981, Beijing stopped all preferential tariffs to Taiwan. In August 1982, it demanded that all imported equipment and publications be approved by the Taiwan Affairs Office (TAO) at various levels. As a result, Taiwan exports to mainland China, which had increased by only 81 percent in 1981, exhibited a negative growth rate in the following two years (see table 1).

1984-1986. In 1984, Beijing's foreign trade policy underwent a marked change. After two consecutive years of trade surplus, mainland China's foreign exchange reserves had escalated from US\$4.8 billion in 1981 to US\$14.3 billion in 1983.⁴ To avoid inflation, many mainland Chinese economists proposed loosening restrictions on imports. In the meantime, reformers who had gained the upper hand and were encouraged by successful rural reforms called for reforms of urban areas and the foreign trade system. In September 1984, Beijing's Ministry of Foreign Economic Relations and Trade (MFERT, now called Ministry of Foreign Trade and Economic Cooperation) promulgated the "Opinions Concerning the Reforms of Foreign Trade System," which emphasized the separation of enterprises from the government; delegated trade powers to localities and enterprises; implemented the export/import agent system; delegated responsibility for profits and losses; and loosened foreign exchange controls. The effect of the policy was at once reflected in the year's export/import statistics, in which imports outpaced exports by US\$1.72 billion, increasing 26 percent, while exports grew only 13 percent.⁵ That year, imports from Taiwan increased 153 percent. The trend continued into 1985, thanks to the high growth rate of industrial production and the demand for raw materials and equipment for construction. In that year, imports reported a 58 percent growth rate and exports 9.3 percent; the growth rate of indirect imports from Taiwan also galloped to 131 percent. However, in April 1985, due to concerns about the depletion of foreign exchange reserves (which decreased from US\$16.7 billion of 1984 to US\$11.9 billion that year), Beijing

⁴"Important Mainland Chinese Economic Statistics Between 1980 and 1985," *Zhong-gong duiwai jingmao yanjiu* (Mainland Chinese Foreign Economic and Trade Studies) (Taipei), August 1986, 21-26.

⁵*Zhongguo tongji nianjian 1994* (Statistical yearbook of China, 1994) (Beijing: Xinhua shuju, November 1994), 574.

imposed restrictions on imported consumer products such as televisions, refrigerators, and cassette recorders. For example, the taxes levied on an imported car amounted to 384 percent of its C.I.F. (cost, insurance, and freight) price. Accordingly, in 1986 import volume dropped 4.6 percent; in contrast, exports rose 4.2 percent. In that same year, imports from Taiwan decreased 18 percent (see table 1).

Judging from the aforementioned three periods, Beijing obviously took the initiative in promoting cross-Strait trade relations; on the other hand, Taipei merely responded passively. In the 1978-80 period, two-way trade volume fluctuated thanks to Beijing's united front strategy. After economic factors became increasingly prominent, trade volume grew steadily in the latter two periods. Because of its prohibition of the trade with mainland China, Taiwan (with the exception of 1978 and 1979) experienced a huge trade surplus—at least two times (8.52 times in 1985) that of mainland China.⁶ In comparison, imports from mainland China presented a steady but slow growth, with an annual increase of 17 percent.

The year 1987 inaugurated a new phase in cross-Strait economic relations. Prior to lifting the ban on visits to family members in mainland China, Taipei lifted the ban on indirect imports of twenty-nine agricultural raw materials from mainland China. The relaxation of Taipei's policy toward cross-Strait relations prompted a more reserved and defensive position from Beijing, however. Contrary to its encouragement in past years, it sought to regulate the structure and supervision of Taiwan imports. For instance, on July 1, 1987, it placed cross-Strait trade under the supervision of the MFERT, and prohibited the involvement of other units in either direct or indirect trade with Taiwan. This allowed Beijing to take full control of cross-Strait economic relations and development on the eve of the influx of family visitors from Taiwan. According to MFERT regulations, producers of twenty-seven products in which mainland China had a relative advantage had to obtain MFERT approval for export or reexport to Taiwan. This allowed Beijing to obtain valuable information on the products Taiwan was interested in. In the meantime, it prohibited Taiwan from dumping low-priced products into mainland

⁶Yuh-jiun Nancy Lin, "A Retrospect of Cross-Strait Entrepôt Trade via Hong Kong and Its Latent Impact," Chung-Hua Institution for Economic Research, *Economic Papers*, no. 114 (1988): 4.

China.⁷ The latter proved a serious blow to many local enterprises in the face of the appreciation of the NT dollar and international protectionism in the late 1980s. These same enterprises had placed hope in expanding into the mainland China market to aid in production technology upgrades and avoid the difficulties that the ROC government had warned them to prepare for.

In September 1987, Guangdong province also published a list of thirty-eight imported products which were to be replaced by their domestic counterparts. This list, it was declared, would soon be lengthened.⁸ The announcement was a prelude to Beijing's implementation of import substitution policies, accompanied with development of coastal economic zones. The message to foreign enterprises was clear: they were expected to invest in mainland China rather than covet its market. The aforementioned Taiwanese businessmen who were trapped by Beijing's changes of policies could only take the risk and invest in mainland China since it was also too late for them to engage in industrial innovation.

In short, in the new phase of Taiwan-mainland China economic relations, Beijing made efforts to attract Taiwan capital by creating difficulties in the two-way trade on the one hand and offering tax-free preferential measures for investment on the other. The sticks-carrots policy came at the right time, as many Taiwanese businessmen were facing the dilemma of either declaring bankruptcy or changing their investment strategy. In view of this, Beijing had clearly gained an upper hand in the cross-Straits trade relations. It installed special offices which required an application for a permit to separate cross-Straits trade from trade with other countries. This move was intended to allow Beijing to take full control of these activities before they were expanded.

In comparison to the flexibility of Beijing's policymaking, Taipei had been much more passive and lagged far behind in the regulation of two-way trade. Prior to 1991, the Ministry of Economic Affairs publicized a list of 3,679 items approved for indirect investment in the mainland and encouraged the registration of investment which had already been made. Although these belated approvals received a negative reaction, they marked the beginning of the ROC

⁷ *Jingji daobao* (Economic Reporter) (Hong Kong), August 3, 1987, 33.

⁸ *China Economic News* (Hong Kong), October 5, 1987, 5.

government's active involvement in cross-Strait economic relations and indicated its determination for further development. This was further emphasized in 1994, when Taipei declared its intention to develop Taiwan into an "Asia-Pacific Operations Center" by the twenty-first century and utilize mainland China as its major hinterland, thus pushing the cross-Strait economic relationship to a high position on the agenda. Even after recent PRC missile tests near the waters of the Taiwan Strait brought bilateral relations to an all-time low, the government still continued to encourage investment in mainland China and imports from the mainland.

Trade Development after 1987

Since 1987, encouraged by the more open policies of the two sides and increasing person-to-person contacts, cross-Strait economic and trade relations have rapidly expanded. In addition to two-way trade, Taiwan has also made indirect investment in mainland China. Although the government still insists on the policy of "indirect trade," many businessmen have easily overcome technical difficulties and conducted direct trade in fact, if not in name, with mainland China. However, this has constituted difficulties in cross-Strait trade statistics since 1987.

After 1987, many Taiwanese businessmen imported raw materials or semifinished products from Taiwan to their factories in mainland China. In order to save time and reduce costs, these products were often moved by ships stopping in third ports, as were the imports of finished products from mainland China. By this way, the products were exempted from not only Hong Kong container-handling charges but insurance and service charges required for reexports. Since Hong Kong was not the buyer for these products, they did not need to be reinsured as reexported goods or go through Hong Kong customs procedures. In other words, they were, as categorized by the Hong Kong government, "direct trade" products, and Hong Kong customs statistics only carried the figures of their annual weight.

As expected, this new kind of transshipment has expanded rapidly in cross-Strait trade. According to Hong Kong government statistics, the total weight of Taiwan exports transshipped from Hong Kong to mainland China increased from 500 tons and 1,600m³ in 1987 to 43,757 tons and 106,087m³ in 1990, a leap of 86.5 and 65.3 times, respectively. In 1991, transshipped products from Taiwan comprised

4.39 percent of Hong Kong's export total weight. On the other hand, Hong Kong reexports from Taiwan to mainland China accounted for 5.44 percent of the total volume. The closeness of the two ratios indicates that the value of Taiwan's transshipped products from Hong Kong might be equal to that of Hong Kong reexports from Taiwan. Unfortunately, as the two data are almost unrelated (one gives only annual weight, and the other lacks complete information about the weight of reexported products), they are of little help in estimating the value of transshipped products.

A comparison between Taiwan customs statistics and Hong Kong customs figures probably bears this out. Statistics for 1989, 1990, and 1991, in which all imports and exports were carried out based on C.I.F. and F.O.B (free on board) policies, respectively, are an example. According to Taiwan customs, Taiwan exports to Hong Kong during those three years were valued at US\$7.08, US\$8.56, and US\$12.43 billion, respectively. However, Hong Kong statistics showed that Taiwan imports only totalled US\$6.6 billion, US\$7.46 billion, and US\$9.95 billion. The differences between the two groups of figures (approximately US\$480 million, US\$1.1 billion, and US\$2.88 billion, respectively) may be due to "direct transshipment" into mainland China. For instance, an export registered with Taiwan customs with a value of US\$100 is only valued at US\$80 in Hong Kong. After a deduction of a six percent difference in transportation costs, the difference of the two prices would be US\$24.8 ($100 - 80 \times 94\%$). The maximum estimate value of Taiwan exports to mainland China via Hong Kong comprises the difference (in this case, US\$24.8), added to the values of Hong Kong reexports to mainland China after 15 percent of raw profit for reexports is deducted. It should be pointed out, however, that this maximum estimate value may well be short, as it does not include Taiwan products transshipped through other ports. Even so, this estimate value indicates the rapid increase of Taiwan exports to mainland China since 1987 (see table 2).

Since 1992, mainland China has outstripped Japan as Taiwan's second largest foreign market, accounting for 12.46 percent of total Taiwan exports, ahead of Japan's 10.92 percent. In 1994, of Taiwan's three largest foreign markets, the United States accounted for 26.16 percent of total Taiwan exports; mainland China, 16.60 percent; and Japan, 10.99 percent. The figures of the first half of 1995 for the three areas were 23.63 percent, 17.18 percent, and 11.52 percent, respectively. Taiwan's export interdependence with mainland China can also be illustrated from the percentage of Taiwan imports to total

Table 2
The Estimated Value of Taiwan Exports to Mainland China, 1987-95

Unit: US\$ million, %

| Year | Hong Kong reexports to the PRC | Growth rate (%) | Transshipped goods to the PRC | Growth rate (%) | A ₁ % | A ₂ % |
|------------------|-----------------------------------|--------------------|----------------------------------|--------------------|------------------|------------------|
| 1987 | 1,172 | — | 1,227 | — | 94.17 | 2.19 |
| 1988 | 2,126 | 81.31 | 2,242 | 82.81 | 89.67 | 3.50 |
| 1989 | 3,276 | 54.10 | 2,897 | 29.18 | 75.18 | 4.94 |
| 1990 | 4,297 | 31.18 | 3,278 | 13.18 | 64.85 | 6.39 |
| 1991 | 7,381 | 71.77 | 4,667 | 42.37 | 53.75 | 9.69 |
| 1992 | 10,149 | 37.51 | 6,288 | 34.73 | 52.66 | 12.46 |
| 1993 | 13,436 | 32.39 | 7,586 | 20.63 | 47.99 | 15.79 |
| 1994 | 15,446 | 14.96 | 8,517 | 12.28 | 46.87 | 16.60 |
| 1995 (Jan.-June) | 9,144 | 26.33 | 4,865 | 22.71 | 42.56 | 17.18 |

Notes:

1. The raw profit deducted for reexports was 15 percent (the profits deducted for 1987 and 1995 were 10 and 20 percent, respectively).
2. A₁ indicates the value of Hong Kong reexports from Taiwan to mainland China after a deduction of the raw profit divided by the estimated value of Taiwan exports to mainland China.
3. A₂ denotes the ratio of the estimated value of Taiwan exports to Taiwan's total exports.

Sources:

1. Hong Kong government statistics.
2. Taiwan customs statistics.
3. The PRC customs statistics.

PRC imports. In 1993 and 1994, Taiwan was the second largest supplier of goods to the PRC, comprising 12.44 percent and 12.17 percent, respectively, of the latter's total imports. It was behind Japan (22.37 percent and 22.75 percent) and slightly exceeded the United States (10.28 percent and 12.08 percent). Hong Kong, which ranked fourth, reported only 8.36 percent and 8.17 percent, respectively. In the first half of 1995, Taiwan's share rose to 16.15 percent while Japan and Hong Kong fell to 21.62 percent and 7.08 percent, respectively.

Nonetheless, the aforementioned method cannot apply to estimating the value of mainland Chinese indirect exports to Taiwan via Hong Kong. This is because for decades, PRC customs provided only statistics about the destination of its exports. Although over 90 percent of its goods exported to Hong Kong were reexported to other countries, all of them were placed under the category of Hong Kong goods. In 1991, under U.S. pressure, Beijing finally followed international conventions in categorizing exports and imports according to the final consumer areas and country of origin, respectively. However, because of inexperience with the new system, the statistics of the first two years were not only unreliable but sometimes even misleading. For instance, the wide difference between mainland China's 1993 statistics for imports from Hong Kong and the numbers calculated by Hong Kong customs rendered the former meaningless. The data finally became more accurate in 1994 when the difference between the two sets of statistics was narrowed to US\$400 million. Another obstacle to accurately estimating the value of the PRC's indirect exports to Hong Kong is Taipei's ban on mainland China imports, resulting in many products being smuggled into Taiwan across the Strait.

Accordingly, in table 3, a comparison was made using three values: the upper bound, middle bound, and low bound. In the table, V_1 represents the value of the upper bound, or the summation of the PRC's customs data on its exports to Taiwan (here taken as the value of direct exports) and Hong Kong customs statistics for Hong Kong reexports from mainland China to Taiwan (the value of "indirect exports"). S_1 indicates the percentage of V_1 in Taiwan's import total. V_2 represents the value of the middle bound, or the PRC's customs statistics for its total export value to Taiwan; S_2 is the percentage of V_2 in Taiwan's import total. The low bound (V_3) is based on Hong Kong statistics for Hong Kong reexports of the PRC products to Taiwan and S_3 indicates the ratio between this and Taiwan's import

Table 3
The Estimated Value of Mainland Chinese Exports to Taiwan, 1987-95

Unit: US\$ million, %

| Year | Hong Kong Reexports from Mainland China to Taiwan | | | | | | Growth Rate | | | B% |
|------------------|---|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|-------|
| | V ₁ | S ₁ | V ₂ | S ₂ | V ₃ | S ₃ | G ₁ | G ₂ | G ₃ | |
| 1987 | — | — | — | — | 276 | 0.79 | — | — | — | — |
| 1988 | — | — | — | — | 431 | 0.87 | — | — | 56.47 | — |
| 1989 | — | — | — | — | 529 | 1.01 | — | — | 22.61 | — |
| 1990 | 1,029 | 1.88 | — | — | 690 | 1.26 | — | — | 30.41 | 67.05 |
| 1991 | 1,645 | 2.62 | — | — | 1,015 | 1.61 | 59.96 | — | 47.11 | 61.67 |
| 1992 | 1,784 | 2.43 | — | — | 1,008 | 1.40 | 6.27 | — | -0.62 | 57.67 |
| 1993 | 2,544 | 3.30 | 1,550 | 2.01 | 994 | 1.29 | 45.52 | — | -1.38 | 39.09 |
| 1994 | 3,541 | 4.15 | 2,377 | 2.78 | 1,164 | 1.36 | 39.20 | 53.39 | 17.10 | 32.88 |
| 1995 (Jan.-June) | 2,254 | 4.39 | 1,611 | 3.13 | 644 | 1.25 | 50.91 | 73.00 | 14.36 | 28.55 |

Note: B% denotes the percentage of V₃ to V₁.

Sources: See table 2.

total.⁹ Judging from the small variations between the ratios in 1994 (4.15 percent, 2.78 percent, and 1.36 percent) and those in 1995, Taiwan's dependence on imports from the PRC should be within 5 percent.

Strategies for Developing Cross-Strait Economic and Trade Relations

In the economic interactions between two areas, investment involves many more risks than trade. To be more specific, Taiwan's growing investment in mainland China renders it more vulnerable to Beijing's economic policies. In view of this, Taiwan should decrease direct investment across the Strait and encourage two-way trade or investment through international corporations, which are much less risky. For instance, although Japan has enjoyed a much larger scale of economy than Taiwan, it has taken few economic risks and has rigorously sought investment; it has been ahead of Taiwan in its exports to mainland China but far behind Taiwan in mainland investment. According to PRC customs statistics, Japanese exports to mainland China totalled US\$26.32 billion in 1994; Taiwan's exports were estimated to be only US\$15.45 billion. As for direct investment in mainland China, Japan's investment between 1979 and 1993 was totalled US\$8,895 million; Taiwan's investment, however, amounted to US\$18,432 million. Evidently, Japanese businessmen have been much more cautious than their counterparts in Taiwan.

Since the PRC conducted missile tests in the waters near the Taiwan Strait in July 1995, the cross-Strait relationship has spiralled downward. The tests and the military exercises have caused the depreciation of the NT dollar, a tide of emigration, and the rapid outflow of capital. Many local businessmen have hence decided to postpone their plans to increase investment in the mainland. Only some large-scale firms which have been cooperating with their counterparts outside Hong Kong have continued to increase their investment. The merits of the so-called "strategy of international alliance" have begun to emerge.

⁹Fifteen percent of raw profit has been deducted from all reexport values (10 percent in 1987 and 20 percent in 1995).

In the 1987 wave for investment in mainland China, both the Taipei government and scholars of the Chung-Hua Institution for Economic Research urged local businessmen to cooperate with a third country in cross-Strait trade, as such cooperation could place them under the protection of investment agreements between the PRC and the third country. In this way, they could avoid unexpected political risks and solve disputes via other channels, and in the meantime gradually upgrade their production technology. The strategy, which was geared to benefit Taiwan enterprises undergoing the transition to manufacturing high-end products, won little response except from large and medium-sized enterprises who were concerned with risk appraisal. Many small firms focused on short-term profits, which were then used for speculation on mainland China real estate. As a result, Beijing's implementation of its macroeconomic control policy in 1994 was a great blow to them. In the current deterioration of cross-Strait relations, they are the ones who are suffering most.

Presently, many businessmen have begun to readjust their investment strategy and adopt the policy of "international cooperation." This is conducive to the internationalization of Taiwan's enterprises and the dispersion of their foreign markets. Judging from the experience of advanced countries, an enterprise must undergo three stages to become a multinational corporation. In the first stage, it manufactures products at home and exports them to other countries through the traditional international trade method. In the second stage, branch companies and factories are established overseas to manufacture products which have lost their competitive edge at home, and import them back to the home country before they become competitive in the international market. In the third, the enterprise breaks economic boundaries, forming a multinational corporation with other enterprises in order to utilize the comparative advantages of other countries, such as conducting international research and development (R&D), production, and marketing. Presently, Taiwan enterprises are between the second and third stages; if they can utilize the investment in the low-cost labor area to maintain its competitive edge and simultaneously enlarge their production scale and upgrade their production technology to seek entry into the international market, they will be able to enter the third stage, which enhances their competitiveness through surcharges. In view of this, the PRC's missile tests may be a blessing in disguise for cross-Strait investment.