

Post-ECFA Outlook for the Relationship across the Taiwan Strait

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This paper discusses the Economic Cooperation Framework Agreement (ECFA) between Taiwan and China. It examines its contents, trade-expectations, and problem areas. Since "cooperative behavior" (as demonstrated in the signing and implementation of the ECFA) does not have the functional equivalence of "trust" in cross-Strait ties, the paper identifies some of the pathways that a post-ECFA ecosystem could provide for Taiwan in the coming years, and the risks they present.

KEYWORDS: ECFA; Taiwan; mainland China; managing status quo; economic gains.

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The rationalization of tariffs on identified goods and the liberalization of trade in select services included in the Economic Cooperation Framework Agreement (ECFA) between Taiwan and China open up new options for Taiwan's political and economic future. The exit of the Democratic Progressive Party (民進黨, DPP) from the electoral centre stage after Chen Shui-bian's (陳水扁) two terms as president, and

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the election to the presidency of Ma Ying-jeou (馬英九) of the Kuomintang (國民黨, KMT) in March 2008, following his party's victory in the January 2008 legislative elections, were signs of an impending shift in political and policy approaches toward China.

Since the 2008 elections, relations between Taiwan and China have to a large extent been normalized.¹ The first regular air service between Taiwan and the mainland since 1949 (China Southern Airlines flights from Guangzhou to Taipei) has been set up.² Other new initiatives include co-operation in industrial standards, the Bridges Building Project,³ and the deregulation of Chinese inward investment to Taiwan. However, arguably the most crucial development, and one that promises Taiwan greater economic benefits, has been the institutionalization of economic ties between Taiwan and its largest trading partner, China, through the ECFA. The culmination of five rounds of talks that started after Ma Ying-jeou came to power, between the chairman of Taiwan's Straits Exchange Foundation (SEF), Chiang Pin-kung (江丙坤), and his Chinese counterpart, Chen Yunlin (陳雲林), chairman of the Association for Relations Across the Taiwan Strait (ARATS),⁴ the ECFA was signed in 2010. The ECFA was "

¹The restrictions associated with earlier KMT leaders such as Chiang Kai-shek (蔣介石) and Chiang Ching-kuo (蔣經國) (the three no's: no contact, no negotiations, and no compromises), and the varying degrees of restriction on trade, transport, and investment under subsequent administrations before 2008 were all lifted.

²Gordon C. K. Cheung, "New Approaches to Cross-Strait Integration and Its Impacts on Taiwan's Domestic Economy: An Emerging 'Chaiwan'?" *Journal of Current Chinese Affairs* 39, no. 1 (2010): 11-36.

³The purpose of the Bridges Building Project (BBP), which was approved by the Executive Yuan in August 2008, is to set up exchange platforms for each industry and to hold a series of cross-Strait conferences on exchanges in individual industries as a way of building bridges between the two sides. See "MOEA Bridges Building Project 2010—A Platform for Cross-Strait Industrial Cooperation and Exchange," Department of Industrial Technology, Ministry of Economic Affairs, R.O.C., November 4, 2000, <http://doit.moea.gov.tw/doiteng/contents/printPage.aspx?name=event&sn=20>.

⁴The SEF and ARATS are semi-official intermediary bodies set up by Taiwan and China, respectively, to handle cross-Strait ties in the absence of official relations. Institutionalized dialogue between the two sides halted in 1995 after President Lee Teng-hui (李登輝) of Taiwan irked Beijing by paying a visit to his U.S. alma mater, Cornell University. Following Ma Ying-jeou's victory in early 2008, the ECFA was finalized over five rounds of SEF-ARATS meetings: June 13, 2008, November 4, 2008, April 26, 2009, and December 22, 2009, and signed on June 29, 2010. See <http://www.mac.gov.tw/public/data/11199164471.pdf> for the content of each of these meetings.

passed" by the KMT-dominated Legislative Yuan in September 2010, allowing for the rationalization of tariff rates for identified sectors to come into effect from January 1, 2011. In the next section of this paper, I shall outline the scope of the ECFA. In section three, I shall identify the chief exigencies facing Taiwan which merited the signing of such a framework agreement, and in section four, I shall discuss the expectations and potential problems associated with the agreement, reexamining what it promises to deliver and the trends visible in recent years. Section five depicts the normalization of cross-Strait ties (as under the ECFA) as a "stag hunt," as found in international relations (IR) theory, discusses the pathways available to Taiwan in an ECFA ecosystem, and identifies issue areas of concern therein. The final segment brings together the main observations made in each of the previous sections.

What Is the Cross-Strait ECFA?

The ECFA is the first step in the institutionalization of economic relations between China and Taiwan. It is a "preferential framework agreement"—a pact outlining the broad contours of the economic partnership (structure and objectives) between the two sides with specific reference to a limited set of goods and services that are due to be liberalized to zero-tariff levels by 2013. The pact has a preamble and five chapters (covering the schedule for phasing out tariffs on goods, the liberalization of trade in services, mechanisms for cooperation, and dispute settlement, etc.). While the text of the ECFA does not commit to its development into a full-scale free trade agreement (FTA), the expectation is that it will have positive trade creation effects for the two parties due to a mutually preferential reduction in tariff rates and trade barriers. It is therefore hoped that it will indeed be the precursor of some sort of FTA.⁵

⁵In its present form, the ECFA is not yet a full-fledged FTA as compliance with some of the substantive and procedural requirements of WTO law (discussed in the following segments) is pending. The WTO Annual Report 2012 clarifies that "China, India and Chinese Taipei

As per the ECFA, the export items from Taiwan to China subject to tariff rationalization comprise 539 products, 8 service industries, and 3 financial service sectors (with modes of supply including cross-border supply, consumption abroad, and commercial presence). Likewise, China's exports to Taiwan cover 268 products, 8 service industries, and 1 financial service sector (see sections A and B of table 1 for a breakdown; see table 2 for a schedule of the rationalization of tariffs).

Why Was the ECFA So Urgently Needed?

There were specific economic exigencies facing Taiwan which made the signing of the ECFA imperative. The transfer of power from the DPP to the KMT came at a time when the 2008 financial crisis was beginning to engulf the global economy, with Taiwan taking a direct hit to its exports. It is useful to bear in mind that since the mid-1990s, Taiwan's export market has undergone changes in line with the international reorganization of production away from "Fordist" lines (mass-production, dominated by large vertically integrated corporations handling all aspects from design to manufacturing and sales/marketing).⁶

Such a reorganization of production means that Taiwanese goods are routed through assembly lines in China though the final export destinations (largely the United States and Europe) remain the same.⁷ Within Asia, China is Taiwan's number one trade partner (see figure 1), with official

notified the Committee on Trade and Development (CTD) of their preferential trade arrangements (PTAs) under the new transparency mechanism." Curiously, the notification is under the category of PTAs which offer preferential treatment to the products of the least developed countries (LDCs). See "Building Trade Capacity," http://www.wto.org/english/res_e/booksp_e/anrep_e/anrep12_chap6_e.pdf (accessed September 4, 2012).

⁶Timothy J. Sturgeon and Ji-Ren Lee, "Industry Co-evolution and the Rise of a Shared Supply-Base for Electronics Manufacturing" (paper presented at the Nelson and Winter Conference, Aalborg, June 12-15, 2001), 46-49, <http://ipc-lis.mit.edu/globalization/globalization%2001-002.pdf> (accessed August 12, 2010).

⁷Tun-jen Cheng, "China-Taiwan Economic Linkage: Between Insulation and Superconductivity," in *Dangerous Strait: The U.S.-Taiwan-China Crisis*, ed. Nancy Bernkopf Tucker (New York: Columbia University Press, 2005), 93-130.

Table 1
Scope of Early Harvest Plan for Goods and Services

A. Industry	Taiwan's exports to China			China's exports to Taiwan		
	Items	Export amount in 2009 US\$ M.	% of Taiwan's total exports to China	Items	Export amount in 2009 US\$ M.	% of China's total exports to Taiwan
Petrochemicals	88	5,944.08	6.93	42	328.69	1.21
Machinery	107	1,143.39	1.33	69	473.97	1.75
Textiles	136	1,588.34	1.85	22	116.33	0.43
Transportation equipment	50	148.44	0.18	17	408.94	0.02
Others	140	4,997.21	5.84	117	1,529.83	5.64
Agriculture	18	16.08	0.02	0	0	0.00
Total	539	13,837.54	16.14	267	2,857.76	10.53

Source: <http://www.mac.gov.tw/ct.asp?xItem=85849&ctNode=6256&mp=3>.

B. Services	From China to Taiwan	From Taiwan to China
Business Services	Accounting, auditing, and bookkeeping	Research and development
	Software implementation and data processing	Conventions
	Research and Development	Exhibitions
	Conventions	Special designs
	Special designs	Motion pictures
	Audiovisual services	Commission agents' services
	Hospitals	Sporting and other recreational services
	Aircraft repair and maintenance	Computer reservation system
Financial Sector	Banking and other financial services	Banking and other financial services
	Insurance and related services	
	Securities, futures, and other related services	

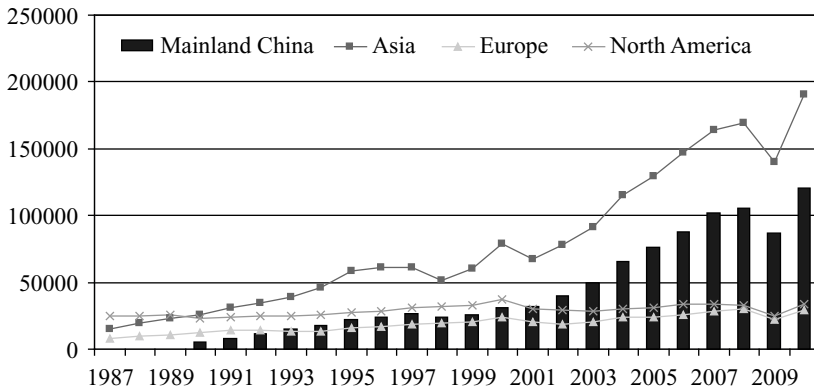
Source: Chiang Pin-kung, "Opportunities and Challenges for Economic Development in Taiwan under the ECFA," Straits Exchange Foundation, September 30, 2010, <http://www.ecfa.org.tw/Download.aspx?No=11&strT=ECFADoc> (accessed January 12, 2012).

Table 2
Schedule for Rationalization of Tariffs

	Import Tariff (X%)	1st Year of Early Harvest Plan (2011.1.1)	2nd Year of Early Harvest Plan (2012.1.1)	3rd Year of Early Harvest Plan (2013.1.1)
China	$0 < X \leq 5$	0		
	$5 < X \leq 15$	5	0	
	$X > 15$	10	5	0
Taiwan	$0 < X \leq 2.5$	0		
	$2.5 < X \leq 7.5$	2.5	0	
	$X > 7.5$	5	2.5	0

Source: See ECFA website, "Annex I of the Product List and Tariff Reduction Arrangements," <http://www.ecfa.org.tw>, and also <http://www.mac.gov.tw/ct.asp?xItem=85849&ctNode=6256&mp=3>.

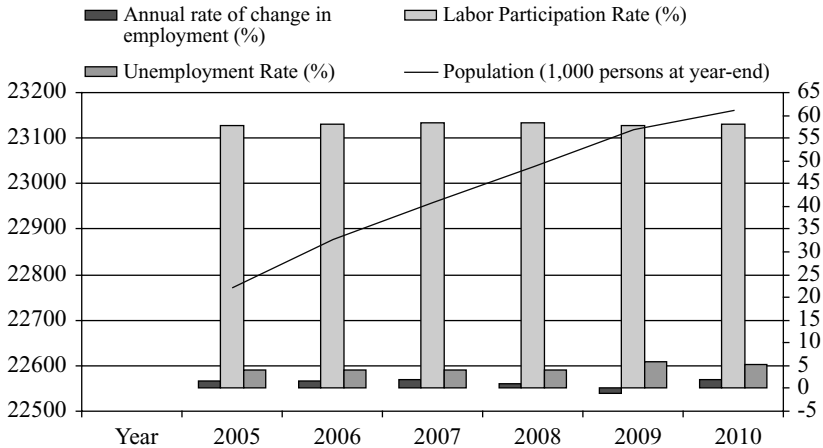
Figure 1
Taiwan's Export Direction (US\$ Million)



Source: Based on datasets from the *Taiwan Statistical Databook 2011*.

figures indicating that China accounts for over 60 percent of Taiwan's total trade. Thus, reduced export demand from China caused a cyclical downturn in Taiwanese trade routed to its trade partners via production units in China. The accompanying impact on unemployment levels in Taiwan (which breached the sensitive 5 percent mark) constituted another eco-

Figure 2
Taiwanese Population and Employment



Source: based on datasets from the *Taiwan Statistical Databook 2011*.

conomic exigency facing the island in 2009, on top of a series of natural disasters such as typhoon Morakot.

The next major reason why the ECFA was prioritized by the authorities in Taiwan is related to changes in the regional economic architecture. It is clear that despite the World Trade Organization's (WTO) mandate concerning trade liberalization, over three hundred regional trade agreements (RTAs) or free trade agreements (FTAs) are concurrently in effect globally.⁸ The ECFA was seen as a means of countering the trade diversion effects of this web of preferential trading arrangements in the Asian region (particularly the FTA between China and the Association of Southeast Asian Nations, ASEAN).⁹ Another reason why the ECFA was so urgently needed

⁸The number of RTAs (FTAs) in the WTO Consideration Process is 328. See <http://rtais.wto.org/UI/publicsummarytable.aspx> (accessed March 14, 2012).

⁹Trade diversion refers to sales gained in a new trade zone at the expense of third country suppliers who now face a higher tariff barrier that is not applicable to the new FTA-area suppliers. According to a Taiwan Bureau of Foreign Trade briefing note of January 2010, the value of Chinese imports from ASEAN surpassed that of imports from Taiwan for the first

was the threat to Taiwan posed by competition from South Korea—there is an 80 percent overlap in their exports (IT and machinery products).¹⁰ Before June 2007 (the date of the Korea-ASEAN FTA), Taiwan's exports to ASEAN were growing at 20.1 percent compared to 16.6 percent for those of South Korea. A year after the FTA was signed, the growth rate for Taiwan had plunged to 11.8 percent while that of South Korea had risen to 24 percent.¹¹ Since neither the WTO nor the Asia-Pacific Economic Cooperation (APEC) forum could fulfill Taiwan's aspirations for extra-trade-and-investment liberalization agreements with other countries, there was a real prospect that Taiwan would be economically marginalized by the proliferation of such preferential trading arrangements. An expanded zero-tariff zone covering ASEAN, China, and eventually Japan and South Korea could mean that, in the absence of similar tariff rationalization, Taiwanese products would cost more in the Chinese market.

The other factor providing impetus for the ECFA is China's own motives (political calculations > economic benefits). Clearly, Chinese actions, such as the military exercises, including missile tests, held shortly before Taiwan's presidential elections in 1996; the missile tests prior to the 2000 presidential elections; the military drills held by the People's Liberation Army (PLA) on Dongshan Island (東山島) in 2004; and the passing of an Anti-secession Law in March 2005, were all prompted by the steadfast rise of pro-independence forces in Taiwan and the growth of a feeling of Taiwanese identity. The DPP's two consecutive victories in presidential elections (2000 and 2004) attest to this. Hence, it made political sense for China to try an economic carrot when the stick had yielded unwelcome

time in 2005, after China lowered tariffs on ASEAN imports. In 2008, China's imports from ASEAN were worth US\$116.9 billion (compared to US\$103.33 billion for imports from Taiwan). Under the ECFA, it is hoped that goods susceptible to ASEAN competition (textiles, automotive parts, petrochemicals, selected services) will gain a new lease of life. See also "'ASEAN Plus China' Impacts Taiwan's Exports: Minister," *China Post*, April 11, 2010, <http://www.chinapost.com.tw/taiwan/2010/04/11/252060/ASEAN-plus.htm> (accessed December 29, 2011).

¹⁰Cited in Pasha L. Hsieh, "The China-Taiwan ECFA, Geopolitical Dimensions and WTO Law," *Journal of International Economic Law* 14, no. 1 (2011): 135.

¹¹Ibid.

outcomes. The ECFA may therefore be seen as China's big bet on a "friendly" political dispensation for Taiwan, leaving more space for Beijing to possibly toy with another innovative "one X and Y system" formulation for unification, a continuation of the "peaceful accord" or "peace agreement" line proposed by Hu Jintao (胡錦濤) and Wen Jiabao (溫家寶) over the past few years.

Gains and Points of Contention

The economic benefits of the ECFA projected in simulated studies—mostly using estimates calculated by the Chung-Hua Institution for Economic Research (CIER)—include an increase in Taiwan's GDP of between 1.65 percent and 1.72 percent¹² (that is, from roughly US\$6.9 billion to US\$7.1 billion). Other studies, which utilize the Global Trade Analysis Project (GTAP) model¹³ and incorporate dynamic modeling that allows for the inflow of new capital as opposed to static simulation, estimate that Taiwan's real GDP growth will be as high as 1.83 percent after trade normalization.¹⁴ The trade liberalization effect of the ECFA is expected to take effect by 2020, with Taiwan's GDP higher by 4.4 percent (US\$21 billion) than the baseline scenario.¹⁵ Other structural benefits emerging from the ECFA include the Taiwanese business community in China (*Taishang*)

¹²See "Economic Cooperation Framework Agreement (ECFA) Background," <http://www.mac.gov.tw/public/data/051116322071.pdf>.

¹³The GTAP model is a statistical tool for evaluating the benefits of free trade agreements in multi-nation quantitative analysis. See Thomas W. Hertel, *Global Trade Analysis: Modeling and Applications* (New York: Cambridge University Press, 1997) for a detailed exposition.

¹⁴Da-Nien Liu and Hui-Tzu Shih, "New Economic Development Opportunities for Taiwan in the Post-ECFA Era," *Asie.Visions*, no. 51 (April 2012): 19, <http://www.ifri.org/downloads/av51complet.pdf>.

¹⁵Daniel Rosen and Zhi Wang, *The Implications of China-Taiwan Economic Liberalization*, Policy Analyses in International Economics 93 (Washington, D.C.: Peterson Institute for International Economics, 2011), 69. Other studies also support these projected gains, see Shin-Horng Chen, Pei-Chang Wen, and Meng-chun Liu, *Trends in Public and Private Investments in ICT R&D in Taiwan* (Seville: Institute for Prospective Technological Studies [Joint Research Centre, European Commission], 2011).

routing investment and trade away from third countries (reversing a practice adopted to circumvent official restrictions in Taiwan) and aligning their fund flows and supply chains to China "directly" from Taiwan. The ECFA is also expected to create an environment in which the *Taishang* may repatriate their earnings and invest more in Taiwan. As of the end of 2011, this type of "return investment" by Taiwanese businesspeople had increased to NT\$46.9 billion.¹⁶

Since the categories of products that receive maximum coverage under the ECFA are textiles, machinery, and petrochemicals, a revival of Taiwan's sunset industries may be anticipated, both in terms of Taiwanese companies obtaining favorable access to the Chinese market and also being able to source duty-free intermediate supplies from China. This could mean greater two-way trade in intermediates and industrial realignment in Taiwan in the aforementioned industries. In addition, there are five key areas in which Chinese domestic policies—including post-financial crisis stimulus measures—may induce growth in Taiwan¹⁷ in the overall ECFA ecosystem:

1. The public works projects that have resulted from China's infrastructure-oriented stimulus package have the potential to benefit Taiwanese cement manufacturers (including Taiwan Cement, Chia Hsin Cement Corporation, Asia Cement, Goldsun Group, and Chien Kuo Group), and the steel industry (China Steel).
2. The Taiwanese consumer electronics and automotive electronics industries can potentially benefit from two Chinese projects aimed at boosting the supply of home appliances and automobiles to rural areas.
3. Taiwanese businesses could find investment opportunities in the expansion of power facilities, railways, and telecommunications in China.

¹⁶Liu and Shih, "New Economic Development Opportunities for Taiwan," 26.

¹⁷See Hsiao-hung Nancy Chen, "Political Economy of Cross-Strait Investments: The Taiwanese High-tech Industry as an Example," *Seoul Journal of Economics* 24, no. 2 (2011): 191; Chen, Wen and Liu, *Trends in Public and Private Investments*, 66, 67.

4. Cross-Strait cooperation in industrial standards (TD-SCDMA, LCD, LED, and solar cells) could enable Taiwanese firms to get involved in developing or designing Chinese industrial standards, and this may translate into a greater market presence. This would also imply participation in global innovation standards.
5. Taiwanese service providers may be able to tap the Chinese market. Expansion in China could provide a lifeline for Taiwanese banks, for example.

Already, it seems, the ECFA is delivering on expectations where the upgrading of services in Taiwan is concerned. The increase in tourism from China, for example, has led to the construction of thirteen new hotels, and thirty-one more are expected to be completed before 2013, with a total investment of NT\$120 billion.¹⁸ According to figures released by Taiwan's Tourism Bureau under the Ministry of Transportation and Communication, the number of Chinese nationals visiting Taiwan in 2011 totaled 1.7 million, up 42 percent from the 1.2 million who visited in 2010.¹⁹ In some ways, this is similar to Hong Kong's experience with the post-2003 Closer Economic Partnership Arrangement (CEPA) with China, under which the growth in tourism from China stimulated growth in the restaurant and hotel sectors along with other service industries.²⁰

Problem Areas

The official English translation of the text of the ECFA expressly states that it adheres to the principles of equality, reciprocity,²¹ and progres-

¹⁸Chiang Pin-kung, "Opportunities and Challenges for Economic Development in Taiwan under the ECFA," Strait Exchange Foundation, September 30, 2010, <http://www.ecfa.org.tw/Download.aspx?No=11&strT=ECFADoc> (accessed January 12, 2012).

¹⁹Jeffrey Wu, "Taiwan Economic Forecast to Grow on ECFA Effect, Chinese Tourists," March 13, 2012, http://focustaiwan.tw/ShowNews/WebNews_Detail.aspx?ID=201203130035&Type=aECO (accessed March 18, 2012).

²⁰Jiann-Chyuan Wang, "The Strategies Adopted by Taiwan in Response to the Global Financial Crisis, and Taiwan's Role in Asia-Pacific Economic Integration," *Japan and the World Economy* 22, no. 44 (December 2010): 260.

²¹See Preamble of the Agreement, <http://www.ecfa.org.tw/EcfaAttachment/ECFADoc/ECFA.pdf>.

siveness, in effect implying that it does not compromise Taiwan's political status. The stress on equality and reciprocity is overstated (eighteen farming and fisheries categories are permitted to enter the Chinese market with no reciprocal liberalization offered by Taiwan, for example). The terms-of-offer are also "unequal" in some instances. In the banking sector (under services), branches of Taiwanese banks will have the privilege of offering Renminbi (RMB) business to Taiwanese companies after just *one year* of profitable operations (emphasis added).²² This is a lower entry threshold compared to those for "foreign" banks, but is similar to the profitability requirement for Hong Kong banks under the CEPA.²³ The contentious issues raised in the letter and substance of the ECFA include:

1. ECFA: a political compromise?

According to Chapter 5 (Articles 10 and 11) of the ECFA, disputes will be handled by the Cross-Strait Economic Cooperation Committee (CSECC) (specifically Article 11, sub-clause 1 (5)).²⁴ What is problematic here is that though this committee is to be a task-oriented liaison mechanism, this sort of institutional arrangement is different from that of the WTO²⁵ (see Appendix I for the WTO stages of dispute settlement). In the

²²See "Sectors and Liberalization Measures under the Early Harvest for Trade in Services" at: <http://www.ecfa.org.tw/EcfaAttachment/ECFADoc/Annex%20IV%20Sectors%20and%20Liberalization%20Measures.pdf>.

²³See "Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA): Bank Service Liberalization Measures under CEPA" at: http://www.tid.gov.hk/textonly/english/cepa/trade_services/bank_liberalization.html. Interestingly, unlike the ECFA text, the CEPA notes that "for Hong Kong banks to set up branches or body corporates in the Mainland, the total asset requirement at the end of the year preceding application is not less than US\$6 billion."

²⁴The CSECC comprises senior officials from both sides and is a "joint" organization for cross-Strait ties in which member officials represent their respective ministries on trade issues. See also Pasha L. Hsieh, "The China-Taiwan ECFA, Geopolitical Dimensions and WTO Law," *Journal of International Economic Law* 14, no. 1 (2011): 142.

²⁵The WTO GATT 1994 section (Article XXIV: 6 para 12) dealing with Dispute Settlement stipulates that "the provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding may be invoked with respect to any matters arising from the application of those provisions of Article XXIV relating to customs unions, free-trade areas or interim agreements leading to the formation of a customs union

"Safeguard Measures between the Two Parties Applicable to Products under the Early Harvest for Trade in Goods,"²⁶ it is noted under Article 5 that

the Agreement on Safeguards of the World Trade Organization is applied *mutatis mutandis*²⁷ under this Annex, the "Council for Trade in Goods" or the "Committee on Safeguards" mentioned in the Agreement on Safeguards of the World Trade Organization refers to the "Cross-Straits Economic Cooperation Committee" under the Cross-Straits Economic Cooperation Framework Agreement.

This arrangement is thus both interesting and ambiguous. Although China has in the past avoided internationalizing Taiwan's status by using the WTO Dispute Settlement Understanding against Taiwan, it has been used on some occasions.²⁸ There are three disputes involving Chinese Taipei as the complainant and sixty-seven in which Taiwan is a third party.²⁹ During the WTO's first Trade Policy Review (TPR) on Taiwan, China, led by its deputy permanent representative to the WTO, Li Enheng (李恩恆), protested measures adopted by Taiwan (a ban on the import of more than 2,200 Chinese products) and Taiwan's huge trade surplus with China that limited trade with his country.³⁰ The point being stressed is that

or free-trade area." Those provisions already privilege consultation. See http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_09_e.htm, and also see http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_08_e.htm#article22 (accessed September 3, 2012).

²⁶See "Safeguard Measures between the Two Parties Applicable to Products under the Early Harvest for Trade in Goods," <http://www.ecfa.org.tw/EcfaAttachment/ECFADoc/Annex%20III%20Safeguard%20Measures%20Between%20the%20Two%20Parties.pdf>.

²⁷*Mutatis mutandis*, in Latin, means: "with those things having been changed which need to be changed."

²⁸One example is Taiwan's imposition of anti-dumping duties against China in 2006 when Chinese-made towels allegedly took over 70 percent of the market share in Taiwan. See Jessie Ho, "Taiwan to Levy Anti-dumping Duties on Chinese Towels," *Taipei Times*, July 26, 2006, <http://www.taipeitimes.com/News/front/archives/2006/07/26/2003320426> (accessed March 12, 2012). Interestingly, Taiwan's MOEA had in April that year submitted a proposal to the WTO to increase duties on Chinese towel exports. Likewise, China too has filed anti-dumping investigations against trading partners, involving Taiwan as a third party.

²⁹Search for disputes at: http://www.wto.org/english/tratop_e/dispu_e/find_dispu_cases_e.htm#results.

³⁰Allen Hsu, "Taiwan Delegates Clarify Positions at WTO Trade Policy Review in Geneva," *Taiwan Today*, June 30, 2006, <http://taiwanauj.nat.gov.tw/fp.asp?xItem=21931&ctNode=122> (accessed September 3, 2012).

following accession to the WTO by both China and Taiwan, it was somehow felt that the WTO framework would provide *the* foundation of the principle of equality and non-discrimination applicable to bona fide WTO members.³¹ However, since the signing of the ECFA, it seems as if a "political understanding" on equality has been compromised since an "ex-WTO" mechanism is in the process of being developed under the rubric of the WTO in order to facilitate the "normalization" of cross-Straits relations. Nowhere in the ECFA does it state that institutional arrangements such as the CSECC will lapse once the ECFA graduates into an FTA. Moreover, it has been pointed out that other cross-Straits agreements (such as Article 15 of the Cross-Straits IPR Agreement and Article 11 of the Cross-Straits Arrangement on Cooperation in Agricultural Product Quarantine and Inspection) have their own dispute settlement provisions which could result in a "jurisdictional impasse" since they lie outside the ECFA CSECC structure.³²

Curiously, the WTO homepage listing the ECFA has two versions of the RTA "ID CARD" (a segment that carries a description of each RTA). The default navigation leads the reader to a page (URL: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=713>) which lists the ECFA as an agreement between ARATS and the SEF, and the column "RTA Composition" is left blank. However, a less noticeable link on the same page lists this agreement as being between existing members of the WTO, namely China and Chinese Taipei, with the RTA composition defined as "bilateral." The latter is the more accurate description, which somehow is not carried on the homepage itself. This may reflect the fact that China consi-

³¹Rong-I Wu and Chi-Chen Chiang, "WTO jia gou xia de guoji maoyi yu Taiwan de yinying celue" (The architecture of the WTO and international trade: strategies for Taiwan), *National Policy Quarterly* 2, no. 2 (2003): 1-28; refer also to Lee Teng-hui's six-point statement (specifically point 4) on "joining international organizations on the basis of equality"; See Kevin G. Cai, *Cross-Taiwan Straits Relations Since 1979: Policy Adjustment and Institutional Change Across the Straits* (Singapore: World Scientific Publishing Company, 2011), 5.

³²Hsieh, "The China-Taiwan ECFA," 153.

ders the ECFA to be an "internal matter" and not a matter of bilateral external relations.³³

The ECFA does not contravene the current provisions of the WTO, specifically paragraph 4 of Article XXIV of the General Agreement on Tariffs and Trade (GATT) 1947 which recognizes the desirability of "increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries party to such agreements."³⁴ However, the agreement falls into a gray area when it comes to meeting the requirement of paragraph 8 (a.1) of Article XXIV of GATT 1947 (elimination of duties with respect to substantially all the trade between the constituent territories) and paragraph 1 of Article V of the General Agreement on Trade in Services (GATS)³⁵ (substantial sectoral coverage of services). The ECFA clearly does not cover "substantially all the trade" between Taiwan and China. Moreover, in its current form the ECFA even fails to qualify as an interim arrangement prior to an FTA, since paragraph 5(c) of Article XXIV stipulates that an interim agreement will "include a plan and schedule for the formation of such a customs union or of such a free-trade area within a reasonable length of time."³⁶ The official WTO "Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994,"³⁷ also known as the "1994 understanding," clearly points out that the "reasonable length of time" referred to in paragraph 5(c) of Article XXIV should exceed ten years only in "exceptional cases." This does not preclude the ECFA from eventually becoming a WTO-covered agreement. However, for that, additional appended "har-

³³Rosen and Wang, *The Implications of China-Taiwan Economic Liberalization*, 142.

³⁴"General Agreement on Tariffs and Trade (GATT) 1947," Article XXIV, http://www.wto.org/english/docs_e/legal_e/gatt47_02_e.htm (accessed May 21, 2012).

³⁵"General Agreement on Trade in Services," Article 5, http://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm#ftnt1 (accessed May 21, 2012).

³⁶*Ibid.*

³⁷The 1994 Understanding is available at http://www.wto.org/english/docs_e/legal_e/10-24.pdf. It states that "in cases where members parties to an interim agreement believe that 10 years would be insufficient they shall provide a full explanation to the Council for Trade in Goods of the need for a longer period."

vest lists" and liberalization schedules (not excluding the remaining ban on the import into Taiwan of over two thousand items from China) need to be introduced in the not too distant future. Courting the exceptions clause under paragraph 5(c) of Article XXIV, however, would bring Taiwan (not just the agreement) within a gray area, the ramifications of which are detailed in section 5 of this paper.

2. Necessary trade enhancement?

The second set of contentious issues raised in connection with the ECFA relates to the nature of the production reorganization that may emerge as a result of the liberalization of trade. For instance, both Taiwan and China are looking to similar emerging industries (electric vehicles, cloud computing, biotechnology, and green energy, among others), and hence, in many ways, the two economies are poised at similar starting points for technological upgrading.³⁸ It is likely that there will be even more relocation of operations and manufacturing capacity from Taiwan to China as a result of the ECFA, a continuation of the reorganization of production that was taking place in the previous restricted economic climate (when Taiwanese companies were the original equipment manufacturers/original design manufacturers [OEMs/ODMs] of transnational corporations in global production networks). This could actually result in a reduction in investment-induced trade, as trade previously generated from Taiwanese investment in China may actually be replaced by local sourcing of inputs due to the localization of operations in China as Taiwanese firms move further upstream in Taiwan (i.e., away from consumers and more entrenched in global production networks).³⁹ The arguments relating to China's market potential and the prospects for economic gains for Taiwan

³⁸Shin-Horng Chen, Pei-Chang Wen, and Meng-chun Liu, "The ECFA and Its Effect on Cross-Strait Trade and Investment: A Taiwanese Perspective" (paper presented at the 22nd Annual East Asian Seminar on Economics, National School of Development at Peking University, CCER Beijing, China, June 24-25, 2011), 16, <http://www.nber.org/~confer/2011/ease11/shinhorngchen.pdf> (accessed January 11, 2012).

³⁹*Ibid.*

may actually generate such a trajectory as well.⁴⁰

It is predicted that the ECFA will create over 260,000 jobs.⁴¹ Some of the existing quantitative studies on the effects of the liberalization of cross-Strait trade following the ECFA predict that changes will be less pronounced in the agricultural sector compared to manufacturing (chemicals, rubber and plastic products, machinery and equipment, textiles, and ferrous metals).⁴² It is, however, too early to disaggregate the employment trends after 2010 as strictly accruing to an ECFA-induced ecosystem (given that the Early Harvest Plan is restricted to only 539 items from Taiwan, and we should not prematurely assess the tariff rationalization schema) (see table 3).

Based on the available data, it seems that there is a visible pattern of employment recovery starting in 2010. The cause of this recovery, however, cannot be conclusively attributed to an ECFA-induced revival of Taiwanese manufacturing, since the employment gains are spread fairly evenly over the services sector as well, and some of this may well be a cyclical recovery from the slump in manufacturing and services after the 2008 financial crisis. This is also in line with the observation that for core manufacturing exports, such as Taiwan's number one export to China, electronic equipment products (HS Code 85), for which tariffs are already low on both sides of the Taiwan Strait (0.58 percent in China and 0.71 percent in Taiwan), the touted benefits of ECFA-induced liberalization would be limited.⁴³ In the coming years, therefore, it is more vital to observe *how* the labor force is distributed within the economy across sectors and if that reflects the emergence of any comparative disadvantages from reallocation of competitiveness over time.

Apart from these contentious issues, there is also fear of the unknown. For instance, Chinese investors were previously barred from Taiwan, but

⁴⁰Ibid.

⁴¹"Harnessing the Opportunities of ECFA," *Taiwan Review*, September 1, 2010, <http://taiwanreview.nat.gov.tw/ct.asp?xItem=113946&CtNode=1337&mp=1> (accessed March 12, 2012).

⁴²Liu and Shih, "New Economic Development Opportunities for Taiwan," 21.

⁴³Ibid., 22.

Table 3
Employment Trends in Taiwan: Pre- and Post-ECFA

Year	Total labor force	Employed persons	Unemployed persons	Private total	Government employed	Agriculture	Industry	Services	Unemployment rate (seasonally adjusted)
2000	9,784	9,491	293	5,790	955	738	3,534	5,220	2.99
2001	9,832	9,383	450	5,766	961	706	3,432	5,245	4.57
2002	9,969	9,454	515	5,825	946	709	3,388	5,356	5.17
2003	10,076	9,573	503	5,910	988	696	3,398	5,480	4.99
2004	10,240	9,786	454	6,137	994	642	3,514	5,631	4.44
2005	10,371	9,942	428	6,374	961	590	3,619	5,733	4.13
2006	10,522	10,111	411	6,608	934	554	3,700	5,857	3.91
2007	10,713	10,294	419	6,803	932	543	3,788	5,962	3.91
2008	10,853	10,403	450	6,945	958	535	3,832	6,036	4.14
2009	10,917	10,279	639	6,850	1,040	543	3,684	6,051	5.85
2010	11,070	10,493	577	7,055	1,049	550	3,769	6,174	5.21
2011	11,200	10,709	491	7,291	1,038	542	3,892	6,275	4.39
2012	11,277	10,806	471	7,405	1,028	545	3,920	6,340	4.18

Source: Compiled from "Manpower Survey Results in April 2012," Department of Census, Directorate General of Budget, Accounting and Statistics, R.O.C., <http://eng.stat.gov.tw/ct.asp?xItem=31389&ctNode=1608&mp=5>; "Employed Persons by Class of Workers," <http://statdb.cla.gov.tw/html/mon/c2090.htm>; "Employed Persons by Section (Table)," <http://statdb.cla.gov.tw/html/mon/c2080.htm>.

thanks to the ECFA, around 247 investment opportunities have been made available to them.⁴⁴ By 2010, ninety-two Chinese investments had been approved by Taiwan (thirty-seven in Taipei City alone). Seventy-seven of these projects were in the wholesale and retail sectors, while thirty-six Chinese companies had invested in the professional (R&D), science and technology, and ICT-related sectors.⁴⁵ Another intense debate relates to the field of higher education. On August 19, 2010, Taiwan's Legislative Yuan passed amendments to the Regulations Governing Relations between the People of Taiwan and Mainland China, the University Act, and the Junior College Law to allow Taiwanese universities to enroll full-time degree-level students from mainland China. Yet another area of concern is the

⁴⁴Chen, "Political Economy of Cross-Strait Investments," 184.

⁴⁵*Ibid.*, 185.

non-reciprocal liberalization of select agricultural commodities (and fish), and how the Chinese may make inroads into Taiwanese farming and fisheries, an important constituency that has traditionally been strongly protected. The fear of the unknown, though articulated via various stakeholders, is more a matter of conjecture at this stage.

Taiwan's Critical Moment

If we were to operationalize the normalization of ties between China and Taiwan in the form of a game in IR theory, the schema of payoffs that best reflects the "trust dilemma" between the two is that of the "stag hunt."⁴⁶ This trust dilemma can be understood from a cursory survey of the literature on the ECFA where critics and proponents alike have yet to assign any "cooperative behavior" (as demonstrated in the signing and implementation of the ECFA) with the functional equivalence of "trust." The stag hunt is a game in which each hunter has the choice of hunting down a stag (bigger meat; payoff of 2) or a hare (smaller meat; payoff of 1). To hunt the stag for a bigger payoff, the hunters have to cooperate. So if one of them chooses to go after the hare, which does not require cooperation, the other hunter gets a payoff of 0 as it is not possible for one of them to catch the stag on his own.

This kind of balance of interests is helpful in conceptualizing the trust dilemma in cross-Strait relations. The payoff for both parties is based on two strategies/actions: "managing status quo" (the equivalent of hunting the stag since it involves the complicated task of managing peace) and "changing status quo." In Taiwan's case, the latter refers to the red lines that the main political parties are sometimes accused of breaching,⁴⁷ namely

⁴⁶For an overview, see Brian Skyrms, "The Stag Hunt," *Proceedings and Addresses of the American Philosophical Association* 75, no. 2 (November 2001): 31-41.

⁴⁷The pan-Green parties comprise, chiefly, the Democratic Progressive Party (DPP) and Taiwan Solidarity Union (TSU) and are considered pro-independence; whereas the "Blue camp" (Kuomintang [KMT] and People First Party [PPF], chiefly) insisterd soft on defending the status quo.

Figure 3
The "Stag Hunt" in Cross-Strait Ties

		Taiwan	
		Action/Payoffs	
China	managing status quo	(2,2)	(0,1)
	changing status quo	(1,0)	(1,1)

declaring independence (an allegation against the DPP) and reducing cross-Strait relations to an "a-security" scenario (i.e., ending the "security conceptualization" of cross-Strait ties, something that the KMT is accused of). Likewise, for China, "changing status quo" would entail the use of military force or diplomatic action to totally exclude Taiwan from participating in the international community. The payoff matrix, according to one of the possible utility functions, is illustrated in figure 3.

From figure 3, it is clear that the "stag" will be captured if both hunters can coordinate a range of actions (cooperation need not be analogous to compromise for either party). However, the option of "changing status quo" leaves the hunters with a lower payoff. "Changing status quo" is the equivalent of the hare since individual strategies pursued thus are expedient and reflect no mutuality of interests in the outcomes that are obtained.

Even within the range of behavior that could be interpreted as "managing status quo" areas of concern could emerge. For instance, there is an expectation that the signing of the ECFA will act as a bridge for Taiwan, leading to the signing of economic cooperation agreements with other countries.⁴⁸ If one assumes that China will "allow" Taiwan to sign trade agreements with other trading partners, what are the foreseeable options? In principle, this is not impossible given the interest that China has shown since 2001, when it expressly incorporated the need for "actively

⁴⁸Chiang, "Opportunities and Challenges," 25.

participating in the multilateral trade system and regional economic cooperation" in its tenth Five-Year Plan.⁴⁹ For Taiwan, then, three pathways stand out:

1. A bilateral preferential agreement-based approach where Taiwan would get to sign preferential agreements, similar to the ECFA, with its key trading partners. The most commonly cited instances are the negotiations investigating the establishment of trade enhancement measures (TEM) with the European Union, a trade and investment framework agreement (TIFA) with the United States, an ECA with New Zealand, and possible FTAs/CEPAs with India and Singapore. It is reasonable to assume that the conclusion of similar pacts would involve China's tacit agreement, otherwise some of these (and others) would have made further progress than they have. There is clearly an inward-bilateral bias toward China in this particular approach even though in economic terms it is expedient, or least painful in terms of domestic economic restructuring on preferential terms. China would probably prefer this option as it gives the highest visibility to its economic carrots, and narrows the perimeter of cross-Strait interaction with an explicit inward bias.
2. The second pathway involves Taiwan utilizing the aforementioned spirit of "greater flexibility" to build bridges in a distinctly plurilateral context (i.e., not preferentially excluding others). The initial economic costs are higher compared to option 1 since a multilateral initiative such as the Free Trade Area of the Asia-Pacific (FTAAP; growing out from the Trans-Pacific Partnership or TPP⁵⁰), for in-

⁴⁹Outline of the Tenth Five-Year Plan for National Economic and Social Development of the PRC, adopted on March 15, 2001, http://news.xinhuanet.com/zhengfu/2001-10/18/content_51471.htm.

⁵⁰The TPP is a proposed trade agreement between Australia, Brunei, Chile, Malaysia, New Zealand, Peru, Singapore, Vietnam, and the United States under the APEC umbrella (with Japan, Mexico, and South Korea recently expressing interest).

stance, would entail deeper economic reforms than would bilaterally (individually) negotiated preferential agreements. This also requires Beijing to accommodate the economic interests that Taiwan wishes to pursue. The implicit assumption in drawing this distinction is the "functional elbow space" that Taiwan has gained in those multilateral forums (such as the WTO, ASEAN, the European Union, and APEC) in which China's overt influence remains subject to multilateral pressures as well. Given Taiwan's successful application for observer status in the World Health Assembly in 2009, its attempt to gain observer status in the International Civil Aviation Organization (ICAO), or, even earlier, Taiwan's accession to the WTO as a customs territory, or its membership of APEC, the inward bilateral bias toward China that exists in option 1 is a shade muted in this option.

3. The third option entails a restructuring of the Taiwanese economy where existing tariff barriers across the board are rationalized unilaterally. This process, albeit less expedient than options 1 or 2 (since it would entail more economic costs with deeper reforms), would allow Taiwan some room to move away from the necessary inward-bilateral bias toward China of the ECFA. However, this option is not likely to fly with the business community as it is explicitly focused on unilateral reforms.

In the normal course of events, Taiwan would pursue a combination of these pathways in the ECFA ecosystem, depending on considerations of expediency. However, a problem will arise when the ECFA generates dispute legislation against China and Taiwan by other WTO members. As most favored nations (MFNs), other WTO members who are not extended the benefits of tariff reductions, intellectual property protection, or preferential treatment in areas such as banking (which is extended to Taiwanese banks in the ECFA), could mount challenges to China and Taiwan. While the "enabling clause" permits WTO members to provide "differential and more favorable treatment" to developing countries "in spite of" the MFN obligation to all WTO members, neither China nor Taiwan could benefit

from this interpretation since the "enabling clause"⁵¹ exclusively concerns agreements among "developing" countries—and Taiwan is not a developing country. Agreements involving developed and developing WTO members may only be subject to the requirements contained in GATT Article XXIV (refer to the earlier discussion on WTO compliance).⁵²

What this could imply for Taiwan is the evolution of a distinct trading template over the coming years. Such a "WTO-plus" template could take the form of "walls" (along the lines of the high tariff walls for non-members of the North American Free Trade Agreement [NAFTA] or non-EU members, for instance) which draws both Taiwan and China into a narrower perimeter by projecting this arrangement as a "Greater China economic space" or as an "internal matter" (as China claims that it is). This template gets re-enforced whenever Taiwan exhibits an inward-bilateral bias toward China in its pursuit of "bridges" with other WTO members. Therefore, even a strategy of "managing status quo" would entail an active Taiwanese strategy at multiple levels to avoid a multilateralization strategy from descending into a "WTO-plus" template that would be outside the comfort zone of the ECFA—and might eventually automatically lead to a "changed status quo." The dilemma is exemplified further by the expectation that the new Chinese leadership under Xi Jinping (習近平) may have a more hands-on/flexible approach, as Xi, unlike previous leaders, has experience in Fujian Province (and consequently *guanxi* with the *Taishang*).⁵³ New policies, such as "winning Taiwanese hearts and using economics to push for unification," have already been articulated.⁵⁴ This could imply that Tai-

⁵¹The "enabling clause" is technically known as the special and differential provision of "differential and more favourable treatment reciprocity and fuller participation of developing countries." See original text at http://www.wto.org/english/docs_e/legal_e/enabling1979_e.htm. For an excellent discussion on this with respect to Taiwan see Hui-wan Cho, "WTO Needs to Know about ECFA," *Taipei Times*, June 1, 2009, <http://www.taipeitimes.com/News/editorials/archives/2009/06/01/2003445066> (accessed May 14, 2012).

⁵²Jo-Ann Crawford and Roberto V. Fiorentino, "The Changing Landscape of Regional Trade Agreements" (discussion paper, no. 8, World Trade Organization, Geneva, Switzerland, 2005), 7.

⁵³See "Xi Jinping 'Transcends' His Predecessors: Expert," *Taipei Times*, February 17, 2012, <http://www.taipeitimes.com/News/taiwan/archives/2012/02/17/2003525696>.

⁵⁴*Ibid.*

wan's comfort zone may actually increase and for that reason there is even more need to prevent cross-Straits ties from descending into a "WTO-plus" template. For Taiwan, the spillover effect of an unmanaged status quo could be similar to that in the European Union, where the free movement of goods, services, personnel, and capital has generated a European identity.⁵⁵ This should influence the various appended agreements that will alter the final shape of the cross-Straits ECFA in the coming years.

Conclusion

By closely reexamining the narrative and substance of the ECFA (its contents, claims, and problem areas), we can see that, initially, for areas such as employment generation, there will be no simple causal relationship between the ECFA-induced ecosystem and the revival of Taiwanese manufacturing. However, the benefits are certain. Cross-Straits relations will not be limited to an ECFA-only framework since it is hoped that normalization of relations between Taiwan and China will set the stage for more trade liberalization agreements with other trading partners. Taiwan should eschew politically and economically expedient strategies with an inward-bilateral bias toward China and instead use the ECFA ecosystem to pursue its multilateralization strategy in the spirit of the "greater flexibility" promised by China.⁵⁶

⁵⁵Ching-Chang Chen, "Understanding the Political Economy of Cross-Straits Security: A Missing Link," *Journal of Chinese Political Science* 15, no. 4 (December 2010): 408.

⁵⁶This is not to suggest that this is what is happening at present in the light of improved cross-Straits relations. As recently as July 28, 2011, responding to a statement made by Wang Yi (王毅), director of the Taiwan Affairs Office, that "the Taiwan issue is mainland China's internal affair and must be resolved through negotiations between the Chinese people on both sides," Taiwan's Mainland Affairs Council (MAC) reiterated that "*the Republic of China is a sovereign and independent country instead of the Mainland's internal issue*" (emphasis added). Further, on August 23, 2011, while attending the ROC Centennial Peace Day activities in Kinmen, President Ma Ying-jeou emphasized that "no unification, no independence, and no use of force is the fundamental principle under which the government currently handles cross-Straits relations." See <http://www.mac.gov.tw/ct.asp?xItem=100490&ctNode=6605&mp=3>.

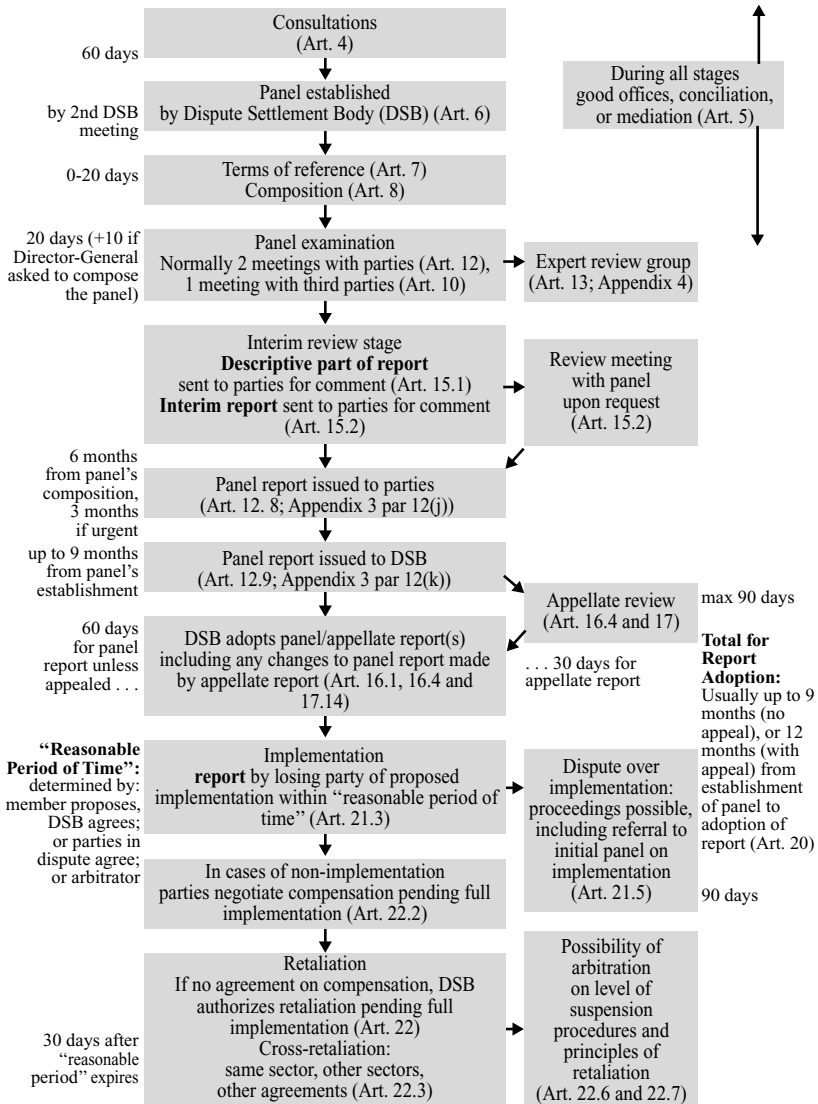
As we noted earlier, the signing of the ECFA itself is indicative of mutual cooperation (as in the stag hunt game), making games such as the prisoner's dilemma, which involve non-cooperation, less useful for conceptualizing the situation between Taiwan and China. In this context, we identified a number of possible pathways from which Taiwan could choose one (or a combination thereof). Recent efforts, such as the signing of an investment protection agreement with Japan or the initiation of talks with Singapore or New Zealand, are being touted as direct gains from the ECFA.⁵⁷ As of now there have not been many tangible diplomatic gains that can be attributed directly to the ECFA. The long-term objective should be to help Taiwanese companies leverage China's resources, build strong brands (the lack of mainstream Taiwanese brands compared to their OEM/ODM success has been noted), and evolve economies of scale, penetrate global markets, and boost Taiwan's international competitiveness.⁵⁸ If, instead, Taiwan's path-dependency is toward the Chinese economy as a final market, without an accompanying further restructuring of its own economy as a knowledge-based, innovation-driven, diversified-trading entity—then Taiwan may be locked into a situation in which it will have to pay the political costs of economic integration.

⁵⁷Grace Kuo, "Taiwan to Embrace Greater Trade Liberalization," *Taiwan Today*, June 4, 2012, <http://taiwantoday.tw/ct.asp?xItem=191669&ctNode=453&mp=9> (accessed June 5, 2012). However, a similar investment protection agreement was signed with India as early as 2002, and a scientific and technological cooperation agreement was signed in 2007. Taiwan and Australia signed an agreement on avoidance of double taxation even earlier in 1996.

⁵⁸Wang, "The Strategies Adopted by Taiwan," 255.

Appendix I

Flow chart of the WTO Dispute Settlement Process



Source: http://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c6s1p1_e.htm

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