

## **ECFA and its implications to East Asian Economic Integration\***

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### **Abstract**

The 2008 global financial crisis had made a wakeup call to Asian economies for their long term distorted development strategy and ASEAN plus China marked a great milestone for Asia economic integration. As for the Taiwan Strait, after twenty years of informal but extensive investment and trade between Taiwan and Mainland China, the two sides has reached the agreement to sign the Economic Cooperation Framework Agreement (ECFA) to normalize and institutionalize their economic relations. This paper argues that Asia should switch development gear from export-promotion to domestic consumption to consolidate the process of East Asian economic cooperation and integration. Likewise, China's potential consumption market plays a very important role. Moreover, ECFA enables Taiwan and China to collectively develop the Chinese domestic market. Based on past remarkable achievement and experience, Taiwan can be an effective resource coordinator, technology provider, and risk buffer for the region. For a prosperous and peaceful Asia, Taiwan needs Asian friends and Asian community cannot neglect Taiwan either.

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# **ECFA and its implications to East Asian Economic Integration**

## **I. Introduction**

The rise of China since 1990s has significantly changed the world economy and production networks in Asia. The traditional Flying-geese development paradigm has also been challenged. Ironically, after 2008 global financial crisis the world economy plunged into great recession and the major contribution (50%) of the world economic growth in 2009 was by China, who is likely the driving force of the world recovery in the future. Furthermore, to enhance economic development, economic cooperation despite of the form in bilateral, plural lateral or multilateral has shaped the new order of international trade. Cross-boundary investment and outsourcing has dominated international business. This paper first explains the phenomenon of globalization and regionalism to world economy and then describes the aftermath of the 2008 global financial crisis. Special attention is given to economic relations and ECFA between Taiwan and Mainland China and its implications to the East Asia economic integration. The major conclusion is that for a prosperous and peaceful Asia, Taiwan needs Asian friends and Asian community cannot neglect Taiwan either.

## **II. Globalization, regionalism, and the 2008 global financial crisis: Asian perspective**

The surge of globalization since 1990s with the extensively application of

information and communication technology has significantly changed the operation of the world economy. The share of tariff to manufactured products dropped tremendously from 30-40% in 1913 to less than 4% today in most of the advanced countries, and the cost of air fare per mile for each customer fell nearly 90 percent. The revolution of information technology has narrowed the constraints of geographical boundaries and regional differences. The world is flat. We are now living in a global village that the division of labor can be applied to the whole world market with the exercise of global production networks, FDI, contract manufacturing, and outsourcing. The invention of internet has not only changed the traditional mode of business operations but also generated the surge of trade in services. It is well recognized that the opening of international trade has contributed to the rapid growth of the world economy since the second half of the twenty century.

With the flourished trade in commodities and services, it becomes more and more important to have international institutions to guarantee and facilitate the volume and speed of international trade. As a result, the establishment of World Trade Organization (WTO) in 1995 aiming at an ideal multilateral free trade environment was a typical example. However, due to the protest of anti-globalism and the fear of regional protectionism the slow pace of progress by WTO was disappointed by majority of members. Thus, the emergence of bilateral Free Trade Agreement (FTA)

aiming at promoting trade and especially cross-border investment for economic development turns out to be inevitable. Up to the present, there are more than 400 FTAs have been reported independently to WTO. In Asia, the process of ASEAN plus (ASEAN +1 or +3) is a prominent example.

Since the rise of China in the 1990s, the intraregional trade in Asia has grown rapidly. Cheap labor cost with outward development strategy in China attracts FDI inflow and facilitates regional production networking, which soon turns China as the regional assembler and the world factory.

However, the 2008 global financial crisis hit outward-oriented Asian economies seriously; Taiwan and China were without exception with a significant drop of their exports in 2009. Devaluation game in the region is not a solution. The main reason behind falling Asian exports is the credit crunch, faltering demand and weakening purchasing power in Europe and the US. Many countries are now having a hard time and are beginning to save. This means that Asian countries are not to blame for their falling export figures. However, it is not very wise to rely on devaluation to try to stimulate exports that are falling as a result of weak foreign demand.

The way to resolve this problem would be to take the opportunity offered by the global financial crisis to improve the distorted structure with excessive Western consumption and Asian countries doing their best to keep production up to meet

Western demands, while at the same time continuing to save to make up for Western spending. In other words, the most important economic issue for Asia now is to find ways for its countries to collectively expand domestic demand and allow their people to share the fruits of past economic development. Asian nations are not short of cash. Among the top 10 countries with the most foreign reserves, which account for more than 60 percent of the world's foreign reserves, seven are in Asia. The Asian economy's biggest problem lies in high savings and low consumption.

Therefore, the best way is to expand domestic demand while strengthening regional economic and trade integration. Most important, the primary task should be to build a common currency unit, so as to stabilize the regional exchange rate structure and prevent a financial crisis from happening.

Thus, the focus should gradually be shifted toward Asian consumer markets. This is the only way for Asia to be able to sustain its own development and eventually stand side by side with the EU and North America. It would also be beneficial to global economic development and a more equalized global income distribution. This is perhaps the most important lesson that Asia can take away from the global financial crisis, and it also offers the greatest opportunity for Asian regional economic development.

### **III. Cross-Strait economic relations and the essence of ECFA**

Since the mid 1980s due to currency appreciation, environmental protection, and increase in labor cost and implementation of Labor Standard Law, Taiwanese firms have started to invest abroad beginning from Southeast Asia and gradually to China after the lift of Martial Law in 1987. According to Taiwan's official statistics, up to 2009 the accumulated Taiwan's investment in China reached US\$82.7 billion and accumulated trade across the Strait amounts to US\$854 billion despite of Taiwan government's restricted trade policy toward China started in 1996. In May 2008 after Mr. Ma Ying-Jeou won the presidential election by accomplishing second political power turnover, a policy switch toward closer economic tie between Taiwan and Mainland China to realize the division of labor across the Strait was emphasized. A better way to lower transaction costs and reduce market risk is to institutionalize the economic relations between Taiwan and China. Thus, the Cross-strait Economic Cooperation Framework Agreement (ECFA) between Taiwan and Mainland China was signed on June 29, 2010 to realize the *de facto* market-driven economic integration.

There are at least four important implications of ECFA for Taiwan:

1. To strengthen specialization and division of labor across the Strait. The underlying force behind the rigorous investment and trade between Taiwan and

Mainland China is vertical division of labor for manufacturing industry as a whole and electronic parts and components in particular. ECFA is an institutional arrangement that validates and reinforces the development. This is also a means to allow Taiwan to concentrate on industries having comparative advantage and to prevent from hollowing out industries.

2. To target at China's huge domestic market. As China develops and moves its strategy from export promotion to domestic market stimulation, huge domestic consumption demand provides the potential market for Taiwanese firms to explore and form a complete supply chain.

3. To develop Taiwan as a regional operation center and a gateway for global business. Taiwan is a small and open economy and international trade is the key for its sustainable economic development in the past as well as in the future. The rise of China supports the formation of international and regional production networking and the normalization of economic relations with China allow Taiwan to engage in regional resources coordination with the other countries in the region and thus penetrate the global market.

4. To avoid being marginalized and create rooms for internationalization and participate in international organizations. If Taiwan excludes from the process of regional cooperation and integration such as ASEAN plus, by and large as the scope

of regional integration enlarges then the damage on Taiwan will explode and eventually Taiwan will be marginalized. ECFA is a stepping for Taiwan to gradually involve into Asian economic integration, which means that Taiwan should at the mean time looking for having FTAs with the neighboring countries in Asia. ECFA is a means while participation in regional integration and international organizations are the goals for Taiwan as they are the determinants for Taiwan's economic endurance.

Note that the form of cross-strait industry cooperation has changed from the mode of vertical division of labor to the one of both vertical and horizontal division of labor. Further deepening in industry cooperation between Taiwan and China is a major issue after the signing of ECFA. The 12th Five-Year Plan proposed by Chinese Communist Party's Central Standing Committee on October 18<sup>th</sup>, 2010 is the guideline for the Chinese economic development for the period 2011-2015. The core of the 12th Five-Year Plan is to apply the development of science and technology to the transformation of economic development strategy, namely from export-oriented to domestic market-oriented. The seven strategic emerging industries, new-generation information technology, high-end equipment manufacturing, advanced materials, alternative-fuel cars and energy-saving and environmental protection, alternative energy and biotechnology, and modern service industry have been targeted for future development. In fact, Taiwan also identifies six emerging industries, four intelligence



industries and ten major strategic service industries for future development. There are several similarities, such as green energy, electric vehicles, cloud computing, logistics and distribution services that are mutually beneficial to industry cooperation across the Strait. In general, Taiwan is good in applied research and ability to commercialization, while China is strong in basic research and development of certain advanced technologies. Thus, mutual benefits and complementary exist among both sides to collectively develop branding, especially in light of China abundant labor resource, huge domestic market, and relatively cheap raw materials. It is clear that without own brand-name products China huge domestic market will become a partition market carved up by those multi-national corporations. Therefore, cross-strait industry cooperation should have the following:

1. Grasp the opportunities of globalization and regional integration and make efforts to establish a comprehensive product supply and value chain, including R & D, manufacturing, marketing channels and technical cooperation, and cross-industry cooperation between manufacturing and service.
2. Relax cross-strait exchanges and cooperation policies and regulations, particularly the market access standards of practice.
3. Promote the institutionalization of the cross-strait exchanges and cooperation in science and technology and strengthen the depth and breadth of R & D. In the mean

time, the two sides should encourage the cooperation of Taiwanese firms and the Mainland technology companies or research institutions to collectively develop technology and patents, making use of Taiwan's products commercialization advantages and management capabilities to enter the global market.

4. Speed up cooperation in industry standards and develop mechanism for mutual products authentication. In particular, the development of brand-name products with high technological content targeting at international market should be emphasized.

5. Co-develop low-carbon economy and its related industries and technology fields in response to shortage of resources, prevailing international prices of energy, and problems of global warming.

In short, cross-strait industrial cooperation should focus on market needs, innovation and industrial relevance. The successful development of Chinese domestic market requires in particular domestic market-oriented channel construction and creation of brand-name product. More importantly, Taiwan has the experience of internationalization, high level of service quality, and technology advantages to help China global move. By strengthening cross-strait cooperation in the industrial chain and optimizing the spatial distribution of cross-strait, Taiwan can take advantage of expanding the mainland investment in Taiwan to re-export back to the mainland market, which in turn will promote Taiwan's domestic employment and enhance trade

in services as well, making Taiwan a technology island of Innovation, creation and knowledge services. The 12th Five-Year Plan is a turning point to China and it is also something that is not a rare opportunity for Taiwan.

#### **IV. The implications of ECFA on East Asia economic integration**

The past four decades of Taiwan's economic developmental experience was the process of internationalization. Taiwan benefited from opening trade and had also contributed to the global community by providing inexpensive and good quality products. ASEAN is our closer trading partner, second only next to China. Based on Taiwan's past experience in industrialization centered by small- and medium-sized enterprises, Taiwan can be an excellent resources coordinator and technology provider for Asia region and a gateway to China in particular based on past experience. Cooperation instead of competition should be the motto for Asian regional development. The lesson we learned from 2008 global financial crisis is that Asia should switch development gear from export-promotion to domestic consumption to increase the welfare of majority working class in the region. In this regard, China's potential consumption market plays a very important role. From China's own perspective, it is important to development the inner rural area to increase the income of rural sector to mitigate regional income disparity and boost domestic consumption

and maintain constant economic growth rate. From Asian perspective, the growth of Asia requires a mass growth momentum to sustain regional demand and supply. China in particular and Japan should be the pivotal role. According to the report of 2009 World Economic Outlook the contribution of China to world economic growth increased significantly from 22% in 2008 to 50% in 2009. China's rapid urbanization and the emergence of middle class are the driving forces for China's domestic economy. McKinsey (2009) predicts that from 2005 to 2025 there will be a net increase of urban population by 354 million people, about the population size of the U.S., within which 70% are from rural area and a total of 23 megacities with population over 5 million and 221 cities with population over one million (a comparable of 35 cities currently in Europe). By 2025, China should have 520 million middle class.

ECFA enables Taiwanese firms to develop China's domestic market in the sense that Taiwan and Mainland China share common language, culture, and similar business practice. Moreover, for the past twenty years Taiwanese firms have intensive and direct investment in China, and since the turn of century especially after China's accession to the WTO in 2001 Taiwanese firms, such as food products, home electronics and distribution chained stores, have started to focus on China domestic market and utilized local upstream suppliers. The large Taiwanese manufacturing

firms together with small- and medium-size component supplier and distributors will form a complete supply chain from upstream R&D and product design to downstream manufacturing and logistic services such that not only the coastal development experience will be smoothly transferred to the central and western inner China but also the creation of brand name and establishment of products standard become possible in light of huge domestic consumption market. At the moment, the huge Chinese domestic market is segmented by bearing with lots of risk and uncertainty with different market access restrictions and regulations in cities and regions. Thus, for foreign investors Taiwan can be an effective risk buffer to penetrate Chinese domestic market.

ASEAN plus China had concluded in 2010 signifying a new era for East Asia economic integration. The process of ASEAN plus (+3 or +6) will keep evolving no matter in what form or in what name in the future. It is confident that Asia will soon be the center stage of the world economy. No one in Asia should left behind the process; in fact everyone should play its role to facilitate the process. Among them, based on its past remarkable experience and contribution to international community Taiwan should actively participate in the process as a regional resource coordinator and technology provider.

The signing of ECFA normalizes the economic relations between Taiwan and

Mainland China; and thereafter Taiwanese firms will play an even more vital role in China's domestic market than they used to be. To consolidate the process of East Asian economic cooperation and integration, it is in the interest of ASEAN or other economies in Asia to consider seriously signing FTAs with Taiwan as a middleman coordinator as well as a risk buffer to enter Chinese market.

Setting the political issue aside and focusing on the real economic matters, we believe ECFA is the first step for the two sides to negotiate and learn each other and hopefully reaches certain consensus. However, China should not unilaterally consider ECFA as a means for economic reunification which eventually lead to political reunification. If they think so, China will definitely try to marginalize Taiwan by excluding Taiwan from Asian regional integration. However, the marginalization of Taiwan is unfavorable for the security and stability of the region and also not in the national interest of the U.S. and Japan. As a result, the U.S. and Japan or other Asian countries will sign FTAs with Taiwan if Taiwan is under the threat of being marginalized. Thus, for a win-win solution, China should welcome Taiwan to sign any FTAs with the other countries in Asia and our Asian neighbors should be please to having FTAs with Taiwan after ECFA.

## **V. Conclusion**

The 2008 global financial crisis had made a wake up call to Asian economies for their long term distorted development strategy and ASEAN plus China marked a great milestone for Asia economic integration. As for the Taiwan Strait, after twenty years of informal but extensive investment and trade between Taiwan and Mainland China, the two sides has reached the agreement to sign the Economic Cooperation Framework Agreement (ECFA) to normalize and institutionalize their economic relations. Setting political arguments and controversial issues aside, as economic cooperation looks for mutual benefits ECFA is likely to trigger the learning process of the two sides finally leading to certain consensus.

For a small and open economy like Taiwan, internationalization is the only way for its long term economic growth. Under the wave of globalization especially the process of East Asia Economic cooperation and integration, Taiwan cannot afford being excluded from regional integration. In this regard, ECFA is surely an important stepping stone for Taiwan's internationalization. However, the successfulness heavily depends on having FTAs with the other countries in Asia at the same time. This paper argues that China should welcome Taiwan having FTAs with other Asian countries and Asian neighboring countries should express their contentment to have FTAs with Taiwan.

Economically, ECFA reduces transaction costs and market risks of Taiwanese

firms' investment in China and more importantly it enables Taiwanese firms to form a complete supply chain with the cooperation of China's domestic firms to serve the huge domestic consumption market. Moreover, Taiwanese firms can take the position as a resources and management coordinator for the regional production networks to explore the global market. For Asia as a whole to become more inward-oriented, it requires a mass and thick market like China to govern and maintain the growth momentum. The current form of ASEAN plus is heading toward this direction. It is thus apparent that the signing of ECFA and FTAs between Taiwan and the other Asian economies will definitely further consolidate and facilitate the on going process of East Asian economic integration. Marginalization of Taiwan is not in the common interests of Asian economies. For a prosperous and peaceful Asia, Taiwan needs Asian friends and Asian community cannot neglect Taiwan either.