

# Economic and Political Interaction across the Taiwan Strait Facing the Trend of Economic Integration in East Asia

Lee-in Chen Chiu



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## Executive Summary

Regional economic integration has been an important issue for decades in Europe and North America. However, this has been less the case in East Asia due to the complexity and diversity of politics, diplomacy, culture, and economics. Another important reason is that one crucial country Taiwan is ignored. This paper aims to explore the possible roles Taiwan might play in a more closely integrated East Asia.

Four major initiatives have been considered worthy of being put into action: (1) an integrated financial and monetary system, (2) closer East Asian open regionalism, (3) an agriculture "early harvest package" for economically vulnerable countries, and (4) an intra-industry specialization and manufacturing division of labor. The theoretical and practical approaches in tackling those issues are reviewed. As to strategies for approaching free trade agreements (FTA) within ASEAN+3, Malaysia and Indonesia prefer a multilateral approach, while Singapore and Thailand prefer a bilateral approach. Japan and Korea are undertaking cautious evaluation. China targeted the first ASEAN+1 negotiation in 2002. Meanwhile, two closer economic partnership arrangements with Hong Kong and Macao were signed in 2003. The effects of those FTAs are yet to be evaluated.

This paper elaborates how regional economies can mutually benefit from the manufacturing division of labor accruing from Taiwan's investment in China. Firstly, the policies that initiated economic interactions across the Taiwan Strait were analyzed in four stages from 1978 to the present. The shifting patterns of investment, moving from southern coastal China northward, and from a relatively small scale to large is investigated. Secondly, this paper also investigates the ways in which Taiwan's investment to China have contributed to, (1) inducing

more FDI and promoting China's international trade, (2) establishing local industrial networks so as to promote local industrial development, and (3) introducing and upgrading local technology transfers. Thirdly, the benefits to Taiwan economy in increasing business efficiency; establishing an authoritative logistics operation model; and increasing Taiwan's IT hardware market, making Taiwan a 21st century Asia-Pacific hub are elaborated.

Finally, the conclusion offers perspectives on how Taiwan can contribute to the above mentioned four regional economic integration issues. A dialogue on cross-strait peace and an operational framework is proposed aimed at inaugurating political and economic interaction with China. After all, only with peace across the Taiwan Strait, can economic integration in East Asia proceed peacefully and stably.

JEL classification: E63, F02, F15, F21, O14, O53

Keywords: Economic integration, FTA, ASEAN+3, East Asia; financial and monetary system, exchange rate, basket peg; manufacturing division of labor, technology transfer.

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# **Economic and Political Interaction across the Taiwan Strait Facing the Trend of Economic Integration in East Asia**

Lee-in Chen Chiu

## **I. Introduction: Taiwan is Ignored in East Asia Regional Economic Integration**

Economic integration had been an important issue in North America and Europe after World War II. It has been about fifty years. However Asian countries did not go through regional integration in the same way. The first regional integration organization in Asia was the Association of South East Asian Nations (ASEAN), which was established in 1967 and focused on discussing the political, economic and security issues. After 30 years of operation, the economic effects or impacts were not significant. The focus was largely on political and security issues.

Asia Pacific Economic Cooperation (APEC), was created in 1989, and was the first economic related inter-governmental organization in this region. The operation of APEC is based on the principles of voluntarism and consensus building. APEC believes in the spirit of open regionalism. Members of this organization include non-Asian countries such as US, Canada, Peru, Chile, Mexico. APEC operations are not as solid as EU or NATFA. Therefore East Asia is regarded as a region with no solid economic integration mechanism or organ so far.

The economic integration of East Asia became a hot issue after the Asian financial crisis in 1997. Discussions on financial cooperation among East Asian countries have vigorously progressed in academic

and policy circles. With the inauguration of ASEAN+3 informal summit in 1997, many papers discuss the different approaches of how East Asian countries should be integrated: Some emphasized the importance of trade or FTA; some focused on the industrial specialization and investment. Some proposed the tax initiative. Some emphasized the intra-regional financial and monetary cooperation. In fact, those are all-important areas and can be dealt with separately or simultaneously. Most importantly, each country needs to identify its relative comparative advantages in leading or arranging those economic integration issues.

Among various feasibility studies, except papers dealing with financial and monetary cooperation, Taiwan has been ignored. As the fourth largest economy in the region and the second to fourth largest FDI and trade partners for most countries in this region. Overlooking Taiwan completely. This paper aims to explore the possible role of Taiwan's participation in regional economic integration.

This paper is arranged in the following structure. The second section explores the emergence of economic integration in East Asia. The four are interpreted. Due to the weakness of conducting FTA impact analysis in the region, this paper adapts Taiwan's investment to China as an example to elaborate the possible effects of economic integration. The third section first excerpts the policy history. Taiwan's trade and investment flows toward China were analyzed in four stages: 1978~86, 1987~96, 1997~2001, 2001~present. Following such stage classification, the changing investment flows and patterns in China were analyzed. The fourth section stresses the mutual benefits via cross-strait economic interactions. In one hand how Taiwan's investments contribute to China's local economic development is analyzed. On the other hand, how Taiwan's economic competitiveness especially in the IT industry is enhanced via such manufacturing division of labor across the Taiwan

Strait is examined. The fifth section concludes the paper and gives some proposals on possible roles that Taiwan can play during the process of economic integration in East Asia.

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## II. The Emergence of Economic Integration in East Asia

An agreement signed in 1991 was the first step for ASEAN for moving toward economic integration in which all ten countries of ASEAN agreed to achieve an ASEAN free trade area by 2005. However such action was among countries in South East Asia only. The first signal that political and economic integration is linking countries from Southeast Asia to Northeast Asia is the inauguration of ASEAN+3 Informal Summit in 1997. The plus three countries (namely China, South Korea, and Japan) started to play significant roles in studying how to make the regional economic integration into solid policies and actions. The leading think tank in these three countries (NIRA in Japan, KIEP in Korea, and CDRC of China) inaugurated a series of studies on how to facilitate trade and investment in the region.

The effects of ASEAN+3 in setting the agenda for regional economic integration were revealed from 1999. During the third ASEAN+3 informal summit (1999), the "East Asia Cooperation Alliance Statement" was signed. From then on, annual meeting among ministers of finance, economic affairs and foreign affairs was established. This annual meeting aims at establishing a cooperative framework on finance, trade, and investment for East Asia.

The Asian financial crisis in 1997 gave East Asians a strong impetus to search for a regional cooperative mechanism that could forestall future crises and promote financial and monetary integration in East Asia. Recognizing the need to establish regional financial arrangements to supplement the existing international lending facilities, the finance ministers of ASEAN+3 agreed to establish bilateral currency swap

arrangements (Ahn, Ito, Kawai, and Park, 2003). The Chiang Mai Initiative (CMI) was signed in Chiang Mai, Thailand, on May 2000. This laid the foundation for the future financial cooperation.

Another important agenda for economic integration among ASEAN +3 entering twenty-first century is the negotiation on establishing the East Asia FTA. In the beginning stage, the ASEAN+3 FTA had been considered. However due to the difficulty on coordinating economic interests among Japan, South Korea, and China, recent development has been changed to three ASEAN+1 FTA. China leads the first ASEAN+1 and signed an "Agreement on Overall Economic Cooperation Framework between China and ASEAN" in November 2002 and targets a China +ASEAN FTA to be established in 2010. Shortly thereafter, Japan announced a Japan+ASEAN FTA will be established in 2012 to 2017. Korea is promoting a FTA with Japan and the agreement is expected to be signed in 2005.

According to the economic integration planned by ASEAN, an ASEAN common market is to be achieved in 2020. The first step in 2004 is to establish a specialized agency for solving the discrepancy on economic and trade disputes. Several practical issues are under study, such as the standard of identifying the origin of commodity, cost on procedure, mechanism for solving trade disputes, commodity and service standard, etc.

Economic integration began with economic cooperation in Europe in the 1950s and continued to develop into more advanced type of free trade area in 1970s. A regional exchange rate mechanism was initiated to restrict the volatility of the intra-regional exchange rate such as the European Monetary System (EMS) employed by the European countries during 1979~98. It finally launched the European Monetary Union (EMU) in January 1999. European economic integration takes fifty years.

Will East Asian economic integration take as long as European integration?

In year 2002, the world economy is regarded as three major regional blocs: EU (34.5% of GDP share and 35.6% of trade share of the world), NAFTA (29.6% of world GDP and 20.4% of trade) and East Asia (mainly ASEAN+3, taking 18.7% of world GDP and 19.62% of trade). The issue of establishing bilateral or multilateral FTA and economic integration in East Asia came to the political and economic agenda of major countries in the region.

In sum, for making the economic integration of East Asia feasible, many issues to be studied or coordinated. In addition, due to the conflicts on economic interests, different countries have different attitudes and strategies toward FTA arrangement. The following two sub-sections will elaborate those issues.

### **1. The Four Major Issues of Economic Integration in East Asia**

Generally speaking when the term "economic integration" is mentioned, it normally refers to four types of economic cooperation among countries: abolishing the tariff and non-tariff barrier, adapting common tariff or not, the mobility of production factors, and coordination of economic policy. As to the degree of integration is concerned, there are five different depth of integration level commonly undertaking: (1) preferential trade agreement, (2) free trade area, (3) custom union, (4) common market, and (5) economic union. Among which the most common used strategies are FTAs and CUs.

East Asia does not necessarily fit such integration concepts or strategies due to the unique experience of political and economic development. In addition to the diversity of politics, culture and

religion, a major FDI receiving region of the world since late 1980s and a financial crisis in 1997 has laid some economic strength and weakness for the region. The major initiatives on implementing economic integration in East Asia thus are somewhat unique.

*A. An Integrated Financial and Monetary System*

Due to the Asian financial crisis during 1997/98, the agenda of economic integration in this region has been using a different priority. The leaders of ASEAN+3 (China, Japan, and Korea) have sought a mechanism of financial cooperation that could safeguard the region from future crises. Recognizing the need to establish regional financial arrangements to supplement the existing international lending facilities, a bilateral currency arrangement, the so-called Chiang Mai Initiative (CMI) was signed by the finance ministers of ASEAN+3 in May 2000.

Among various debates or ideas on an integrated financial and monetary system for East Asia, the following three are worthy of putting into actions.

- (i) An institution that allows mutual consultation regarding exchange rates, interest rates, and foreign exchange reserves.

"A search for robust East Asian development models after the financial crisis: mutual learning from East Asian experiences" (Ahn, 2001) stressed "East Asia's organized economic cooperation or potential integration movement might come first in the financial arena, rather in trade and investment as found elsewhere. There is a critical need for East Asian countries to establish an institution that allow mutual consultation regarding exchange rates, interest rates, and foreign exchange reserves. They also must create an early warning system

concerning unusual symptoms in financial indicators, and then take prompt and corrective actions."

- (ii) The Asia Bond Initiatives (ABI) for the purpose of constructing the infrastructures and for the development of regional bond market.

For stable long-term funding in Asia, it is important to establish an Asia Bond Market. Current vulnerabilities of the Asian financial market stemmed from the "double mismatch" problem that is currency and maturity mismatch. Ito (2003) suggested a system of bridging the Issuers and Investors with credit rating function. Perspective investors are postulated as (1) pension funds in Japan, Singapore, and Malaysia, (2) central banks in the region, and (3) asset management companies in the region. However there is still no consensus on how the Asian Bonds should be issued. Chiaipravat (2003), Oh and Park (2003), and Ito (2003) suggested a basket currency bond. Wong and Ho (2003) focused on corporate bonds and their rating problems. There are also two other organizational bonds proposed: Asian Bond Fund and Asian Bond Corporation. Ito (2003) supported an idea to issue basket-currency bonds.

- (iii) An integrated intra-regional exchange rate system with a "basket peg".

Cho (2004) suggested a "Basket peg" for integrated intra-regional exchange rate stabilization. It is suggested that the "basket peg" can be designed to consist of (1) Japanese Yen, Euro, and US Dollars or (2) major currencies in the region. This viewpoint is based on three major

reasons. First, intra-regional trade is increasing in this region. Up till 2003, the share has been approaching 50%. Second, the structure of export commodities of the East Asian countries is becoming more similar. Third, there have been macroeconomic instabilities in the yen/dollar exchange market. When the yen appreciates against the dollar, the growth rate of emerging East Asian markets increased and vice versa. Therefore, East Asian countries have to cooperate in their exchange rate policies to set up as an institutional mechanism to avoid macroeconomic instability and competitive devaluations due to intra-regional exchange rate fluctuations (Cho 2003).

Of the above mentioned three directions, two of them (an integrated financial and monetary system and ABI) can be negotiated separately. Nonetheless, an integrated intra-regional exchange-rate system with a "basket peg" needs to be implemented within the framework of coherent regional monetary and financial policies. Otherwise there may be some difficulties in terms of operations (such as the snack shape to exchange rate during 1972 to 1979 in Europe) or even a major crisis (such as the European exchange rate mechanism crisis during 1992~93).

### *B. Open East Asian Regionalism*

Open regionalism normally has four possible implications: (1) open membership to non-regional countries; (2) providing unconditional or conditional MFN, (3) pro-global liberalization, (4) promoting trade facilitation via non-tariffs and non-border reform. It is, therefore, necessary to come up with new ideas on how to integrate the regional economy, and this will demand creative or functional strategies.

The East Asian Vision Group (EAVG), which was established following a decision reached at the Hanoi ASEAN+3 Summit Meeting, submitted a report to the leaders of ASEAN+3 on October 31, 2001. In

this report, the EAVG describes its vision of an "East Asian Community," and recommends the formation of an East Asia Free Trade Area well ahead of the Bogor goals set by APEC. Based on this EAVG recommendation, President Kim Dae-jung proposed at the Brunei ASEAN+3 Summit Meeting that there should be more concerted efforts towards an East Asia Free Trade Area.

According to the Bogor Declaration, APEC's industrial economies should achieve the goal of a free trade and investment area no later than 2010, and developing economies, no later than 2020. Although it is unclear at the moment whether the first target of 2010 for the industrial economies can be met, the formation of an East Asia Free Trade Area well ahead of 2020—say 2015—will significantly raise the chances of realizing the APEC goal. Furthermore, it will contribute greatly to worldwide trade liberalization.

However, if an East Asia Free Trade Area is hard to achieve due to some unexpected changes in ASEAN, a Northeast Asia Free Trade Area can be a long-term vision for Northeast Asian countries (Lee, 2004).

The final goal of open East Asia regionalism is to pursue globalization and liberalization of trade, investment, manufacturing, and logistic intra and inter regions. Therefore, economic leading countries have planned the following three functional hubs. (1) regional FTA hub or bilateral FTA strategies (Singapore, Thailand, China, Japan), (2) regional financial hub (Japan, Hong Kong, Singapore, Korea, Taiwan), (3) regional logistic hub (Singapore, China, Hong Kong, Korea, Taiwan)

### *C. Early Harvest Package (Agriculture)*

China's FTA Policy rides on its "New Diplomacy." In recent years, China appears to take more sophisticated and confident approach toward regional and global affairs. Park Dao-bok (2003) sees contemporary

Chinese foreign policy strategy as having transformed from a defensive and passive position ("*Tao-Guang-Yang-Hai*" in Chinese) into one that emphasizes the principle of actively resolving issues without evasion ("*You-Suo-Zuo*" in Chinese), which in turn focuses on one's responsibility and role.

The Early Harvest Package (EHP) provides tax free preferential treatment on agricultural items with the new additions of Cambodia, Laos, Myanmar, and Vietnam (CLMV). The EHP contains the liberalization of eight kinds of agricultural and marine products (animal, meat and organs, fish, milk products, other meat products, wood, vegetables, fruits, and nuts). China's EHP is effective on January 2004. Korea intends to follow this creative and humanitarian FTA model soon.

*D. Intra-industry specialization and manufacturing division of labor approach*

Sohn and Yoon (2001) did an empirical study on Korea's trade patterns for an APEC project and concluded that Korea's bilateral trade patterns fit the basic gravity model. This means that Korea tends to trade more with countries in close proximity and having large economies. Other important findings are that Korea's trade patterns are based on inter-industry trade rather than on intra-industry and Korea trades more with APEC countries than with non-APEC ones (This is probably due to US and Canadian membership).

Another research examining the formation of natural trading blocs in East Asia found little evidence showing that ASEAN+3 is centered around Japan, while the influence of the U.S. on the intra-regional trade in ASEAN+3 is positive and strong (Lee and Park 2002). ASEAN+3 is emerging as a strong candidate for a natural trading bloc in East Asia however it is also open to trade with the rest of the world. The creation

of a regional trading bloc in East Asia is expected to contribute to a worldwide institutional framework of multilateralism. This finding matches the principles of open regionalism and multilateralism of ASEAN.

Park (2003) examined changes in patterns of specialization and geographical concentration in East Asia. He found that the differences in economies of scale between East Asian countries have been greatly reduced over time, however geographical concentration has increased. During the 1989/91–1995/96 period, seventeen industries experienced the increase of geographical concentration more than 10%, while only three industries show the decline in geographical concentration more than 10%. The industries with increased concentration are characterized by above medium level of economies of scale, capital and skill intensity. In comparison with the United States and the EU, East Asian countries show a low level of specialization and concentration. Thus, if East Asia countries follow the development patterns of the more integrated regions, a regional trading agreement in this region may lead to further specialization and concentration.

Considering China has become the major FDI attracting country in East Asia and the comparative advantages of manufacturing division of labor from different countries may have different strength, Chiu Chen (2002) utilized the database from the Third National Census of PRC, undertaken in 1995 to examine the total factor productivity (TFP) of 33,256 FDI firms from seven different origin countries/regions (as shown in Table 2-1). Fifteen labor-intensive and high FDI intensity industries were selected among 33 industries to be regressed. This study concluded that South Korea, Taiwan, and ASEAN (the 5 economic leading countries only, not 10) had learned the best experiences (so as the statistically significant positive TFP value) in conducting the

manufacturing division of labor from home country to host country (namely China).

Among the 5 industries, each country has different strength. The most common positive high TFP industry in China is the Food Industry. Japan, Korea, ASEAN, and HK/Macao/Taiwan all show comparative advantages in it. The next strongest is Metal Smelting & Pressing which covers three FDI-origin countries, namely Singapore, ASEAN, and HK/Macao/Taiwan. As for the Electrical and Electronics industry, South Korea and Taiwan showed an outperforming ability.

This study along with all studies reviewed in this section imply that if an East Asian FTA is to be signed, the manufacturing division of labor will be exhibited in a better and deep way. A further regional cooperation strategy on industrial development in East Asia can be easily schemed following the lines of those findings.

Following the comparative advantages of manufacturing division of labor within East Asia, intra-industry specialization has increased significantly. According to analysis carried out by the World Bank (Ng and Yeats 2003), from 1985 to 2001, the trend of trade integration among East Asian countries became increasingly apparent. This can be observed from the increasing of IIT (intra-industry trade) index 0.260 in 1985 to 0.384 in 2001 in the region. A similar pattern prevails for each individual country. Take Taiwan as an example, The IIT index raised from 0.213 in 1985 to 0.519 in 2001, a faster rate than the regional average.

**Table 2-1. Industry Comparative Advantage of FDI Firms in PRC**

	Comparative Advantage	Comparative Disadvantage
Whole	Metal Smelting & Pressing (1%, 0.61) Food (9%, 0.41) Electric & electronics (11%, 0.33) ■ Chemical & Medicine (6%, 0.32) ■ Precision Instrument (2%, 0.32) ◆ Clothing (18%, 0.13)	Nonferrous Metal Products (5%, -0.36)
U.S. Canada		Nonferrous Metal Products (5%, -0.54)
Japan	Food (13%, 0.48)	Metal Products (4%, -0.42)
Singapore	Metal Smelting & Pressing (1%, 3.17)	
Korea	○ Transportation (1%, 1.68) Food (7%, 1.11) △ Textile (11%, 0.80) Electric & electronics (11%, 0.75) ◆ Clothing (25%, 0.63)	
ASEAN	△ Chem Fiber (1%, 1.66) Metal Smelting & Pressing (2%, 1.53) Food (22%, 1.06) △ Machine (5%, 0.94) ○ Transportation (4%, 0.85)	
HK Ma Tai	Metal Smelting & Pressing (1%, 0.60) Food (8%, 0.41) ■ Chemical & Medicine (6%, 0.40) Electric & electronics (11%, 0.39) ■ Precision Instrument (2%, 0.33)	Nonferrous Metal Products (4%, -0.34)

Notes: 1. The first number in parentheses denotes the proportion of firm in that specific industry; the second number in parentheses denotes the statistically significant TFP values adding or reducing to that specific industry in the TFP regression model with 15 industrial dummy variable.

2. △ denotes the unique high TFP industry existing in that particular FDI-origin country or blocks only. ■ and ◆ denotes one sole FDI-origin country's high TFP industry making whole FDI high TFP in same industry.

## 2. The Commons and the Discrepancies in Approaching the EA FTA

The discussion on this section will tackle with the strategies and attitude of the major countries which are now handling the FTA issue in the region, namely ASEAN, China, Japan, Korea, and Taiwan.

### A. ASEAN

ASEAN was proposed by Indonesia in 1960s and established in 1967. Due to her huge population size (nearly 238 millions), Indonesia always likes to play the role of opinion leader in ASEAN. The initiative behind establishing ASEAN was to integrate the political, economic and security issues in Southeast Asia. With the gradual involvement of Vietnam (1995), Laos, Myanmar (1997), Cambodia (1999)<sup>1</sup>, Indonesia proposed the Initiative of Economic Integration. The ASEAN free trade area (AFTA) was agreed and signed in January 1992 (effective 1993). Recently Thailand is proposing a Tax Initiative in ASEAN.

However there is strategic discrepancy on approaching an integrated economy for ASEAN+3. Malaysia and Indonesia prefer all ASEAN countries to work together. That means a pro multilateral approach. Singapore and Thailand prefer bilateral types of FTA. These two countries claim to be the FTA hub of the world. The former Malaysian Prime Minister Mahathir had criticized Singapore that signing too many

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1) Regarding the membership of CLMV, The Association of Southeast Asian Nations or ASEAN was established on 8 August 1967 in Bangkok by the five original Member Countries, namely, Indonesia, Malaysia, Philippines, Singapore, and Thailand. Brunei Darussalam joined on 8 January 1984, Vietnam on 28 July 1995, Laos and Myanmar on 23 July 1997, and Cambodia on 30 April 1999.

FTA will open the back door for AFTA. However after the financial crisis, Malaysia and Indonesia had so many domestic economic and political instability, their voices became weak.

*B. China*

China's FTA policy rides on its "New Diplomacy" and it intends to build a China-centered "East-Asianism" so as to counter balance the Japan-centered East-Asianism. China is not only actively pursuing a FTA with ASEAN but also enhancing security cooperation as well with ASEAN. China unfolded a series of intense summit-level meetings and high-level diplomacy with ASEAN countries between 1999 and 2000. China-ASEAN FTA agreement was signed in November 2002, in which both regions reached a consensus to start the FTA in 2010 and will take effect by 2015.

The Japan-ASEAN FTA was hindered by Japan's domestic political power from agriculture sector, and therefore China realized its closer economic relationship with ASEAN 10 by increasing its agriculture cooperation (so called the Early Harvest Package) which provides tax free preferential treatment on 550 agricultural items<sup>2)</sup> with the new additions of Vietnam, Myanmar, Laos, and Cambodia (hereafter CLMV). The EHP is effective on January 2004. Considering these four countries are all traditional agriculture-centered countries, this measure to abolish tariffs may be relatively unfavorable to China.

For political purpose, China signed Closer Economic Partnership

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2) According to ASEAN website, the Product Coverage of the Early Harvest Programme is described as follows: All products in the HS 01-08 chapters at the 8/9 digit level (HS Code) shall be covered by the Early Harvest Programme. So it is assumed that number of agricultural may be about 550.

Arrangement with Hong Kong (June 2003) and Macao (Oct. 2003). CEPA includes three special arrangements: (1) Seven new measures in facilitating and simplifying trade and investment, (2) preferential treatment on 18 service industries, and (3) preferential treatment on 273 manufacturing products. It intends to attract Taiwan's interest of signing a non-international agreement type of economic cooperation framework with Taiwan. However it is very obvious that it holds no interest for Taiwan.

### *C. Japan*

Considering the economic leadership in East Asia, Japan is supposed to be the most active country in pursuing the FTA with ASEAN. However due to its domestic conservative political power from the agriculture/rural sectors, Japan has so far signed only two FTAs. One is with Mexico. The other is with Singapore. For the latter, the Japan-Singapore Economic Partnership Agreement (EPA) was signed on January 2002 and became effective on December 2002. On his January 2002 visit to Southeast Asia, Japan's Prime Minister Koizumi Junichiro proposed the establishment of the ASEAN-Japan FTA Study Group. The Japanese government started bilateral negotiations with Korea, Thailand, Malaysia, and the Philippines in early 2004 and consultations with ASEAN. It is expected that Japan-ASEAN negotiations will not commence until 2005.

Japan government set its benchmarks of strategic priorities for signing a FTA or EPA as follows (Urabe 2004):

1. Economic criteria: advantage vs. disadvantage analysis on whether it is beneficial to domestic structure reform; helpful for the revitalization of Japan economy; conceivable by the business

community, domestic community, etc.

2. Geographic criteria: factors such as location importance, shipping costs.
3. Political and diplomatic criteria: the importance of the counterpart countries; increasing bargaining power in WTO negotiations; influencing and speeding up WTO negotiations; trust-building among FTA/EPA members.
4. Feasibility criteria: the targeting countries are interested; and do not affect the agricultural competitiveness.
5. Time-related criteria: normally one to two years of negotiation time are expected. Bureaucratic system changes every two years. The consensus had better been achieved in two years.

Korea is actively pursuing the FTA agreement with Japan. However Japan is not so interested for the following reasons (Yukdo 2004):

1. Japan government is not eagerly seeking Japan-Korea FTA or an FTA between ASEAN plus three for several reasons. First, the agriculture problem is more important (Korea has the same problem). Agriculture products imported from China is not accepted. Secondly, the interweaving of the political-economy has to be considered before hand. Jimin Tou (Liberal Democratic Party) was originally from the political foundation in rural area. They need to take care of farmers' interests first. Thirdly, insecurity from North Korea is threatening the region. The Korea peninsula will be unstable within one year. Fourthly, Korea's suggestion of FTA with Japan is too big and too complicated. Other factors such as, US army in Korea is also an obstacle. Korean people do not like US army. Iraq issue, etc.
2. The more possible partner will be ASEAN in short run. China+

ASEAN FTA will make progress in 10 years. Japan+ASEAN FTA will make progress in 2005. These two FTA are less complex.

3. Japan and Mexico had signed a FTA because the agriculture products between the two countries are less sensitive and the shipping distance also makes it a natural obstacle.
4. EU and NAFTA have been so successful. If East Asia intends to be strong in political and economic influence to the world, an integrated FTA (or economic integration) is important.
5. Electronics and car industries seem to have more chances to be considered in J-K FTA.
6. FTA *per se* has little economic impact. One can do investment without FTA. So, FTA *per se* is more a political incentive (closer relationship between two countries).

#### *D. Korea*

Concerned about being left out of East Asia integration, Korea started its active study and negotiation of FTA within East Asia in 2003. Before that, Chile was chosen as Korea's first FTA partner for forming a task force on December 1998 because it showed a strong interest in concluding an FTA. Korea believed that Chile's open trade policy and its accumulated experience in concluding FTAs with other countries would certainly serve as a guide to conducting successful negotiations. However they encountered the sensitive problems on tariff concession on agriculture sector and some manufacturing products. After a comprehensive study, it was concluded that Chile is a suitable partner for Korea's first FTA since the effects of structural adjustment would be moderate due to Chile's distance from Korea, opposite seasons, and complementary trade structure. The effects of increasing exports would be great. The Korea-Chile FTA was signed

on March 2004.

As to the FTA with East Asian countries, Korea-Singapore and Korea-Japan FTAs had completed joint research on October 2003 and started negotiations on January 2004. Korea-ASEAN FTA started joint study on February 2004. It is expected that Korea will start FTA negotiation with ASEAN on 2005.

Korea's strategies on negotiating FTA with ASEAN kept in mind the experience of China and Japan. Two strategies will be prevailed simultaneously: (1) To CLMV countries, Korea will consider giving them some special treatment. Korea-Laos negotiation will start October 2004. (2) For countries with higher income and probably similar industrial structure, Korea will adapt a bilateral approach (similar to Japan). The first target now is Singapore and afterward Thailand and Malaysia. Three years of joint study and negotiation is expected.

#### *E. Taiwan*

Although Taiwan is excluded from the ASEAN+3 FTA framework, in facing the challenge of entering the WTO, Taiwan has conducted several important research projects to evaluate how to select economically significant countries with which to sign FTAs. Tu (2001) adapted "principal component analysis" to analyze the best targets, using a World Bank dataset of 11 economic variables with 38 countries. It was found there are three major elements in the economic impact of FTAs. The first comprises four variables of domestic economic strength: namely GDP, total trade volume, total population, and weakness of agriculture sector. The second comprises variables of the country's trade, such as trade intensity, trade complementary, trade openness and geographic distance from Taiwan. The third

comprises average tariffs of manufacturing goods and their share of GDP.

After calculating the weighted score of the above three key components for each country, the 10 most suitable countries for signing FTAs with Taiwan are ranked as follows: the EU, the USA, Singapore, Japan, Thailand, Mexico, Malaysia, the Philippines, Indonesia, and Korea. In other words, all the major ASEAN economies are all included.

However due to highly unfriendly political interference by the PRC, Taiwan has not achieved FTAs with any of the above 10 countries. The only FTA that Taiwan has signed is with Panama in 2003 for similar reasons that Japan and Mexico and Korea and Chile signed similar agreements. The remoteness of the FTA targets negates the impact on agricultural products while increasing trade in manufacturing products. One extra mutual benefit that Taiwan expects to enjoy from Taiwan-Panama FTA is in the shipping industry.

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### III. Cross Strait Economic Interactions and Political Interference

#### 1. Policies on Initiating Economic Interactions across the Taiwan Strait

Resuming economic relations with Taiwan has always been one of the most important political objectives of China. This can be observed from China's various strategies for reestablishing economic relations with Taiwan. Conversely, for the Taiwan government, minimizing economic relations and contact with the mainland as much as possible for the sake of national security was the guiding principle before 1985. Such conflicting approaches to bilateral relations have implied that resumed economic interaction would be actively pursued by China authorities but resisted by Taiwan authority. This is clearly illustrated by comparing each side's policies, as summarized in Table 3-1.

**Table 3-1. Comparison of China's and Taiwan's Policies for Initiating Economic Relations**

The Taiwan Authorities	The China Authorities
1977 Except for a few herb medicines and agri-ind materials, imports from PRC are illegal	1978 Open trade policy
1985 Noninterference principle on indirect exports to the mainland	1979 Suggest two sides have interactions in navigation, mail, and trade
1987 Permit 30 items of mainland natural resources to be imported Martial Law lifted, Permit to visit the mainland relatives	1980 Mission to H.K. to buy Taiwanese goods
	1980-81 Free tariff on goods imported from Taiwan
	1982 Imports of Taiwan products became more strictly regulated due to trade policies

Table 3-1. Continued

<p>1989 Import materials increased to 92 items Promulgate regulations on permitting indirect trade, investment and technical cooperation with the mainland</p>	<p>1984 Encourage imports (not aiming at Taiwan)</p>
<p>1990 MOEA announced "The Regulations on Indirect Investment and Technology Cooperation with the Mainland Area"</p>	<p>1985 Xiamen designated tax free with domestic sale privilege for Taiwan investors Designate ten coastal ports for Taiwan navigation, trade and investment Announce general import regulations (not aimed at Taiwan)</p>
<p>1991 (April) Deadline of spontaneous registration of mainland investment to MOEA Import materials increased to 165 items Guidelines for National Unification announced Open exports to the mainland, and procedure for remittance in Taiwan to make mainland investors' financial management convenient</p>	<p>1987 Trade rights with Taiwan shifted to local governments from central government</p> <p>1988 Announced "Regulations on Encouraging Investment by Taiwanese"</p>
<p>1992 13 items of semi-finished industrial products are allowed to be imported (Sept.) Statute Governing Relations between the Peoples of the Taiwan Area and the Mainland Area</p>	<p>1990 Set up several Taiwanese Investment Zones</p> <p>1991 Preferential treatment to Taiwan investors initiated by many inner cities</p>
<p>1993 Allowed imports of more than 400 semi-finished industrial (March) Regulations Governing the Approval of Investment or Technical Cooperation in Mainland China (April) Regulations Governing the Approval of Trade with Mainland China</p>	<p>1992 Encouraging Taiwan's investment shift from labor-intensive to technology-intensive products</p> <p>1993 Nationwide Meeting on Taiwan Affairs was held</p> <p>1995 PRC announced "Provisional Rules for Instructing the Investment Direction for FDI firms" and "Industrial Guidance Pamphlet for FDI firms"</p>
<p>1994-97 (April) Continuous open the permitted imported commodities up to 5185 items (54.8% of total)</p>	<p>1996 Military exercise and missile test over Taiwan Strait</p>

Table 3-1. Continued

1996 President Lee Deng-Huai announced the "No Hasted, Be Patient" China Investment Policy	1997 Cooperate with Taiwan Authority on port-to-port direct voyage policy
1997 (July) New version of Regulations on Approval of Investment toward the Mainland	2001 Passively cooperating with Taiwan Authority on small direct voyage link dialogue between Kinman and Xiamen local government.
2001 (Aug) President Chen Shui-Ben held Economic Development Consultation Conference and concluded to change cross strait economic policy to "Open Actively, Manage Efficiently"	
(Nov) PRC and Taiwan authorities are accepted as separated new members in WTO	
2003 Taiwan successfully joins the G-10 of small agricultural negotiation group in WTO.	2004 PRC responded by peace framework
2004 (April) President Chen pursuits a "Framework" of "Peace and Stable" interaction with China.	(June) Tsinghua University (Beijing) invite an inaugurating scholarly Peace Voyage Lecture to KunShan (a city with most densely Taiwan investors)
2005 The "Cross-Strait Peace Development Committee" is expected to be formed	

Since the Kuomintang (KMT) regime withdrew to Taiwan in 1949, any trade or business activity with the Mainland has been regarded as treason. The "Regulations on Prohibition of Commercial Products from Bandit-Controlled Areas" promulgated in 1977, is one obvious example of the severity of tensions. According to that regulation, only a very few medicinal and essential agricultural or industrial materials were allowed to be indirectly imported via Hong Kong. Until the lift of Martial Law, permitting the relative visiting from Taiwan to China, Taiwan businessmen initiated circuitous investment toward the

mainland in 1987. The impact of resumed economic interactions became significant.

Resumed economic interactions can be interpreted into four stages: 1978~1986, the trade resumption period; and 1987 to 1996, the investment resumption and legalization period; 1997~2001, "No Haste, Be Patient" period; and 2001 to the present, "Open Actively, Manage Efficiently" period. They are elaborated further below.

*A. Trade Resumption Period: 1978~1986*

Mainland China opened its foreign trade door in 1978 and simultaneously suggested indirect trade with Taiwan via Hong Kong and Macao. Early in 1979, China further suggested both sides begin interaction in navigation, mail and trade. However, these requests failed to produce a response from the Taiwan authority. China soon organized a mission to Hong Kong and purchased US\$ 80 million worth of Taiwanese products in 1980. In the same year, to encourage further trade interaction, China announced a tariff-free policy on Taiwan made imported goods. That policy ended in 1981 because non-Taiwan products masquerading as Taiwan products flooded the Chinese market.

Due to the politically hostile relationship between two authorities, direct contacts for business negotiation, mail exchange and voyage/air links between China and Taiwan were not allowed. The trade across the Taiwan Strait had to be conducted via transit shipping through Hong Kong. Owing to China's intentional strategic design, trade between the two sides of the Taiwan Strait started to grow significantly during 1978~1981. The trade between Taiwan and Hong Kong had gradually grown due to the growth of transit trade from China to Taiwan. Table 3-2 shows the transit trade of Taiwan with Mainland

China, as percentage of external trade with H.K. was about 20% in 1984. This ratio grew to 65% in 2003. If the transit exports are considered, this ratio grew even higher, reaching 73.4% in 2003. This is due to the restriction on imports from China by Taiwan authority.

Due to the increase in China's foreign exchange reserves and inflationary pressure from internal economic prosperity, the Ministry of External Economies and Trade (MEET) released a document called "Several Points on External Trade Reform" in September 1984 which decentralized trade rights to local governments and enterprises.

In 1985, Xiamen Shi (in Fujian Province) announced the four-year tax-free privileges and opened its domestic market to Taiwan investors. In the same year, China designated ten coastal ports for Taiwan investment, shipping, and trade. In 1985, Taiwan for the first time responded to the demand for trade between the two sides of the Taiwan Strait and announced the "Noninterference Principle of Indirect Exports to the Mainland." From this point on, the trade volume between the two sides of the Taiwan Strait grew steadily (except for a negative growth rate in 1986 which was caused by China's internal foreign trade policy adjustment).<sup>3)</sup> The rapid transit export growth between Taiwan and China via H.K. commenced at 1988 (a jump from 27.5% to 36.3%). A new stage so called investment induced exports (Chen Chiu & Chung 1993) was inaugurated along with the investment resumption.

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3) Facing such strong growth in trade with Taiwan, MEET decided to regain its control over Taiwan trade in 1987. Three strategies were announced: (1) trade between the two sides of the Taiwan Strait should be controlled by MEET; (2) the twenty-seven commodities that could be exported or reexported to Taiwan must be reported to and examined by MEET; and (3) no more imports from Taiwan of products for which China had invested in import substitutes were to allowed.

**Table 3-2. Trade between Taiwan and Hong Kong and  
Transit Trade to Mainland China**

(Unit: US\$ million, %)

Period	Taiwan Exports to H.K.			Taiwan Imports from H.K.			Total Trade between Taiwan and Hong Kong		
	Amount	Re-exports to Mainland China		Amount	Imports from Mainland China		Amount	Transit Trade with Mainland China	
		Amount	As Percentage of Exports to H.K.		Amount	As Percentage of Imports from H.K.		Amount	As Percentage of External Trade with H.K.
1982	1,671.8	194.5	11.6	436.4	84.0	19.2	2,108.2	278.5	13.2
1983	1,705.2	157.8	9.3	473.2	89.9	19.0	2,178.4	247.7	11.4
1984	2,224.0	425.5	19.1	624.1	127.8	20.5	2,848.1	553.2	19.4
1985	2,679.2	986.9	36.8	554.5	115.9	20.9	3,233.7	1,102.7	34.1
1986	3,074.0	811.3	26.4	761.4	144.2	18.9	3,835.4	955.6	24.9
1987	4,274.0	1,226.5	28.7	1,241.7	288.9	23.3	5,515.7	1,515.5	27.5
1988	5,686.8	2,242.2	39.4	1,811.5	478.7	26.4	7,498.3	2,720.9	36.3
1989	6,613.7	2,869.5	43.4	2,112.6	586.9	27.8	8,726.3	3,483.4	39.9
1990	7,446.7	3,278.3	44.0	2,724.1	765.4	28.1	10,170.8	4,043.6	39.8
1991	9,563.0	4,667.2	48.8	3,175.0	1,126.0	35.5	12,738.0	5,793.1	45.5
1992	11,301.2	6,287.9	55.6	3,396.9	1,119.0	32.9	14,698.1	7,406.9	50.4
1993	12,203.7	7,585.4	62.2	3,658.6	1,103.6	30.2	15,862.3	8,689.0	54.8
1994	13,936.3	8,517.2	61.1	3,700.3	1,292.3	34.9	17,636.6	9,809.5	55.6
1995	16,572.6	9,882.8	59.6	4,580.6	1,574.2	34.4	21,153.2	11,457.0	54.2
1996	15,795.1	9,717.6	61.5	4,274.8	1,582.4	37.0	20,069.9	11,300.0	56.3
1997	15,967.6	9,715.1	60.8	4,693.7	1,743.8	37.2	20,661.3	11,458.9	55.5
1998	13,342.9	8,364.1	62.7	4,342.7	1,654.9	38.1	17,685.6	10,019.0	56.6
1999	12,875.2	8,174.9	63.5	4,225.6	1,628.1	38.5	17,100.8	9,803.0	57.3
2000	15,919.5	9,593.1	60.3	5,102.6	1,980.5	38.8	21,022.1	11,573.7	55.1
2001	13,837.0	8,811.5	63.7	4,534.2	1,693.3	37.3	18,371.2	10,504.8	57.2
2002	14,859.8	10,311.8	69.4	4,433.4	1,708.1	38.5	19,293.2	12,019.8	62.3
2003	16,051.7	11,789.4	73.4	5,419.2	2,161.1	39.9	21,470.9	13,950.4	65.0

Source: Census and Statistics Department, Hong Kong.

*B. Investment Resumption and Legalization Period: 1987~1996*

A few experimental and relative-assisted cases of investment began in 1982, but major investment from Taiwan to China mounted only when the Taiwan government started to soften its hostile political relationship with China in 1987. In that year, two important China policies were announced by Taiwan: the nullification of martial law and permission for visits to relatives in China. Taiwan's businessmen quickly detected that the change in political atmosphere between Taiwan and China would be followed with increased economic interaction.

To attract Taiwan enterprises to invest in the mainland, the State Council of China promulgated the famous 22 articles of the "Regulations on Encouraging the Investment of Taiwanese" in July 1988. This policy was effective, as Taiwan's investment toward China began to increase. In October 1989, Taiwan promulgated regulations sanctioning indirect trade, investment, and technical cooperation with China. Contracted investment items and volume with Taiwan enterprises skyrocketed in 1990. Facing a surge in indirect investment in China, the Taiwan government tried to guide China investment boom rather than to reverse it. The National Unification Council, organized by President Teng-Hui Lee, and "Guidelines for National Unification" were first initiated in March 1991. In this key document, the Taiwan Authority clearly specified that economic interaction with China should be achieved in gradual phases under the principles of reason, peace, parity, and reciprocity.

Hence, it is apparent that further openness of economic interaction (which means direct trade and investment) is subject to the relaxation of political tension. On October 6, 1990, the Ministry of Economic Affairs announced "The Regulations on Indirect Investment and Technology Cooperation with the Mainland Area" and requested spontaneous

registration and reporting of previous investment toward China by April 8, 1991. At about the same time, 3,319 products were authorized for indirect investment (this was later increased to 3,679 items). Generally speaking, almost all labor-intensive industries that are no longer competitive in Taiwan are allowed to invest (indirectly) in China.

Whether the government should legalize the indirect investment with China became a big political and economic interwoven issue at that time (around 1991 to 1992). Opinion editorial articles in newspapers and journals discussed the possible positive and negative effects to the country. In March 1992, the National Economic Forum (held every ten years) came to the conclusion of lifting the ban on cross-strait trade and investment under two important policy slogans "Roots remain in Taiwan" and "Production division of labor across the Strait." Thus the policy guidance is defined and related measures were planned and implemented gradually. In May 1992, MOEA legalizes three categories of mainland investment: positive (or open) lists, negative (or prohibit) lists & case by case evaluation among 7,296 items of CCC code commodity goods.

The following steps on legalizing the Regulations governing people interaction, investment or technical cooperation, and trade with Mainland China were reviewed and promulgated by Legislative Yuan from September 1992 to April 1993 as shown in Table 3-1. Up to April 1997, the commodity lists in positive, negative, and evaluation categories for manufacturing industries were respectively 4,842, 299, and 2,518 items.

For the convenience of implementing production division of labor across the Taiwan Strait, the ban of prohibiting importing manufacturing goods from China to Taiwan had to be lifted too. In spring 1992, the first 13 items of semi-finished industrial products (mainly for shoe making) were allowed to be imported. MOEA reviews the necessary

open list every six months. Up to the end of June 1997 when the China investment policy were changed to "No haste, Be patient", there were 5,185 commodities (54.8% of the total) that were allowed to be imported.

*C. "No haste, be patient" period: 1997~2001*

The cross strait investment and trade open policy was implemented smoothly and gradually until August 1996 when PRC people's army provoked political tension by engaging in military exercise and missile test around the ocean territory surrounding Taiwan. President Lee announced a new "No haste, be patient" investment policy toward China in August 1996. Political tension hinders the further openness. After nearly 10 months of study, four additional case-by-case evaluation criteria were added to the above mentioned investment regulation for the purpose of controlling Chinese investment among big companies. They are:

- (i) setting the upper limit of accumulated investment volume to China for each firm in terms of their net capital value;
- (ii) setting the upper limit of each investment application case (no more than US\$ 50 millions);
- (iii) The approval criteria of case-by-case project evaluation were to be conducted according to the industrial and firm features;
- (iv) The investors have to submit the explanation of economic benefit and accounting balance sheet of their applying projects to the government.

Due to such troublesome application and approval procedure, Taiwanese businessmen started to hide their real investment plans and volume from the government. Therefore the reported projects to MOEA

in 1996 were shrunk to 383 cases only as shown in Table 3-3. The government realized the difficulty of implementing such strict regulations. MOEA tried to install some remedy measure to encourage the honest report of Chinese investment to the government. With some penalty rules and some loan benefit to the reported firms, the supplemented approval cases on 1997 and 1998 markedly rose.

*D. "Open actively, manage effectively" period: August 2001~president*

Such strict project evaluation criteria induced some political trust problem between the government and businessmen. During the 2000 presidential campaign, the then opposition party (Democratic Progress Party, hereafter DPP) came to power. President Chen Shui-Ben and his cabinet held Economic Development Consultation Conference with business and academic leaders on August 2001. This highest level of economic conference (held by Presidential Hall) concluded to change cross strait economic policy to "Open actively, manage efficiently." Two major policy review and open actions were taken under this new regime: (1) Review the necessity of open Notebook PC to be produced in the Mainland in 2002 and (2) Analyzing the benefit and risk of allowing eight inches of integrated circuit factory to be moved to China in 2003.

November 2001 when WTO accepted both China and Taiwan as two separated customs territory members, Taiwan first earned an international stage on negotiating and coordinating economic and trade issues. Taiwan's Permanent Representative office to WTO worked to learn how to become one of the opinion leaders in a strategic alliance of agricultural negotiations within small agriculture countries. After two years of learning coalition strategies with other nine countries, Taiwan successfully became one of the important opinion leaders in the G-10 of

Small Agricultural Strategic Alliance in WTO in 2003. The partnership countries including Switzerland, South Korea, Japan, Norway, Mollicys, etc (Yuen 2004). This experience laid important confidence for Taiwan authority to deal with multilateral negotiations and coordination on trade issues relating to small countries' interests.

The most updated issue in mid 2004 (the second term of President Chen) is how to inaugurate dialogue and peaceful political and economic interactions with PRC. A peaceful and stable interaction framework were raised by Chen on April and got a friendly reaction from the Chinese authority on May 17, 2004. A new stage of friendly political and economic interactions across.

Taiwan is expected to be sent under the assistance of international community.

## **2. Investment Flows and Patterns**

### *A. The shifting of overseas investment from Southeast Asia to China since 1992*

Owing to the above-mentioned political barriers and a lack of confidence in China's protection of property rights, Taiwanese businessmen pursued economic profits in China with great caution. Comparing direct investment flows from Taiwan to ASEAN and to China until 1992 (Chiu Chen 1995, Table 3), the accumulated approved investment volume (US\$ 1.07 billion) in China is much smaller than that in ASEAN (US\$ 1.86 billion), though the accumulated number of firms is larger in the latter country. Interestingly, the average investment size in ASEAN increased from US\$ 2.33 million in 1986 to US\$ 4.44 million in 1991, while the comparable figure for China investment was US\$ 0.84 million in the same year as shown in Table

3-3. Therefore the shifting of overseas investment from Southeast Asia to China obviously started from 1992.

*B. The average investment scale grew bigger since 1995*

The largest approved cases of 9,329 in 1993 obviously reflected that the legalization of circuitous direct investment toward the mainland<sup>4)</sup> had encouraged the businessman to honestly report to the government. The average investment scale jumped from \$1.03 million in 1994 to \$2.23 in 1995 indicated the new stage of larger investment scale, or the launch of big multinational companies' China investment.

**Table 3-3. Statistics on Indirect Investment from Taiwan to Mainland**  
(Unit: million US\$)

Year	Approved by Taiwan				Announced by China (Contracted Amount)				Realized Amount	Realization ratio
	Case	Amount	Growth Rate	Amount per Case	Case	Amount	Growth Rate	Amount per Case		
1991	237	174.16	--	84	3,053	2,833.00	--	86	844.00	30.33
1992	264	246.99	42%	94	6,430	5,543.00	49%	86	1,050.00	18.94
1993*	9,329	3,168.41	652%	34	10,948	9,965.00	252%	91	3,139.00	31.50
1994	934	962.21	-70%	103	6,247	5,395.00	-46%	86	3,391.00	62.85
1995	490	1,092.71	14%	223	4,778	5,777.00	7%	121	3,162.00	54.73
1996	383	1,229.24	12%	321	3,184	5,141.00	-11%	161	3,475.00	67.59
1997		0.00			3,014	2,814.00	-45%	93		
Current yr	728	1,615.00	31%	222					3,289.00	116.88

4) According to then Taiwan policies, investment from Taiwan to China cannot be directly carried out. It must be conducted and registered under a company in Hong Kong (or other third-party countries) and then circuitously invested in China.

Table 3-3. Continued

Supplemented	7,997	2,720.00		34						
1998										
Current yr.	641	1,519.00	-6%	237	2,970	2,982.00	6%	100	2,195.00	97.75
Supplemented	643	515.00		80						
1999	488	1,252.78	-38%	257	2,499	3,374.40	13%	135	2,598.70	77.01
2000	840	2,607.14	108%	310	3,108	4,041.89	20%	130	2,296.28	56.81
2001	1,186	2,784.15	7%	235	4,214	6,914.19	71%	164	3,979.94	43.10
2002										
Current yr	1,490	3,858.76	39%	259	4,853	6,740.84	-3%	139	3,970.64	58.90
Supplemented	3,950	2,864.30		73						
2003										
Current yr	1,837	4,594.99	19%	250	4,495	8,600.00	28%	191	3,377.24	39.46
Supplemented	8,268	3,103.80		38						
1991~2003	31,151	34,308.57		110	60,624	70,825.00		117	36,487.82	52.1

Source: Investment Commission, Ministry of Economic Affairs.

*C. The political interference seems to increase the tendency of bigger investment projects*

From 1995 to 2003, the average investment scale increase steadily from \$2.23 millions to \$2.59 millions except for two years: 1996 and 2000. In those two years politics interfered with the economic interactions as stated above. The average investment scale grew to \$3.21 and \$3.10 respectively. It reflects that Taiwanese businessmen were afraid that the new economic policy across the Strait might hinder their long-term business operational arrangement in China. Those who obey government regulations tend to apply or register higher investment volume to the government so that they can earn some flexibility in the

possible political fluctuation coming two or three years.

*D. The effective ways of managing investment toward China are still being explored*

Second evidence of political interference on business investment behavior is the periodical warning from the government that if investment projects to China do not report to the government, the enterprises will be fined. Such stick strategy had its effects as shown on the supplemented approval cases in 1997, and 1998. After ten years of such policy operation, MOEA still frequently finds unreported China investment cases. In 2002 and 2003, the government started to add some carrot strategies, such as the granting of bank loans for exporting orders from China factories company staff can enjoy the benefit of commuting via small direct link voyage between Kinmen and Xiamen etc. So, the stick and carrot simultaneous managing tools are regarded as effective so far.

The management of getting real investment volumes had never achieved. From Table 3-3 one can easily recognize that Chinese investment statistics approved by Taiwan authority is only about half of those announced by China. This is partially due to the contracted FDI announced by PRC normally takes three to five years to be realized. However Taiwan authority had done some double-checking tasks through the foreign exchange system of the central bank (as shown in Table 3-4). Up to the mid 2003, Taiwan had invested US\$ 60 billions in China. The effective management mechanism is still to be explored.

**Table 3-4. Investments from Taiwan to China in Recent Three Years**

(Unit: US\$ 100 million)

Date provided by Central Bank of China*	Realized amount calculated by Department of Foreign Trade, Ministry of Commerce of the PRC	Amount approved by Investment Commission, Ministry of Economic Affairs, Taiwan	Amount estimated by Department of Foreign Exchange, Central Bank of China, Taiwan
2001.3	255	170	500
2002.3	284	200	500
2003.5	343	313	(March) 600 **

Notes: \* The date is based on when the amount is reported to Legislative Yuan each year rather the end of year.

\*\* The amount of March is quoted from Commercial Times on March 13, 2003.

*E. The major invest industries and types of firms had been dramatically changed*

As shown in Table 3-5, the major industries of investment to China had been dramatically changed. In the beginning stage (1991~93) small and median sized enterprises led the pioneering wave of investment. The industrial distribution in that stage was even, the highest proportion 14.24% of Electronic and Electric Appliances is quite close to the second and third largest industries, namely 12.35% of Plastic Products and 10.87% of Food & Beverage Processing. The fourth to eighth largest industries took at least 5%, ranking as Precision Instruments (8.59%), Basic Metals & Metal Products (7.7%), Textile (6%), Chemicals (5.63%), and Non-metallic Minerals (5.45%). They are labor-intensive industries and the main purpose of investing to China was for low labor cost and pursuing competitiveness in exporting markets.

**Table 3-5. Approved Indirect Mainland Investment by Industry in different stages**

(Unit: US\$ 100 million)

Industry		1991~1993		1994~1997		
		Accumulated Amount	Ratio	Accumulated Amount	Ratio	△%
First Rank	Agriculture & Forestry	157.40	0.44	447.29	0.59	11.34
	Fishery & Animal Husbandry Industry	142.63	0.40	226.30	0.30	0.58
	Mining	45.95	0.13	197.68	0.26	0.46
Second Rank	Food & Beverage Processing	3,902.78 <sup>③</sup>	10.87	7,180.68 <sup>③</sup>	9.43	0.53
	Textile	2,154.32 <sup>⑥</sup>	6.00	4,081.10 <sup>⑥</sup>	5.36	0.73
	Garment & Footwear	1,259.93	3.51	1,255.55	1.65 <sup>⑧</sup>	1.85
	Leather & Fur Products	612.32	1.71	965.66	1.27 <sup>①</sup>	36.92
	Lumber & Bamboo Products	1,590.15	4.43	2,134.22	2.80 <sup>⑦</sup>	1.91
	Paper Products & Printing	1,034.90	2.88	1,729.07	2.27	1.20
	Chemicals	2,019.63 <sup>⑦</sup>	5.63	5,139.30 <sup>⑥</sup>	6.75	0.48
	Rubber Products	1,657.04	4.62	2,246.28	2.95 <sup>⑩</sup>	1.78
	Plastic Products	4,433.66 <sup>②</sup>	12.35	5,487.99 <sup>⑤</sup>	7.20	1.45
	Non-metallic Minerals	1,956.28 <sup>⑧</sup>	5.45	5,492.04 <sup>④</sup>	7.21 <sup>⑥</sup>	3.00
	Basic Metals & Metal Products	2,764.84 <sup>⑤</sup>	7.70	7,312.23 <sup>②</sup>	9.60	0.83
	Machinery Equipment	714.58	1.99	2,965.74	3.89	0.91
	Electronic & Electric Appliances	5,111.31 <sup>①</sup>	14.24	15,237.13 <sup>①</sup>	20.00	0.94
	Transport Equipment	1,414.33	3.94	4,131.66	5.42	0.80
	Precision Instruments	3,084.89 <sup>④</sup>	8.59	3,607.63	4.74	1.74
	Construction Instruments	106.05	0.30	175.14	0.23 <sup>④</sup>	5.17
Third Rank	Whole Sale & Retail	410.61	1.14	1695.47	2.23	1.24
	Trade	298.94	0.83	618.16	0.81 <sup>②</sup>	11.37
	Restaurant	180.12	0.50	502.17	0.66 <sup>⑤</sup>	4.29
	Transportation	72.95	0.20	453.40	0.60	0.04
	Storage	11.78	0.03	302.45	0.40 <sup>⑨</sup>	1.80
	Banking & Insurance	24.43	0.07	217.01	0.28	-0.68
	Services	682.57	1.90	1993.89	2.62	1.77
	Others	51.22	0.14	389.52	0.51	1.01
Total or Average		35895.61	100.00	76184.76	100.00	0.93

Table 3-5. Continued

	Industry	1998~2002			1991~2002		
		Accumulated Amount	Ratio	△%	Accumulated Amount	Ratio	△%
First Rank	Agriculture & Forestry	502.17	0.33	0.38	1,106.86	0.42	3.79
	Fishery & Animal Husbandry Industry	203.03	0.13	-0.61	571.96	0.21	-0.30
	Mining	177.29	0.12	3.56	420.92	0.16	1.60
Second Rank	Food & Beverage Processing	3,829.07	2.49	0.39	14,912.53	5.60	0.57
	Textile	3,534.02	2.29	0.92	9,769.44	3.67	0.86
	Garment & Footwear	1,835.78	1.19	1.09	4,351.26	1.64	1.21
	Leather & Fur Products	629.26	0.41	1.80	2,207.24	0.83	12.30
	Lumber & Bamboo Products	2,789.74	1.81	1.25	6,514.11	2.45	1.88
	Paper Products & Printing	3,503.37	2.27	0.63	6,267.34	2.36	1.39
	Chemicals	10,387.50	6.74	0.53	17,546.43	6.59	1.35
	Rubber Products	3,163.97	2.05	1.32	7,067.29	2.66	1.11
	Plastic Products	9,029.20	5.86	0.70	18,950.85	7.12	1.01
	Non-metallic Minerals	5,269.70	3.42	0.54	12,718.02	4.78	2.70
	Basic Metals & Metal Products	12,404.55	8.05	0.72	22,481.62	8.45	1.59
	Machinery Equipment	5,077.55	3.30	0.58	8,757.87	3.29	0.78
	Electronic & Electric Appliances	66,350.19	43.08	0.59	86,698.63	32.58	1.01
	Transport Equipment	4,453.64	2.89	0.73	9,999.63	3.76	2.11
Precision Instruments	7,468.32	4.85	1.08	14,160.84	5.32	2.00	
Construction Instruments	420.06	0.27	1.28	701.25	0.26	2.37	
Third Rank	Whole Sale & Retail	3,046.39	1.98	2.68	5,152.47	1.94	1.50
	Trade	1,227.63	0.80	1.46	2,144.73	0.81	18.64
	Restaurant	180.87	0.12	5.93	863.16	0.32	3.27
	Transportation	714.06	0.46	2.55	1,240.41	0.47	1.14
	Storage	421.98	0.27	1.08	736.21	0.28	1.06
	Banking & Insurance	438.10	0.28	47.01	679.54	0.26	23.12
	Serivices	6,081.51	3.95	1.80	8,757.97	3.29	1.26
	Others	878.53	0.57	4.15	1,319.27	0.50	2.06
	Total or Average	154,017.48	100.00	0.54	266,097.85	100.00	1.03

Notes: 1. the order of ratio is marked only when the industry ratio is bigger than 5%.

2. the order of growth rate is marked only when the industry growth rate is among the top ten or above the average.

3. the industry growth rate is based on the arithmetic mean.

4. △% denotes annual growth rate.

Source: Investment Commission, Ministry of Economic Affairs.

The second stage of Taiwan investment to China (1994~97) has shown a gradual concentration of industrial distribution. The investment share of the leading industry, Electronic & Electric Appliances, increased to 20%; as time goes by, this number went up to 43.08% during 1998~2002. The industries that investment share took more than 5% had decreased to three only, namely Basic Metals & Metal Products (8.05%), Chemicals (6.74%), and Plastic Products (5.86%). Electronic and Electric Appliances outperformed all other industries.

If we observe the change of industries by growth rate, we can find that there are only three services industries ranked in the top ten during 1994 to 1997; the number went up to seven service industries ranked in the top ten during 1998 to 2002. Banking & Insurance, Restaurant, Others, Whole Sales & Retails, Transportation led the trend. This reflects the industrial linkage effects as well as the necessary industrial clusters to be formed in Taiwan's outward FDI pattern. In the other hand, this also reflects the local service provided by Chinese business is not satisfactory.

*F. The investment location in China moving from South coastal provinces to Middle and Northern ones*

From Table 3-6, before 1993, Guangdong and Fujian were the two most favorite locations to Taiwanese FDI firms. These two provinces add up to 50% of total investment in China. During 1994 to 1997, Jiangsu replaced Fujian and became the second favorite Taiwanese FDI province. To the period of 1998 to 2002, Jiangsu became the largest Taiwanese industrial clusters. In this most recent period, Jiangsu, Shanghai, and Zhejiang (Yangtze River Delta) adding together had attracted 51.7% of total new investment. Fujian and Guangdong dropped to 38.61%. These location preference changes had reflected the rising investment

environment in middle coastal provinces of China by an annual investment environment and risk assessment report (Chen 2003).

**Table 3-6. Location Change of Approved Indirect Mainland Investment in Different Stages**

(Unit: US\$ 100 million)

Year	1991~93		1994~97		
	Accumulated Amount	Ratio	Accumulated Amount	Ratio	△%
Guangdong	12,331.74 <sup>①</sup>	34.35	24,573.91 <sup>①</sup>	32.26 <sup>⑦</sup>	1.77
Fujian	5,593.45 <sup>②</sup>	15.58	8,013.93 <sup>④</sup>	10.52	1.14
Guangxi	169.07	0.47	189.51	0.25 <sup>①</sup>	17.53
Hainan	639.01	1.78	477.48	0.63	-0.93
Shanghai	4,474.32 <sup>③</sup>	12.46	12,141.55 <sup>③</sup>	15.94	0.64
Jiangsu	4,446.62 <sup>④</sup>	12.39	13,617.19 <sup>②</sup>	17.87	0.56
Zhejiang	1,417.92	3.95	3,482.58	4.57 <sup>⑨</sup>	1.48
Hubei	367.31	1.02	873.04	1.15 <sup>③</sup>	4.22
Hunan	301.11	0.84	807.16	1.06 <sup>⑤</sup>	2.30
Chongqing	90.48	0.25	350.10	0.46 <sup>②</sup>	7.70
Sichuan	532.18	1.48	661.87	0.87 <sup>⑩</sup>	1.30
Beijing	888.21	2.47	1,436.38	1.89	1.01
Tianjin	884.42	2.46	2,959.02	3.88	0.78
Hebei	467.82	1.30	669.36	0.88	0.54
Henan	173.42	0.48	176.76	0.23 <sup>④</sup>	3.40
Shandong	990.71	2.76	2,009.90	2.64	0.77
Liaoning	652.22	1.82	1,217.23	1.60 <sup>⑥</sup>	1.98
Jilin	98.25	0.27	74.00	0.10	-1.00
Heilongjiang	21.96	0.06	124.95	0.16	1.11
Other Area in North East	73.96	0.21	24.46	0.03	-1.00
Other Area	1,281.43	3.57	2,304.38	3.02 <sup>⑧</sup>	1.53
<b>Total</b>	<b>35,895.61</b>	<b>100.00</b>	<b>76,184.76</b>	<b>100.00</b>	<b>0.93</b>

Table 3-6. Continued

Year	1998~2002			1991~2002		
	Accumulated Amount	Ratio	△%	Accumulated Amount	Ratio	△%
Guangdong	47,672.99 <sup>②</sup>	30.95	0.37	84,578.64 <sup>①</sup>	31.78	1.02
Fujian	11,792.42 <sup>④</sup>	7.66	1.38	25,399.80 <sup>④</sup>	9.55	1.20
Guangxi	625.81	0.41	0.37	984.39	0.37 <sup>⑤</sup>	3.8
Hainan	236.43	0.15 <sup>⑤</sup>	1.06	1,352.92	0.51 <sup>①</sup>	4.08
Shanghai	20,840.34 <sup>③</sup>	13.53	0.59	37,456.21 <sup>③</sup>	14.08	1.33
Jiangsu	49,322.51 <sup>①</sup>	32.02	0.73	67,386.32 <sup>②</sup>	25.32	2.19
Zhejiang	9,535.04 <sup>⑥</sup>	6.19	0.82	14,435.54 <sup>⑥</sup>	5.42	1.30
Hubei	939.13	0.61 <sup>⑥</sup>	5.70	2,179.48	0.82 <sup>④</sup>	7.82
Hunan	274.47	0.18 <sup>①</sup>	13.29	1,382.74	0.52 <sup>⑥</sup>	6.01
Chongqing	710.27	0.46	0.78	1,150.85	0.43	2.73
Sichuan	947.61	0.62	0.87	2,141.66	0.80 <sup>③</sup>	9.39
Beijing	3,698.75	2.40	0.37	6,023.34	2.26	0.92
Tianjin	2,152.83	1.40	0.62	5,996.27	2.25	0.66
Hebei	576.77	0.37 <sup>④</sup>	7.38	1,713.95	0.64 <sup>⑥</sup>	7.79
Henan	163.83	0.11 <sup>②</sup>	10.79	514.01	0.19 <sup>②</sup>	12.02
Shandong	1,750.37	1.14	0.90	4,750.98	1.79 <sup>⑤</sup>	2.73
Liaoning	1,033.97	0.67 <sup>⑤</sup>	1.13	2,903.42	1.09	1.08
Jilin	50.62	0.03 <sup>⑥</sup>	6.47	222.87	0.08 <sup>⑤</sup>	2.83
Heilongjiang	8.34	0.01	-1.00	155.25	0.06	2.01
Other Area in North East	69.30	0.04 <sup>③</sup>	9.45	167.72	0.06 <sup>①</sup>	14.06
Other Area	1,615.68	1.05 <sup>①</sup>	1.39	5,201.49	1.95	1.88
<b>Total</b>	<b>154,017.48</b>	<b>100.00</b>	<b>0.54</b>	<b>266,097.85</b>	<b>100.00</b>	<b>1.03</b>

Note and Source as the table above

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## **IV. The Contribution of Taiwan's Economic Policies to China and the Mutual Benefits of Taiwan's Investment in China**

The experiences of Taiwan's economic development and policy formulation had been the pioneer of "market-friendly" government interventions (Ranis, 1992) or "East Asia Miracle" (Meier and Rauch 2000). Chinese basing on the similar language and culture, many good policies or operational models developed by the Taiwan government had transferred to China's policies or practices decades later. This is one kind of special experience that other non-Chinese nations can copy.

Another most impressive contribution that Taiwan had made to China is the FDI contributed employment and manufacturing division of labor across the Taiwan Strait. Due to the lack of studies and data to prove the FTA impact or effects for those FTA signed countries, this section provides a serious analysis on how the civilian autonomously induced economic integration via between Taiwan and China can contribute to FDI receiving country (namely China) or local economies' economic development. This is to supplement the inefficiency of the FTA impact analysis in the region.

This section will first analyze what kinds of economic policy similarity exist between the two sides. Then the second section will elaborate on the contributions of Taiwan's investment to China's economic development, especially the local economies. The third section will then investigate how Taiwan earned its global competitiveness of manufacturing products through the division of labor across the Taiwan Strait.

## 1. The Contribution of Taiwan's Economic Policies to China

Deng HsiaoPing inaugurated China's economic reform in 1978 from rural (or agriculture) sector, and in the next two years he drew attention to city (or industrial) reform. The famous four Special Economic Zones (SEZ, including Zhenzhen, Xiamen, Sautou, Zhuhai) were established from 1980~84 but was actually following the example of Taiwan's Export Processing Zones formed in 1966~70. The preferential tax treatment offering to the FDI exporting firms was also copied from Taiwan's tax exemption for export goods in 1954. The learning time lag in this case is about 14 years. The success of SEZs is in no doubt.

The second significant learning example from Taiwanese policy to Chinese reform is science-based industrial park. The internationally well-known industrial clusters of Hsin-Chu Science-based Industrial Park (HSIP) was established in 1980. The Taiwan government deliberately selected the site near two technology and science oriented universities (i.e. Chinghua and Chiao-Tong) and ITRI (Industry Technology Research Institute). After 15 years of operation, HSIP became a world reputed model of industrial cluster. China learnt from this experience since they promoted the Torch Projects in 1986. From then on until 1992, 53 High-tech Industry Development Zones (HIDZ) were selected and established. However, the performance of those HIDZs mostly failed. This is due to the over development of the land and not enough attention paid to the software and management system as well as the matching arrangement of university and research institute. China is currently reviewing the performance of the 53 HIDZs and may close or reduce the size of selected sites.

The third contribution of Taiwan's economic policy to China is the state-owned enterprise (SOE) reform. Taiwan inaugurated such reform

program since early 1980s and carried out half-success and half-failure cases. China sent scholars to learn from Taiwan on 1996 and started to experiment to top 100 SOEs in 1997 when Chu Ronggi came to power. The outcome is also half success only. This has something to do with the unsuccessful financial and banking reform in China.

The fourth example is the regulation and supporting system for the development of small and median-sized enterprises (SMEs). Taiwan started to set the definition of SMEs in 1967. Thereafter, a SME Development Statute and an SME Office to serve small business under Ministry of Economic Affairs was established in 1987. China started their SME office in 1997. Up to 2003, financial support Web Net are now available in 11 cities, including Tainjin, Gailien, Shanghai, Hiausiu, Zhejiang, Nipaa, Fujian, Xiamen, Guangdong, Shenzhen, and GuanXi.

The last policy gleaned from Taiwan and now functioning well is the policy on encouraging overseas students return to serve the country. Taiwan had such encouragement policies in three waves: 1950, 1973~79, 1982~96. China began such return brain drain attraction program via job placement, salary bonus, research grant, housing arrangement for overseas studying persons in the Ninth Five Year Plan (1996). So far, the attraction effect is significant. 50,191 overseas students or experienced high-tech workers have returned to China during 1996~2001.

In sum, Taiwan's economic development policies did provide China some good lessons and significantly reduced their learning cost. The so-called latecomer effect is prevailed in the above mentioned policy cases. The economic impacts or effects are strengthened when the policy-following country are receiving the similar investors from the policy-initiating country. Next section elaborates the effects.

## 2. The Contribution of Taiwan's Investment to China

The role Taiwan plays in the industrial development of China can be synthetically analyzed through three dimensions: (1) Taiwan's Investment inducing more FDI to China and promoting international trade. (2) Establishing local industrial network, promoting China's local industrial development. (3) Introducing technology transfer and upgrading China's local industries.

Taiwan's Investment inducing more FDI to China and promoting their international trade.

In the initial period (late 80s and early 90s), most of Taiwan's investment in China was in manufacturing industries such as clothing, electric products assembling, which helped the development of international trade. Besides, they contribute a lion share of employment and industrialization in the four Special Economic Zones and the neighborhood.

Until the middle 90s, Taiwan's most labor-intensive industries had moved to China. In 1994, due to the end of dual track of foreign exchange system and deflation of Raminbee, more and more foreign companies flocked into China. During that time, some high-tech and capital-intensive industries started to invest in China, and it's hard to distinguish the difference between the contribution of Taiwan's investment and other foreign one. But some researches (esp. from Japan) showed that foreign companies preferred the site that had been well developed and had advantage of industry clusters created by the Taiwanese.

Before 1995, Taiwan's enterprise invested in China for the appeal of regarding China as the base of manufacturing for export, and therefore Taiwan's investment made a significant contribution in accumulating their amount of international trade.

Table 4-1 shows that foreign investment reached 52.21% the total of

China's export amount in 2002, which are almost twice as the portion in 1993. The rate in some provinces even reached more than half, such as Tainjin (78.5%), Jiangsu (62.76%), Shanghai (60.61%), Fujian (61.65%), LaouNing(58.02%), and Guangdong (54.79%). Most of contribution in Fujian, Guangdong was from Taiwan's enterprises, Tainjin, LaouNing was from Japan and Korea, and Shanghai, Jiangsu was contributed from both Taiwan and other foreign enterprises.

**Table 4-1. The Share of FDI exports to total  
Exports in China (1993~2001)**

(Unit: US\$ million)

Year	(1) FDI export	(2) Total export	Share of (1)/(2)
2002	169,985	325,596	52.21%
2001	133,235	266,155	50.06%
2000	119,441	249,203	47.93%
1999	88,628	194,931	45.5%
1998	80,962	183,757	44.1%
1997	74,900	182,697	41.0%
1996	61,506	151,066	40.75%
1995	46,876	148,770	31.5%
1994	34,713	121,038	28.7%
1993	25,237	91,763	27.5%

Sources: 1. Statistics of 1993~99 cited from *China Custom Statistics* (Monthly).

2. Statistics of 2000~02 cited from *China Statistics Yearbook*.

Table 4-2 shows the trade amount of 10 major international trading countries. Although Taiwan's rank is the 6th, (the total amount is 44.67 billions US dollars) if counted half of the trade amount from H.K. to China as transported from Taiwan ( $692 \times 1/2 = 346.05$ ), and the decinormal

amount from Japan to China is also transited from Taiwan ( $1019.2 \times 1/10 = 101.9$ )<sup>5)</sup>, the summative amount from Taiwan to China equal to 89.466 billions USD. Taiwan should have ranked third of all nations. It can be concluded that Taiwan's contribution to China is equivalent to Japan and United States.

**Table 4-2. China's Foreign Trade with Major Countries in 2002**

(Unit: billion USD, %)

Countries	Amount (1 billion US\$)			△% from last year		
	Total Trade	Export	Import	Total Trade	Export	Import
Japan	101.91	48.44	53.47	1.62	0.78	2.50
U.S.A.	97.18	69.95	27.23	2.08	2.89	0.39
Europe	86.75	48.21	38.54	1.32	1.79	0.79
H.K.	69.21	58.47	10.74	2.37	2.56	1.40
ASEAN	54.77	23.57	31.20	3.17	2.83	3.44
Taiwan	44.67	6.59	38.08	3.81	3.17	3.93
S. Korea	44.07	15.50	28.57	2.28	2.38	2.22
Russia U.	11.93	3.52	8.41	1.18	2.99	0.56
Australia	10.44	4.59	5.85	1.60	2.85	0.78
Canada	7.93	4.30	3.63	0.76	2.87	-1.00

Source: Almanac of China's Foreign Economic Relations and Trade, China Custom Statistics.

※ If one-tenth of Japan's export/import and one-half of H.K.'s trans-shipping counted as Taiwan's, then Taiwan should be the third largest trade partner to China (89.47 \$ billion).

The goals of investing in China are different between Taiwan's enterprises and other foreign investors. The former was attracted by the lower cost manufacturing in China, while the latter was aimed at

5) the rate are quoted from Japan NIRA database recorded in the article "the Japan's contribution to the East Asia Economic System." published in Dec, 2002(the 6th East Asia Economic conference).

China's domestic market. It was until 1995 that Taiwanese investors noticed the market opportunity in China and started to transform to target the inner market and according to statistical data in late 2001, in the total amount (both state-owned and private business which annual sales are more than 500 millions RMB) of 8,677.27 billions RMB.

Taiwan and H.K. investment approached 33%, and other foreign investments are about 19.6%. In 2001, Taiwan's contributions to China's local industrial production jumped to 1/3 of total amount, total amount, while that was only 16.6% in 1995. It's really surprisingly speedy advance.

*B. Establishing Local Industrial Network, Promoting China's Local Industrial Development.*

Even though Taiwan's investment strongly affected China as shown in the last paragraph, there is still significant difference existing in different provinces/areas. Table 4-3 shows that the contribution of FDI enterprise in Beijing, Shanghai, Fujian, Guangdong is above average. At the same time the other FDI firms (i.e. Japan and Korea) developed in those cities such as Tainjin, Jilin.

Since 1985 China introduced large amount of FDI, it took 16 years until 2001 that the influence of FDI investment to China's total export went beyond one half (as showed in Table 4-1). To view the influence of Taiwan's investment to the inland provinces through the same model, Table 4-3 shows that foreign and Taiwan investment gradually helped those inland provinces build their import and export trade ability. From 2001 to 2002, there are many provinces whose FDI contributed trade amount grew significantly: Jiangsu (62.76%→69.94%), Shandong (50.31%→50.75%), Hebei (31.01%→34.48%), Zhejiang (32.16%→37.71%), Hainan (49.64%→51.24%), and the two provinces in central

region, Hubei (31.63%→34.48%) and Anhei (27.20%→37.97%) also rapidly expanded their influence. It's predictable that the influence of FDI to those inland provinces' industrial production may exceed more than 1/3 within five years.

In conclusion, Taiwan's investment influence mode to China's local economy is that introducing export-oriented business first, establishing the local industrial network, and then the diffusion effect would expand to the total local industrial development.

**Table 4-3. Trade and Industrial Output produced by FDI Firms as Compared to Local Total Output (2002)**

(Unit: billion RMB)

Province Name	FDI trade share			National total	
	Total Trade (%)	Export (%)	Import (%)	No. of firm	Total output value
National Total	5.083	50.06	51.66	171,256	8677.270
Beijing	12 3.128	40.93	27.41	4,356	291.866
Tianjin	1 7.850	80.08	77.00	5,561	298.120
Hebei	3.101	32.91	28.19	7,696	312.003
Shanxi	0.801	5.97	15.74	3,308	106.681
Inner Mongolia	0.817	14.38	3.85	1,379	59.752
Liaoning	5 5.802	58.61	57.39	5,847	358.833
Jilin	9 4.262	27.97	53.98	2,608	168.188
Heilongjiang	1.103	11.92	10.02	2,500	133.868
Shanghai	4 6.061	59.40	61.58	9,762	713.387
Jiangsu	2 6.276	56.63	69.94	19,684	1,060.822
Zhejiang	10 3.216	29.26	37.71	18,626	837.702
Anhui	2.720	19.87	37.97	3,698	163.829
Fujian	3 6.165	56.04	70.31	6,583	288.819
Jiangxi	1.555	10.28	23.65	3,283	86.160
Shandong	7 5.031	49.98	50.75	12,268	805.112
Henan	1.744	17.06	17.88	9,720	290.497

Table 4-3. Continued

Hubei	<sup>11</sup>	3.163	27.87	34.48	6,197	291.325
Hunan		1.914	12.21	29.37	4,961	138.330
Guangdong	<sup>6</sup>	5.479	56.74	52.57	20,721	1,456.600
Guangxi		2.221	18.02	29.94	3,126	94.946
Hainan	<sup>8</sup>	4.964	47.14	51.24	589	18.743
Chongqing		1.467	7.88	22.91	2,054	110.631
Sichuan		1.986	14.25	25.50	4,572	214.005
Guizhou		0.730	8.63	5.37	2,054	59.102
Yunnan		0.985	9.55	10.20	2,031	75.629
Tibet		0.223	2.65	0.79	378	0.876
Shaanxi		1.382	7.63	20.95	2,440	107.300
Gansu		0.974	11.08	8.27	3,153	61.165
Qinghai		0.916	0.91	25.41	391	11.399
Ningxia		1.173	14.95	6.42	410	18.022
Xinjiang		0.404	8.80	2.17	1,300	43.557

Province Name	Among which: FDI firms				Among which: HK/Taiwan/Macau firms			
	No. of firm	%	Total output value	%	No. of firm	%	Total output value	%
National Total	13,166	7.69	1,700.569	19.60	18,257	10.66	1,165.783	13.43
Beijing	635	14.58	121.736	41.71 <sup>3</sup>	388	8.91	44.339	15.19 <sup>3</sup>
Tianjin	926	16.65	144.915	48.61 <sup>2</sup>	424	7.62	19.240	6.45
Hebei	423	5.50	18.957	6.08	337	4.38	18.465	5.92
Shanxi	46	1.39	2.922	2.74	55	1.66	3.796	3.56
Inner Mongolia	50	3.63	3.097	5.18	39	2.83	2.022	3.38
Liaoning	754	12.90	61.810	17.23	316	5.40	20.701	5.77
Jilin	170	6.52	35.351	21.02 <sup>6</sup>	75	2.88	6.039	3.59
Heilongjiang	85	3.40	6.191	4.62	62	2.48	5.335	3.99
Shanghai	2,096	21.47	351.332	49.25 <sup>1</sup>	1573	16.11	102.232	14.33 <sup>4</sup>
Jiangsu	1,918	9.74	209.433	19.74	1683	8.55	91.465	8.62 <sup>6</sup>
Zhejiang	1,236	6.64	90.986	10.86	1479	7.94	79.507	9.49 <sup>5</sup>
Anhui	156	4.22	15.437	9.42	121	3.27	12.450	7.60
Fujian	760	11.54	62.826	21.75 <sup>5</sup>	2163	32.86	127.627	44.19 <sup>1</sup>
Jiangxi	65	1.98	7.454	8.65	112	3.41	2.921	3.39
Shandong	1,358	11.07	96.422	11.98	662	5.40	34.520	4.29
Henan	191	1.97	8.586	2.96	230	2.37	12.815	4.41

Table 4-3. Continued

Hubei	166	2.68	28.518	9.79	226	3.65	13.063	4.48
Hunan	93	1.87	10.668	7.71	146	2.94	4.611	3.33
Guangdong	1,478	7.13	374.104	25.68 <sup>4</sup>	7,542	36.40	531.674	36.50 <sup>2</sup>
Guangxi	107	3.42	8.303	8.74	131	4.19	4.926	5.19
Hainan	37	6.28	1.847	9.85	57	9.68	1.382	7.37
Chongqing	84	4.09	11.416	10.32	67	3.26	7.299	6.60
Sichuan	127	2.78	12.900	6.03	141	3.08	7.351	3.43
Guizhou	35	1.70	1.423	2.41	41	2.00	0.686	1.16
Yunnan	48	2.36	2.996	3.96	72	3.55	3.083	4.08
Tibet	5	1.32	0.004	0.46		0.00		0.00
Shaanxi	67	2.75	7.874	7.34	63	2.58	5.445	5.07
Gansu	13	0.41	0.836	1.37	24	0.76	1.887	3.09
Qinghai	2	0.51	0.048	0.42	7	1.79	0.343	3.01
Ningxia	15	3.66	1.575	8.74	9	2.20	0.196	1.09
Xinjiang	20	1.54	0.601	1.38	12	0.92	0.365	0.84

Notes: 1. total output value is calculated in 1990 constant price.

2. Ranking number with shadow means the share higher than 33% (for total output value) and 30% (for total trade).

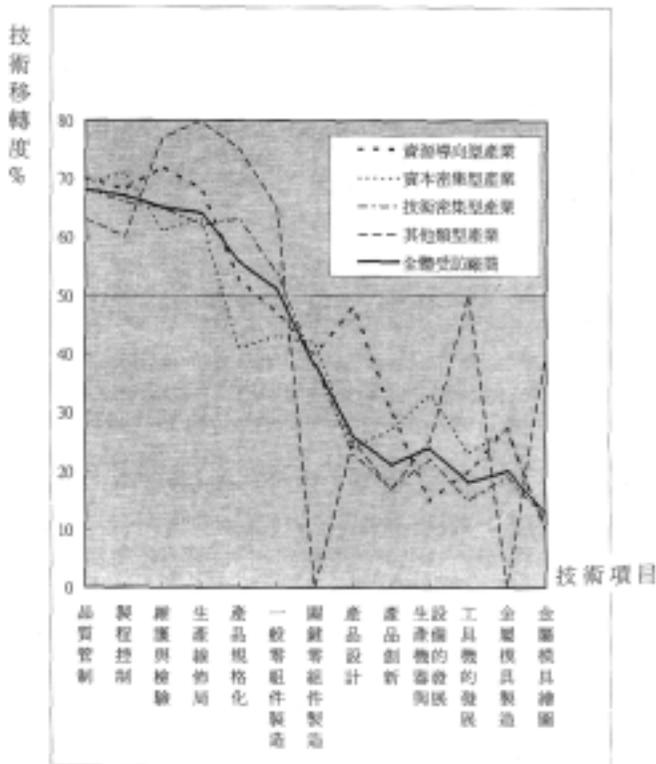
### C. Introducing Technology Transfer and Upgrading China's Local Industries

It's always a difficult problem for industrial economists to measure the degree of technology transfer without completed statistic data. China studies are especially difficult in this aspect.

Chen etc. (1997) investigated the degree of technology transfer of 13 technology items, including product line distribution, and module manufacturing, etc. from 70 Taiwan factories which invested in China. The result is summarized below: Producing fields such as "product line outlet," "maintain and inspect," "quality control," "process control," and "product specification," has a higher technology transfer rate which reached 50~70%. The technology transfer rate of general component is 51%, higher than the key component, which is 38%. It showed that those factories interviewed had different consideration about technology transfer between general and key components: the former technologically transfers to oversea factories more than 50%, while the latter withhold more than 60% in Taiwan's enterprises.

About the rate of technology transfer in the product designing and product innovation software, 1/4 of the interviewees showed that there's still 75% technology held in their Taiwan parent companies, and the machine and equipment product, metal module manufacture and design industries are also under parent companies' control (as shown in Figure 4-1).

Figure 4-1. Degree of Technology Transfer from Taiwan to China



Source: Lee-in Chen Chiu (1997), "An Evaluation of the Policy Effects for The Division of Labor in Manufacturing Production between Taiwan and China," Industrial Development Bureau, Ministry of Economic Affairs, pp. 217.

### **3. Taiwan's Current Economic Competitiveness and Future Plan**

The vast amount of FDI from Taiwan to China is not only benefiting China's economy but also increasing the economic competitiveness of Taiwan. Most significant part of such mutual benefit effects to Taiwan side is on the improvement of business efficiency as shown in Table 4-4.

If we compare the four categories of IMD World Competitiveness Ranking Index, one can see that Taiwan ranked seventh with only "business efficiency" (ranked fourth in 2002 and 2003) outperformed other East Asian countries in the group of population more than 20 million. This is mainly due to the successful integration of manufacturing division of labor across the Taiwan Strait with the new Taiwanese business model of logistics operations on parts and components shipping and assembly. The fall of business efficiency (ranking from fourth to seventh in 2004) mainly owes to the failure of pushing direct voyage and air link across the Taiwan Strait. The high expectation from the multinational companies via the annual policy white papers of European and American business associations in Taiwan is obvious (American Chamber of Commerce in Taipei, 2003).

The famous logistics operation model had been improved from 995 (95% of products will be assembled and shipped to the ordering customers in 5 days) in 1997, to 982 (98% of products in 2 days) in 2000 and then 1,002 (100% products arrived orders in two days) in 2003 in Electronics and Information Industry (TEEMA, 2003). Other famous global operation or logistic strategies by Taiwanese multinational manufacturers are "time to market," "time to volume," and "time to money" (Foxconn, 2004).

**Table 4-4. IMD World Competitiveness Ranking (2002–2004)**

Country		Overall			Economic Performance			Government Efficiency 2003			Business Efficiency			Infrastructure		
		2002	2003	2004	2002	2003	2004	2002	2003	2004	2002	2003	2004	2002	2003	2004
Group One	Singapore	(6)	98.15 (2)	89.01 (2)	(11)	71.8 (4)	60.05 (5)	(1)	90.77 (2)	84.33 (1)	(8)	79.57 (4)	79.52 (6)	(7)	74.99 (7)	73.83 (9)
	Hong Kong	(10)	90.31 (4)	85.77 (6)	(7)	69.46 (6)	62.69 (11)	(4)	85.14 (3)	79.73 (3)	(6)	89.17 (2)	81.18 (2)	(15)	48.18 (17)	61.16 (22)
Group Two	Taiwan	(7)	69.28 (6)	79.54 (12)	(17)	52.71 (11)	56.11 (24)	(9)	63.32 (6)	66.3 (18)	(4)	74.77 (4)	79.19 (7)	(7)	64.16 (7)	62.26 (20)
	Korea	(10)	46.47 (15)	62.20 (35)	(11)	39.32 (18)	43 (49)	(11)	43.23 (18)	47.25 (36)	(10)	42.06 (20)	52.73 (29)	(9)	50 (11)	53.52 (27)
	Japan	(11)	56.3 (11)	71.92 (23)	(15)	47.07 (14)	56.72 (17)	(17)	43.68 (17)	46.79 (37)	(16)	41.47 (21)	47.90 (37)	(6)	76.42 (5)	81.94 (2)
	China	(12)	50.81 (12)	70.73 (24)	(4)	73.85 (2)	79.24 (2)	(10)	56.56 (9)	62.04 (21)	(18)	36.97 (24)	49.50 (35)	(14)	33.93 (17)	40.81 (41)
	Malaysia	(6)	72.87 (4)	75.92 (16)	(8)	63.5 (8)	59.48 (16)	(4)	78.02 (3)	68.17 (16)	(7)	69.79 (5)	71.12 (13)	(10)	60.51 (9)	50.60 (30)

Note: Since 2003, IMD has divided the countries into two groups by their population. Countries, such as Singapore and Hong Kong, in group one have population less than 20 million. The other countries, such as Taiwan and China, in group two have population more than 20 million. The cells show the country's score and rank (in brackets) in each area.

Source: IMD WORLD COMPETITIVENESS YEARBOOK 2003.

Such business efficiency has made Taiwan the world's fourth largest IT hardware producer in 2003 (next to US, PRC, and Japan). There are more than 10 products of IT industry ranked first in market share, such as Mobile Phone, Notebook PC, LCD motherboard, CDT motherboard, IC, etc. (refer to Figure 4-2) Especially the rapid growth of LCD industry production are significant. The speed of production on major IT products have gained world record (III, 2004):

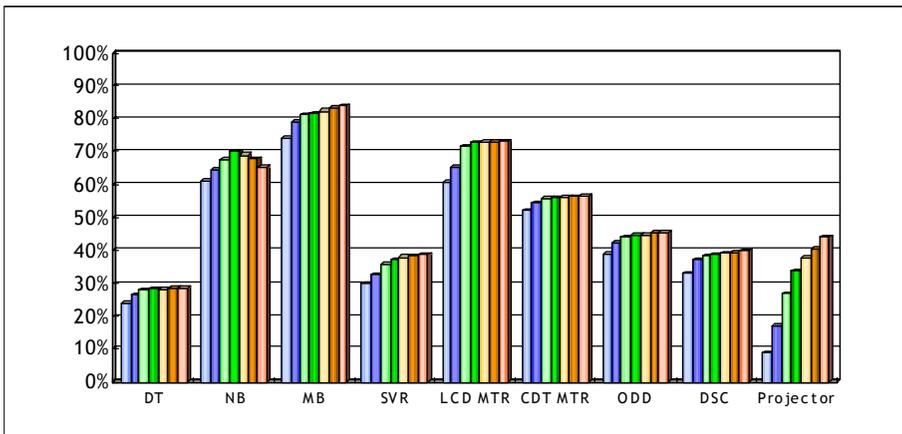
- \* a motherboard per 0.374 second
- \* a CD-ROM driver per 0.469 second
- \* a Monitor per 0.506 second
- \* a Desktop PC per 1.140 second
- \* a Scanner per 1.162 second
- \* a Notebook PC per 2.482 second

By estimation, 75% of PCs installed in the world with Windows OS are produced by Taiwanese IT Companies. That's why "Taiwan Inside" would probably be the most suitable description of Taiwan's vitality and its position in the worldwide IT Industry.

**Figure 4-2. Taiwanese IT Hardware Worldwide Production**

**Share at a Glance**

(worldwide production volume share %)



Source: MIC/III, 2003.

Due to the low and efficient production cost on IT industry, Taiwan is now dominating IT production in mainland China. It is estimated that Taiwanese-exported IT products in China share 73% of China's IT

total exports. The low price of IT products also stimulates the market demand. The mobile phone penetration rate is 111% in Taiwan.

This achievement is highly related to the recent trend of Taiwan's IT companies setting their factories in China. Above mentioned world market share was the successful implementation of manufacturing division of labor across the Taiwan Strait and the global logistics operation. The offshore production of information hardware had rapidly increased. In 2002, Taiwan produced 35.7% of our global market demand; China produced 47.5%, and other regions 16%. In 2003, the production share becomes 20.9%, 63.3%, and 15.8% respectively.

Figure 4-3. Asia-Pacific IT Hub



Hence, Taiwanese IT companies had laid a vision of "Asia-Pacific IT Hub" for the government. For taking advantages of using China as manufacturing base, penetrating the Chinese market, and enhancing the export comparative advantages to the world wide market, Taiwanese IT companies are now seeking strategic partnership with global companies (as shown in Figure 4-3). It is hoped Taiwanese IT companies can

contribute their highly efficient knowledge as a receptor and an integrator. Under the support of industry infrastructure and democratic system from the government sector, we hope to develop the partnership with global companies on (1) technology transfer, (2) joint-develop products for China and Worldwide market, (3) Joint-Venture for key components or infrastructure.

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## **V. Conclusions, Elaborations, and Policy Suggestions**

Due to PRC's intention of politically isolating Taiwan from the international community, Taiwan had been excluded in the recent regional economic integration. The isolation became more serious when ASEAN+3 started to study and negotiate the East Asian FTA issues in 2002. This paper is aimed at exploring the possible role of Taiwan's participation in East Asia's economic integration.

Besides, due to the far-reaching importance of Taiwan's professional participation into the East Asia economic interaction, political and think tank leaders of the plus three countries (namely Japan, Korea, and China) had managed a way of regular and scholarly conference series on discussing the important economic issues in East Asia since 1995. Several collaborative research projects for making Taiwan's businessmen understand China's economy or business environment had also been conducted across the Taiwan Strait (as shown in Appendix).

### **1. Taiwan's Perspectives on the Contribution to Economic Integration in East Asia**

From the analysis of sections II, III, and IV, there is no doubt that ASEAN+3 is currently the most authoritative agency that is in charge of economic integration of East Asia. Taiwan's participation or contribution into the integration process is vital important to the region. Therefore the conclusion and elaboration of this section will be hinged on the reasoning of making Taiwan a member of ASEAN+4 or East Asia Summit (depending on which terminology does the current ASEAN+3

like to use. If the latter term is used, it can reserve a room for the possible participation of North Korea and Mongolia in the future).

*A. Taiwan's possible role in the integrated financial and monetary system*

First section of the paper reviews four major issues that were regarded as important and effective strategies for East Asian economic integration. After the 1997 Asian financial crisis, the necessity of establishing an integrated financial and monetary system had become a consensus and signed a Chiang Mai Initiative by the financial ministers of ASEAN+3 in May 2000. After reviewing related documents and literatures, this paper suggests three directions worthy of further study and putting into actions. They are: (1) A regional institution that allows mutual consultation regarding exchange rates, interest rates, and foreign exchange reserves, (2) The Asia Bond Initiatives (ABI) for the purpose of constructing the infrastructures and for the development of regional bond market, (3) An integrated intra-regional exchange rate system with "basket peg".

Asian financial crisis revealed several fatal defects of the financial safety net and monitoring problems, such as over concentrated bank load within Japan's big conglomerates; high ratio of debt/net asset proportion in Korean Chaebols, weak safety net problem in Thailand's bond and capital market, etc. Due to Taiwan's outstanding performance of not being seriously affected by the Asia financial crisis, Taiwan's experts and government officers can be very helpful in setting up a solid operational framework on monitoring the banks and the related regulations on integrating regional financial and monetary system.

The ideas of developing a regional bond market are to serve the capital demand of constructing regional major infrastructures. This is more like an international obligation of developed countries to less

developed countries. Such obligation is to be fulfilled when one country's international political status is identified and accepted. This is not the issue that Taiwan ought to aggressively strive for without an official status in ASEAN+4 or East Asia Summit.

As to the issue of establishing an integrated intra-regional exchange rate system with a "basket peg," since Taiwan is an important trade partners intra and inter region, it is definitely important to have Taiwanese authority joining the design of the pegging system. Regardless of using a peg with Yen, Euro, and US Dollars or a pegging system adapting major currencies in the region, Taiwan's current economic competitiveness and the importance of NT Dollars in the exchange market places Taiwan in an important role.

*B. Contributions to East Asian Open Regionalism and Industrial Specialization or Clusters*

How much a country can contribute to "Open East Asian" has a lot to do with its geographical location in the region, the ability in managing intra and inter regional trade and investment flows and the hardware and software infrastructure management ability for attracting FDI or capital flow from out-regions. Taiwan has inherited the best geopolitical position in East Asia. The degree of openness of the island automatically plays the double importance on the success or failure of the "Open East Asian Regionalism." Even though the current political tension across the Taiwan Strait prohibited Taiwan from becoming a FTA hub, Taiwan had transformed itself into a most efficient logistic center for manufacturing goods in the region. It is imaginable once Taiwan enters the stage of direct shipping and air flight link with China. The economic integration of Northeast Asia with Southeast Asia will enter a real high rising stage. It is hoped that major countries in

this region can recognize this important milestone for East Asia economic integration and support the equal negotiation status for Taiwan.

Taiwan's successful economic integration across the Taiwan Strait, which has benefited both China and Taiwan mutually in economic development, has been elaborated in Section IV. The famous industrial clusters from Silicon Valley (in US) to Hsin-Chu Science-based Industrial Park (in Taiwan) and then Greater Shanghai region (in China) has been envied by most ASEAN countries. This is related to the governmental policy, regulations, and planning ability in HSIP and IT enterprises' logistic operation ability. Such models can be duplicated in other Asian countries for IT industries or for other high R&D demanding industries (such as car making, petrochemical industries or precision instruments). Taiwan's participating in East Asia FTA or Summit will certainly helping to build a more solid manufacturing division of labor or intra-industry specialization for the region. Thus a major issue in a FTA might be the shift from agriculture to manufacturing and research related service industries in the region. The co-prosperity via job creation and worker quality upgrading can therefore be expected.

As to the contribution to regional financial hub, due to the significant financial hubs that Japan, Singapore, and Hong Kong already play, the most likely opportunity for Taiwan will be a regional hub for funding manufacturing demands oriented services. Venture capital is the most vivid case. Other manufacturing related financing functions could also be plausible. Such financial function differentiation or specialization among major East Asian countries can provide this region a division of labor on banking and financing institutes.

As to the regional FTA hub, it is not Taiwan's comparative advantage to operate bilateral FTA due to political hindrance. However based on

the successful experiences of becoming one of major negotiators and coordinators of G-10<sup>6)</sup> in agricultural interests for small agri-economies in WTO, it will be more efficient for Taiwan to run multilateral FTA for the region. A multilateral FTA focusing on the arrangement of manufacturing division of labor via FDI will be Taiwan's strength in participating in this regional integration (as reflected in Table 2-1 and its related analysis). It is imaginable that after such multilateral negotiation on manufacturing division of labor, the intra-industry specialization in East Asia will have significantly progressed and that each country's macroeconomic welfare (including income, employment, terms of trade) will be greatly improved and even distributed. This special function Taiwan can contribute in the planning of regional integration deserves the special attention of all nations in this region. This is also the strong point why ASEAN+3 should seriously consider expanding to ASEAN+4 for the sake of Taiwan's participation.

### *C. Contributions to Early Harvest Package*

As to the Early Harvest Package which provides tax free preferential

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6) Agricultural negotiations have been the most important and sensitive for most countries. The Agriculture Committee of WTO started its new round of negotiations on January 1, 2000, and they were originally targeted to be complete by January 1, 2005. However, following the Cancun September 2003 meet, negotiations are expected to be extended. The new round of negotiations restarts on March 2004. Currently, negotiating positions can be classified into five different groups: the US, the EU, the G10, the G20, and the G33. The Cairns Group and G20 are strong advocates of liberalization, while the G10 seek protection for their small agricultural sectors. The US and the EU stand in the middle. The G10 group includes Bulgaria, Taiwan, Iceland, Korea, Switzerland, Liechtenstein, Japan, Norway, Israel, and Mauritius.

treatment on agricultural products with CLMV, Taiwan can join the program by providing agricultural technology overseas team or help set up the agricultural lab in those countries so as to promote the food, rice, fish or fruit quality in the region. It will help the FTA issue expanding to technology transfer or assistance, not just trade preferential treatment.

## **2. Taiwan's Perspectives on Future Political and Economic Interaction with China**

### *A. Background*

Politically "One China, Two Systems" is not acceptable by the Taiwanese. Taiwan seeks to keep the *status quo* (*de facto* independence) with China in a mutually acceptable Peace Dialogue and Operation Framework and hope the political framework can be formulated through those friendly dialogue processes. "One China" should not be a principle or a pre-condition for opening friendly interaction between two sides. Nonetheless it can be a serious political issue to be discussed and identified for dialogue.

Internationally, Taiwan already played some significant roles to the world's poverty eradication. Due to the unique international diplomatic situation, Taiwan fostered a humanistic overseas-aid image to our friendly poor countries. As Table 5-1 shows, Taiwan's diplomatic and overseas aids have mostly contributed to the countries that are defined as least developed countries (LDCs) and need poverty eradication programs by the UN. According to the UN standard of 2004, countries with a GDP per capita smaller than 900 US dollars, poverty in human resources (a comprehensive index including health, nutrition, etc.), a high vulnerable economy (a comprehensive index including instability

on agriculture production and export, insufficient diversity and a small economy, etc), and a population of less than 75 million are defined as LDC. Taiwan contributes to 9 countries among the 49 countries specified by UN.

**Table 5-1. Taiwan's Diplomatic and Overseas Aids Contributing to the UN Poverty Eradication in Least Developed Countries:  
9 out of 49 have Diplomatic Relations with Taiwan**

Afghanistan	<input type="checkbox"/>	Gambia	<input checked="" type="checkbox"/>	Rwanda	<input type="checkbox"/>
Angola	<input type="checkbox"/>	Guinea	<input type="checkbox"/>	Samoa	<input type="checkbox"/>
Bangladesh	<input type="checkbox"/>	Guinea-Bissau	<input type="checkbox"/>	Sao Tome & Principe	<input checked="" type="checkbox"/>
Benin	<input type="checkbox"/>	Haiti	<input checked="" type="checkbox"/>	Senegal	<input checked="" type="checkbox"/>
Bhutan	<input type="checkbox"/>	Kiribati	<input type="checkbox"/>	Sierra Leone	<input type="checkbox"/>
Burkina Faso	<input checked="" type="checkbox"/>	Lao's People D. R.	<input type="checkbox"/>	Solomon Islands	<input checked="" type="checkbox"/>
Burundi	<input type="checkbox"/>	Lesotho	<input type="checkbox"/>	Somalia	<input type="checkbox"/>
Cambodia	<input type="checkbox"/>	Liberia	<input type="checkbox"/>	Sudan	<input type="checkbox"/>
Cape Verde	<input type="checkbox"/>	Madagascar	<input type="checkbox"/>	Togo	<input type="checkbox"/>
Central African Rep.	<input type="checkbox"/>	Malawi	<input checked="" type="checkbox"/>	Tuvalu	<input type="checkbox"/>
Chad	<input checked="" type="checkbox"/>	Maldives	<input type="checkbox"/>	Uganda	<input type="checkbox"/>
Comoros	<input type="checkbox"/>	Mali	<input type="checkbox"/>	United R. of	<input type="checkbox"/>
D. R. of Congo	<input type="checkbox"/>	Mauritania	<input type="checkbox"/>	Tanzania	<input type="checkbox"/>
Djibouti	<input type="checkbox"/>	Mozambique	<input type="checkbox"/>	Vanuatu	<input type="checkbox"/>
Equatorial Guinea	<input type="checkbox"/>	Myanmar	<input type="checkbox"/>	Yemen	<input type="checkbox"/>
Eritrea	<input type="checkbox"/>	Nepal	<input type="checkbox"/>	Zambia	<input type="checkbox"/>
Ethiopia	<input type="checkbox"/>	Niger	<input type="checkbox"/>		

Note: countries checked stand for those who have diplomatic relationship with Taiwan (ROC).

Besides, Taiwan's unique domestic and international political situation has fostered socially concerned NGOs active country since 1987. Taiwan has in a unique way contributed to UN meetings since 2000. So far, Taiwan has participated in UN Summits on Social Development (2000), Human Settlement (2001), Sustainable Development (2002), and Information Society (2003).

Economically, unique cross-strait economic interaction formulated a unique way of solving business disputes with China. As Table 5-2

shows, due to the shortage of confidence on solving business disputes with Chinese merchants, Taiwanese businessmen are now mainly using Taiwan Business Association or local governments to solve business disputes with China's business counterparts. This is not normal and should not become regular measures. There is an increasing demand that the world need Chinese to be well educated and trained with knowledge on international business and trade.

**Table 5-2. The Methods for Resolving Business Disputes  
(Multiple Choices) in China by Taiwanese**

Methods	2003 Chiu Chen		2002 Lu		2001 Lin	
	case	%	case	%	case	%
Legal Method	190	22.1	143	22.5	88	28.4
Local Government	258	30.1	165	25.9	72	23.2
Taiwan Business Association	440	51.3	160	25.2	50	16.1
Arbitration	104	12.1	36	5.7	17	5.5
Private Method	205	23.9	132	20.7	83	26.8
Other	23	2.7	-	-	-	-
Total	1,220	100	636	100	310	100

Note: The number of questionnaires with missing values is 1,088.

Source: Chiu Chen, Lee-in, and Nai-Fong Kuo (2003), surveyed data.

China's goal in getting Taiwan to sign CEPA, not FTA, with herself is obvious. However the CEPA model China established with HK and Macao is in fact not fit for Taiwan at all. This is because Taiwan has a unique ability in manufacturing division of labor and fostering industrial clusters via strategic partnership with multinational companies, which HK and Macao do not have. Such ability will not only benefit the FDI receiving countries but also strengthen or upgrade the industrial technology for the home (origin) countries. Besides, either

CEPA or FTA must be signed according to the comparative advantages of Taiwan's capacity building on international production. Different industries will need to build in terms of the supply chain relationship with Japan, US or Europe. Therefore at least trio-partnership has to be built for the sake of Taiwan's own benefit.

Politically Taiwan does not want to be downgraded to the same political status as HK and Macao. Vicent Siew, the former Prime Minister at KMT regime had suggested a "closer economic operation framework" (CEOF) as a better substitute than CEPA. Taiwan business leaders suggest two governments to sign a intermediate term (i.e. fifty years) of peace agreement. President Chen Shui-Ben would rather deal with political and economic issues with China simultaneously so that he proposed a framework of "peace and stable" interactions across the Taiwan Strait on April 2004. He also proposes an idea of organizing a "Cross-Strait Peace Development Committee" in early 2005 (It is now preparing).

*B. Long-term Way Out: A Cross-Strait Peace Dialogue and Operation Framework between Taiwan and China*

– Politically:

- For a better integration and development of Northeast Asia with Southeast Asia politically and economically, Taiwan should be seriously considered a member of ASEAN+4 or East Asia Summit.
- Taiwan should earn a full membership in the UN and contribute to the international society as an UN NGO and ICT Task Force Asian Center as a beginning step.
- Negotiating a peace and operational political framework with China on how to co-existent (i.e. division of labor) in the UN community.

- Negotiating a long-term political framework for greater Chinese countries (i.e. PRC, ROC (Taiwan), Mongolia; If necessary, Singapore can be invited).
- Economically:
  - Military reduction negotiation vs. assisting the development of mid and Western regions of China can be candidly discussed on the negotiation table.
  - Negotiating on the establishment of a Chinese International Court. There are special needs to set up such institute for solving business and civilian disputes (Hopefully, the quality and legal concept of greater Chinese people can be improved).

### **3. The Immediate Participatory Role for Taiwan**

As analyzed in section II, the financial and monetary integration system for East Asia needs to be conducted after sound and coherent financial and monetary policies are implemented. Taiwan's contribution to East Asian economic integration should start with the agriculture, manufacturing and service industries. However it is necessary to initiate an annual or semi-annual workshop on studying how to establish a common acceptable framework of integrated financial and monetary system in East Asia. The Executives' Meeting of East Asia and the Pacific Central Banks and Monetary Authorities (EMEAP) and ASEAN Central Bank Forum (ACBF) should be expanded and integrated to conduct this important mission. Taiwan's Central Bank should be invited to be a member and to take major role in the research.

As to the ideas about the manufacturing and servicing division of labor cannot be implemented and put into action without the

participation of Taiwan. If PRC insists political exclusion of Taiwan, this paper strongly suggests initiating Taiwan participation with ASEAN+3 think-tank workshops. This can be an extension of the annual Scholarly Conference on East Asian Economy cosponsored by NIRA (Japan), CDI (China), CIER (Taiwan) and KIEP (Korea) since 1995 (refer to Appendix). Besides there is a need to create business workshops industry by industry, in order to explore possible ways of manufacturing and servicing division of labor among economic leading countries in East Asia. A tentative proposal for organizing such regional industrial collaboration plan under multilateral negotiation can be sketched below:

Japan & Taiwan: agriculture and food (biotech) industry

Korea & Taiwan: electrical and electronics industry

Korea: transportation, textile, clothing

Taiwan: chemical and medicine, precision instrument

ASEAN: chemistry fibers, machine, transportation

Taiwan & ASEAN: metal smelting and pressing, petrochemical and chemical

For enhancing the effects of the manufacturing and serving division of labor, the negotiation on cross strait direct voyage and air flight link between governments of Taiwan and China is necessary. All neighboring countries need to foster such political atmosphere for the better macroeconomic welfare of the region. The negotiation can be negotiated along with the related economic cooperation issues (i.e. open tourists from China to Taiwan the cooperative plan on manufacturing division of labor in the Region).

If these new ideas of integrating East Asia economy through the "manufacturing and servicing division of labor" can put into action,

stable economic and social development, along with prosperity, can be achieved for decades. It is a plan that could benefit eight to nine countries with comparative manufacturing advantages.

As to the other four economically vulnerable countries, namely Cambodia, Laos, Myanmar, and Vietnam, the Early Harvest Package along with the agriculture technology team dispatched from Taiwan will benefit the majority of their people. The good negotiation experiences accumulated by G10 under WTO operational framework had laid a good foundation for Taiwan, Korea, and Japan to lead the agriculture co-prosperous strategies for the small agricultural economies.

The economic integration in East Asia has been too much focusing on the negotiation of FTA a popular concept of tariff and non-tariff negotiation for bilateral FTA under WTO framework, or so called WTO plus negotiation. Most political leaders in this region ignored the importance of growth engine of this region, namely China, has been relied on the manufacturing division of labor from Taiwan so as the further attraction of more FDI from other advanced countries in the world. This paper leads to call attention on this fact.

The economic integration in East Asia is not easy going due to the political, cultural and economic diversification. The signing of FTA has been a major approach so far. This paper reviews four major initiatives by the scholars and proposes the possible role of Taiwan can contribute basing on her strength on manufacturing division of labor, agriculture overseas aid system. Those revolutionary concepts if accepted and respected, the *de facto* participation of Taiwan into the process of economic integration in the region will certainly benefit the common people, the more evenly distributed employment and income for each country so as the more stable political powers in the region. It is expected a commonwealth of East Asia can be achieved in the first half of the 21st century.

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## Appendix: Some regular and friendly civilian interactions between Taiwan and China

1. Think Tank's Friendly Interaction among NIRA (Japan), CDI (China), CIER (Taiwan), and KIEP (Korea).

Annual Scholarly Conference on East Asian Economy, financially supported by Japan government had been inaugurated in 1995. The conference themes for the past seven meeting are:

- 1) Prospect of South China's Economy and its Future's Inter-dependent Relationships with Hong Kong, Taiwan, and Japan (1995, Shenzhen, China)  
※ Conflict on enforcing using the term "mother country"
- 2) China's Prospects after the Return of Hong Kong (1997, Hong Kong)
- 3) Present Situation of South China's Economies and Tasks for 21st Century (1998, Okinawa, Japan)
- 4) Ideal Course for Regional Cooperation and Role of South China's Economy in East Asia (2000, Macao, China)  
※ KIEP (Korea) observed
- 5) Development Trends in East Asia Based on China's and Taiwan's Entry into WTO (2001, Sanya, Hainan, China) (※ conflict on book title "China's Dual WTO Entry", CDI agree to change)  
※ KIEP joined
- 6) The Prospect of the East Asia Economy in the Process of Economic Integration (2002, Fukuoka, Japan)
- 7) Research on the Future based on progress of the integration and partnership of the East Asian Economy (2003, Taipei, Taiwan)

2. Collaborative Research Projects across the Taiwan Strait (contracted projects from CIER to China's research institutes):
  - 1) Regional Development and Industrial structure in China Implication for Industrial Integration Across the Taiwan Strait (1995, with CASS);
    - ※ A co-rewritten book "Cross Strait Breaking Through: Regional Industry Analysis in China" was published by CASS in 1996.
  - 2) Industrial Development and Investment Environment in Southern Coastal China-Implications for Economic Cooperation across the Strait (1996, with SASS, a regular exchange of publications began)
  - 3) Marketing Strategies and Domestic Sales Channels in Mainland China Case studies on Twenty-One Overseas-founded Firms (1998, Sichuan Academy of Social Science)
  - 4) The Trans-boarder High-tech Human Resources in Mainland China and It's Impact to the Industrial Competitiveness across the Taiwan Strait (2003, CASS)
    - ※ A Memoranda of Cooperation and Exchange Partnership was signed in 2001. Annual Scholarly Conference between CIER and CASS commenced in 2001.

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# Economic and Political Interaction across the Taiwan Strait Facing the Trend of Economic Integration in East Asia

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Regional economic integration has been an important issue for decades in Europe and North America addition to the World Trade Organization. However, this has been less the case in East Asia due to the complexity and diversity of politics, diplomacy, culture, and economics. Another important reason is that one crucial country – Taiwan is ignored. This paper aims to explore the possible roles Taiwan might play in a more closely integrated East Asia.

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