

ECFA: A Pending Trade Agreement?

Also a Comparison to CEPA

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Keywords: ECFA, Free Trade Agreement, Trade, China, Taiwan

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1. Introduction

“If Nature had been comfortable, mankind would never have invented architecture.”/

Oscar Wilde; from Frost (2008), p.131

The proliferation of FTAs (free trade agreements) worldwide, particularly in East Asia, jeopardizes Taiwan who has been left behind due to China’s boycott.² Over the past decades, Taiwan has adopted an export-led strategy to foster sustainable growth. This suggests that signing regional trade agreements (RTAs)³ and/or FTAs is crucial to the economic development of Taiwan. It’s understandable that the opinion about how to break this “Chinese knot” is severely divided in Taiwan.

The Economic Cooperation Framework Agreement (hereafter, abbreviated ECFA), signed on June 29, 2010 in Chongqing, China, is a preferential trade agreement (PTA) between the governments of the Republic of China, Taiwan (hereafter Taiwan) and People’s Republic of China (hereafter, China) . The aim of this trade pact is to establish a FTA by reducing tariffs and commercial barriers gradually, and enhance closer economic ties between the two countries. While there are Pros and Cons to every trade agreement, it is widely believed that FTAs can boost business for both partners and benefit both economies. China has been the primary trading partner with Taiwan since 2000, suggesting that, from the economic perspective, the ECFA is the most significant agreement Taiwan has signed.

However, China has never abandoned attempts to annex Taiwan, suggesting that any economic strategy implemented by China is driven by political motives. This prevents Taiwan from evaluating the influence of the ECFA purely from the economic perspective.

Generally, markets have an inherently expansionary tendency, which can be accelerated or retarded by political factors. Nonetheless, “no matter how closely politics and economics are

² Due to Taiwan’s unique political status on the international stage, Taiwan signed FTAs only with Central America countries sharing diplomatic relations. The trade volume with these countries accounted for only 0.4% of Taiwan’s exports in 2009.

³ RTA here covers Free Trade Agreement (FTA), Customs Union (CU) and partial trade agreement. Conceptually, it is interchangeable with Preferential Trade Agreement (PTA).

interlocked in reality, it is intellectually possible (even rewarding) to keep them apart” (Machlup, 1977). This principle is even more salient to discussions regarding cross-straits economic relations.

The debate on ECFA (previously named the Comprehensive Economic Cooperation Agreement (CECA)) began heating up in Taiwan in February 2009. Critics from both ends of the political and economic spectrum contend that the ECFA will damage Taiwan, by bolstering Taiwan’s economic overdependence on China, with a resulting loss of sovereignty in the long run. In turn, the ECFA will have a lasting impact, not only on Taiwan, but on the regional balance of power in the entire East Asian region. Thus, understanding the content and consequences of ECFA from both the economic and political perspective could provide insight into the implications of these changes to both Taiwan and the East Asian community.

The remainder of this paper is organized as follows. Section 2 presents a brief background of the development of the ECFA in terms of the dilemmas Taiwan face. Section 3 documents the contents of ECFA, also provides commentary on the simulation effects of the ECFA. Section 4 discusses the Taiwanese government’s responses to public suspicion, followed by the Pros and Cons of the ECFA. Section 5 compares the ECFA with the Closer Economic Partnership Arrangement (CEPA), signed by Hong Kong and China in June 29, 2003. The final section provides concluding remarks.

2. ECFA signifies Taiwan’s Dilemma

2.1 *China-Taiwan rapprochement leading to ECFA*

There has been a long-standing and grave dispute over the issue of sovereignty between Taiwan and China, since the two sides split, following the Chinese Civil War in 1949. In 1987, the Taiwanese government implemented a policy in which retired Chinese veterans were permitted to return to China to visit their families and relatives.⁴ Although this policy has

⁴ Approximately one million soldiers following Chiang, Kai-Shek in his withdraw from China to Taiwan in 1949.

opened the door to closer interaction between the two sides, the relationship remains tense reaching a peak when Chen, Shui-Bian of Democratic Progressive Party (DPP) was serving as president during 2000-2008. The Chinese government even promulgated an “Anti-Secession Law” in March 2005 that mandated the use of “non-peaceful means” not excluding military force, to achieve “national unification”.

This tense political situation appears to have eased since May 20, 2008, when President Ma Ying-Jeou of the Chinese Nationalist Party (Kuomintang, KMT) took office. He adopted a policy of “setting aside the sovereignty dispute”, to which Peking agreed, believing that “economic issues could be dealt with first and political issues later.”⁵ In the wake of this shift, cross-strait discussions through two intermediary organizations (SEF and ARATS) have resumed,⁶ long after the interruption by the Taiwan Strait missile crisis of July 1995 through March 1996.

Subsequent negotiations have led to 15 bilateral agreements and one declaration in areas including direct commercial air and sea links, tourism, intellectual property rights (IPRs), judicial mutual help, and a memorandum of understanding (MOU) on financial supervision. These agreements have gone a long way to overcoming previous barriers to cross-strait trade and the flow of personnel. Most notable among the new pacts is the “Economic Cooperation Framework Agreement” (ECFA) signed by SEF and ARATS, following one and a half years of negotiation. This agreement means that Taiwan and China have agreed to establish a free trade zone in the near future. Beyond that, an “early harvest” list with selected manufacturing and service industries that enjoy preferential treatment has taken place on January 1, 2011.”

In actual fact, the ECFA was initiated by Taiwan’s President Ma, Ying-Joeu in November 2008,⁷ receiving a positive response from China’s Paramount Leader, Hu Jintao on 31

⁵ It is often criticized as a policy that essentially constituted a unilateral pretence that the dispute over Taiwan’s sovereignty could be downplayed.

⁶ The abbreviations refer to the Taiwan’s Straits Exchange Foundation (SEF) and China’s Association for Relations across the Taiwan Straits (ARATS), respectively.

⁷ Ma’s initiative was originally called the “Comprehensive Economic Cooperation Agreement” (CECA), and in early 2009, it was changed to the ECFA due to the former’s similarity to the “CEPA”, a preferential trade deal signed by China and Hong Kong on June 29, 2003. In fact, as early as 2007, Ma’s presidential campaign team brought up the proposition of “cross-Straits common market,” which was taken as “one-China market” and was

December, 2008.⁸ As the Chinese government used its influence on neighboring economic powers to prevent them from signing FTAs with Taiwan, the KMT government of Taiwan was motivated to sign the ECFA with China, partly in the hope that China would cease these actions. In a report by the National Development and Reform Commission of China it was suggested that signing an FTA with Taiwan is an important strategy in the promotion of “national unification”, echoing the FTA strategy proposed by Hu, Jintao in 2007. Based on the experience of signing the Closer Economic Partnership Arrangement (CEPA) with Hong Kong in 2003, the political authority of China was inclined to sign a PTA with Taiwan, to foster closer economic relations, and in turn political cooperation.

2.2 *Natural Trading Partner leading to over dependence*

With a combination of economic complementarities (production resources and technology capabilities) and geographic proximity as well as psychological distance,⁹ Taiwan and China appear to be natural-trading-partners, and both could benefit enormously from economic integration.¹⁰

Although Messerlin (2008) argued that smaller countries tend to sign FTAs with larger countries, and particularly with large natural trading partners, it remains unclear whether the two sides of the Taiwan Strait really are natural-trading-partners due to the environmental advantages emphasized by Krugman (1991) and Bhagwati and Srinivasan (1996). The increasing dependence of the Taiwanese economy on China was caused by a surge in outward foreign direct investment (FDI), undertaken by Taiwanese enterprises. Due to enormous changes in the industrial environment, such as environmental protection measures,

thus replaced with the idea of “forming CECAs with other countries.”

⁸ The ‘six-points’ outlined in Hu’s speech were: 1) firm adherence to the ‘one China’ principle; 2) strengthening commercial ties, including negotiating an economic cooperation agreement; 3) promoting exchanges of personnel; 4) stressing common cultural links between the two sides; 5) allowing Taiwan’s ‘reasonable’ participation in global organizations and 6) negotiating a peace agreement (Straits Times, January 2, 2009). See http://www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=34333.

⁹ “Psychological distance” factor brought by similar language and culture is assumed to be an important reason for the Taiwanese FDI to be inclined toward China.

¹⁰ Krugman (1991) referred to those countries with large quantities of trade as a result of geographic proximity and lower transportation costs. However, Frankel *et al.* (1995) argued that increased intra-regional trade in East Asia can be explained entirely by the rapid growth of the economies.

increasing land and labor costs, and violent fluctuations in the local currency of Taiwan in the late 1980s, labor-intensive firms began reallocating their production lines overseas. According to the official statistics provided by the Ministry of Economic Affairs of Taiwan, the magnitude of FDI increased from US\$1,830 million in 1991 to a peak of US\$16,432 million in 2007.

Reallocating resources globally is a natural progression in the development of enterprises in response to economic globalization. However, Taiwanese enterprises have been trapped in the myth of “investing toward China is globalization”(Hong and Yang, 2011). Since the late 1980s, when the KMT government deregulated the restrictions against investment in China, China has quickly outpaced the US and the Association of Southeast Asian Nations (ASEAN) to become the major destination of Taiwanese overseas investment. Due to similarities in culture and language as well as reduced labor costs and an enormous local market, China is a very attractive and highly preferred FDI destination for most Taiwanese enterprises, even though the risk of investment in China is very high.

The value of FDI towards China reveals an overall steady increase with unusual spikes in the years 1993 and 1997, with an exponential increase in 2002 when the government relaxed FDI restrictions against the electronics industry. The share of Taiwanese outward FDI to China (including H.K) climbed to 66.61% (68.27%) in 2002 and has remained steady at approximately 70% ever since. This extraordinarily high concentration of FDI toward one destination is an unusual phenomenon (Hong and Yang, 2011).

In addition, the upsurge in FDI toward China has caused the need for intermediate products and components exported from Taiwan to China,¹¹ representative of typical investment-driven trade. Figure 1 depicts that China and Hong Kong have replaced the United States as Taiwan’s largest export market since 2000. The export ratio of China (plus H.K) to the total increased sharply since 2001 and then increased gradually to 41.09% in 2009. On the other hand, Taiwan has enjoyed a trade surplus with China for many years, e.g. the trade surplus

¹¹ At present, over 90% of Taiwan’s exports to China are intermediate products and components.

with China exceeded \$100 billion in 2007. As Taiwan's economic growth is driven by exports, this implies that the dependence of the Taiwanese economy on China has been increasing.

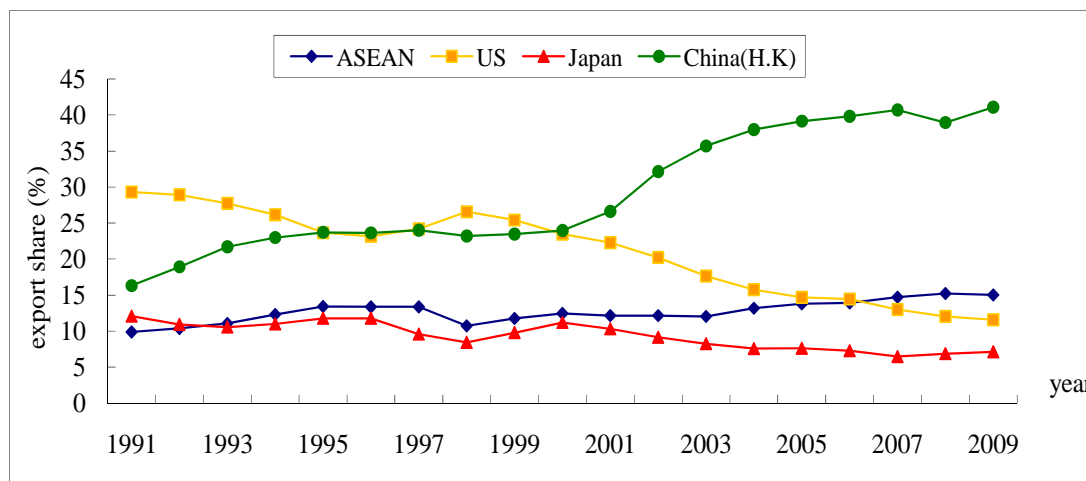


Figure 1 The Time trend of Taiwan's Major Exporting Regions

Even as Taiwan develops a trade surplus with China, the integration of the two economies will also contribute considerably to the economic growth of China. Competitive pressure from globalization is the main reason for East Asian regionalization, expressed according to two aspects: increasing intra-regional trade in intermediate goods and components; and FDI within the region, particularly in the sector of information and communication technologies (ICT). Embracing the globalization of production and utilizing its low labor costs and increased FDI, China has become the so-called "Factory of the World" for a variety of manufactured goods. Because both sides are parts of a closely connected East Asian production network, Taiwanese MNEs have reallocated production lines in China for the final assembly of products before exporting them to consumer markets such as the US and EU. This is the well known model of "Triangular trade" by "taking orders in Taiwan, but producing in China". Recently, approximately 50% of Taiwan's export trade of manufactured products has been produced overseas, particularly in China.¹² This is the main

¹² This figure increased from 16.7% in 2001 to 47.9 % in 2009. Most of the ICT industries were over 80%. Source: Taiwan's Ministry of Economic Affairs.

reason for the increasing dependence of Taiwanese exports on the Chinese market. China has also benefitted from capital and knowledge embodied in FDI inflow from other developed countries. This has enabled China to play a vital role in various manufacturing industries and become an important trading partner for Taiwan and East Asian countries. See Table 1.

Table 1 Trade relations between China and Taiwan along with selected countries, (2009)

	Population (million)	GDP (USD billion) (PPP)	GDP per capita	Leading Markets (%)	Leading Suppliers (%)
Taiwan	22.8	378 (790)	16562	1. China (28.0) 2. H.K. (15.2) 3. US (12.2) 4. Japan (7.5)	1. China (14.1) 2. Japan (20.9) 3. US (10.4) 4. Korea (6.0)
China	1330	4909 (9019)	3681	1. US (18.4) 2. H.K. (13.8) 3. Japan (8.1) 4. Korea (4.5)	1. Japan (13.0) 2. Korea (10.2) 3. Taiwan (8.5) 4. US (7.7)
Hong Kong	7.1	209 (304)	29480	1. China (50.7) 2. US (11.5) 3. Japan (4.4) 4. Germany (3.2) 5. UK (2.4)	1. China (46.4) 2. Japan (8.8) 3. Taiwan (6.5) 4. Singapore (6.5) 5. US (5.2)
Japan	127.1	5078 (4117)	39958	1. US (18.9) 2. China (16.1) 3. EU (12.5) 4. Korea (8.1) 5. Taiwan (6.3)	1. China (22.3) 2. EU (10.7) 3. US (10.7) 4. Australia (6.3) 5. Saudi Arabia (5.3)
Korea	49.4	831 (1374)	16824	1. China (23.3) 2. US (10.4) 3. Japan (6.0) 4. H.K. (5.4)	1. China (16.8) 2. Japan (15.3) 3. US (9.0) 4. Germany (3.8)
ASEAN (6)	575.5	1419 (2793)	2467		
Indonesia	240.3	528 (964)	2197	1. Japan (20.2) 2. US (9.5) 3. Singapore (9.4) 4. China (8.5)	1. Singapore (16.9) 2. China (11.8) 3. Japan (11.7) 4. US (6.9)
Malaysia	28.3	196 (379)	6928	1. Singapore (14.7) 2. US (12.5)	1. China (12.8) 2. Japan (12.5)

				3. Japan (10.8)	3. Singapore (11.0)
				4. China (9.5)	4. US (10.8)
Philippines	98.0	160 (324)	1636	1. China (34)	1. Japan (18.3)
				2. US (16.9)	2. US (15.2)
				3. Japan (16.4)	3. China (14.8)
				4. H.K. (12.0)	4. US (13.8)
Singapore	5.0	172 (193)	34492	1. Malaysia (12.1)	1. Malaysia (11.9)
				2. Indonesia (10.6)	2. US (11.8)
				3. H.K. (10.4)	3. China (10.6)
				4. China (9.2)	4. Japan (8.1)
				5. Japan (5.5)	
Thailand	67.0	256 (534)	3820	1. US (11.2)	1. Japan (18.8)
				2. Japan (11.2)	2. China (11.2)
				3. China (9.1)	3. US (6.4)
				4. Singapore (5.6)	4. UAE (6.0)
				5. H.K. (5.6)	5. Malaysia (5.5)
Vietnam	87	93 (256)	1065	1. US (21.5)	1. China (20.4)
				2. Japan (10.8)	2. Singapore (11.8)
				3. Australia (7.0)	3. Japan (9.6)
				4. China (5.9)	4. Korea (7.7)
US	306.8	14258	46475	1. Canada (19.4)	1. China (19.0)
				2. Mexico (12.2)	2. Canada (14.4)
				3. China (6.6)	3. Mexico (11.3)
				4. Japan (4.8)	4. Japan (6.2)
				5. UK (4.3)	5. Germany (4.6)

Source: EIU (Country Report/Forecast/2010).

Based on the aforementioned development of cross-straits political and economic relations, the Taiwanese government believed that it was necessary, and that the time was right, to sign the ECFA with China. Therefore, despite considerable opposition from opponents on the island the ECFA was signed with China on June 29, 2010.

3. The Contents and Characteristics of the ECFA

3.1 Contents of ECFA: A Framework plus “early harvest program”

The ECFA is an outline of a formal agreement proposing only the framework and targets,

with the remaining details to be negotiated in the future. The framework of the agreement was designed according to the basic principles of the World Trade Organization (WTO) and in consideration of the economic conditions of the two parties, to gradually reduce or eliminate barriers to trade and investment, and create an environment of fair trade and investment. Because signing a formal FTA takes a long time, ECFA negotiations concentrate primarily on the reduction of tariffs and opening the markets of specific industries. This is the so called “early harvest” list.

The ECFA comprises five chapters, including general principles (Chapter 1), trade and investment (Chapter 2), economic cooperation (Chapter 3), early harvest (Chapter 4), and other provisions (Chapter 5). Five annexes are also attached to the ECFA, including Annex I: Product List and Tariff Reduction Arrangements Under the Early Harvest for Trade in Goods, Annex II: Provisional Rules of Origin Applicable to Products Under the Early Harvest for Trade in Goods, Annex III: Safeguard Measures Between the Two Parties Applicable to Products Under the Early Harvest for Trade in Goods, Annex IV: Sectors and Liberalization Measures Under the Early Harvest for Trade in Services, and Annex V: Definitions of Service Suppliers Applicable to Sectors and Liberalization Measures Under the Early Harvest for Trade in Services.¹³ According to the announcement of the Taiwanese government, the legal position of ECFA is unique in being neither a domestic agreement like the Closer Economic Partnership Arrangement (CEPA) between Hong Kong and Mainland China, nor a well known FTA. It is positioned as a special, preferential agreement, in line with the principles of the WTO covering only economic issues between Taiwan and China without touching issues related to politics or sovereignty.

Importantly, the ECFA specifies that within six months of coming into effect, Taiwan and China must proceed to negotiations in the four areas of trade in goods, trade in services,

¹³ The English version of ECFA and annexes can be downloaded from <http://www.ecfa.org.tw>.

investment protection, and dispute settlement mechanisms.¹⁴ However, with regard to the timeline of the negotiations, the pact only states that they should be completed “as soon as possible,” with the ultimate objective being “to diminish or eliminate tariff and non-tariff barriers on “the majority of goods exchanged between the two parties,” similar to the “substantially all the trade” stipulated by GATT XXIV.

3.2 Early harvest

Although the ECFA takes effect on January 1, 2011, it includes only items on the “early harvest” list. This means that the tariff rates on selected goods will gradually be lowered from January 2011, and reduced to zero by January 2013. Taiwan and China will also offer easier access to each other’s markets in selected sectors effective from January 2011.¹⁵

At this point, the only point confirmed by both sides is the “early harvest” list. According to this list which will be implemented in three phases over two years, China will lower tariffs on 539 items, ranging from agricultural goods to manufacturing products including petrochemicals, textiles, metals, machinery, and transport equipment (see Table 2). In 2009, the trade value of 539 items was USD13.84bn accounting for 16.1% of China’s total imports from Taiwan. Conversely, as shown in the lower panel of Table 3, Taiwan will cut tariffs on 267 manufacturing items, covering mainly machinery, transport equipment, petrochemicals, and textiles. In 2009, the import value of these 267 items was USD 2.86 bn, accounting for 10.5% of Taiwan’s overall imports from China.

Table 2 Taiwan’s and China’s “Early harvest”

<i>China’s Industries subject to liberalization</i>			
Industry	No. of items	Taiwan’s exports to China in 2009 (US\$ million)	% of total exports to China

¹⁴ Similar to most recent FTAs, the ECFA covers mainly the liberalization of trade in goods and services, under the auspice of WTO, as well as issues such as “investment protection and promotion,” and “economic and industrial cooperation.”

¹⁵ Taiwan (2008): the applied tariff rate for imports goods was 6.1%, for agricultural goods 16.9% and manufacturing products were 4.5%; and most of the goods in the “early harvest” lay between 2.5%~3%; as to China (2008): the applied tariff rate for imports goods was 9.6%, for agricultural goods 15.6% and manufacturing products were 8.7%; and most of the goods in the “early harvest” lay between 10%~15%. For the tariff rates see <http://stat.wto.org/Country Profile>

Petrochemical	88	5,944	6.93
Machinery	107	1,143	1.33
Textiles	136	1,588	1.85
Transportation equipment	50	148	0.18
Others	140	4,997	5.84
Steel	22	1,078	1.26
Metal	26	1,818	2.12
Tool	5	13	2.00
Electric	14	614	0.72
Agricultural products	18	16	0.02
Total	539	13,838	16.14

Taiwan's Industries subject to liberalization

Industry	No. of items	Taiwan's imports from China in 2009 (US\$ million)	% of total imports from China
Petrochemical	42	329	1.21
Machinery	69	474	1.75
Textiles	22	116	0.43
Transportation equipment	17	409	0.02
Others	117	1,530	5.64
Total	267	2,858	10.53

Source: Ministry of Economic Affairs, Taiwan.

A limited number of services are also on the early harvest list.¹⁶ Each party must open 8 items related to non-financial services. The eight non-financial service sectors opened by China include: accounting, auditing, computer and related services, R&D services, design services, conventions, medical-hospital setup, the importing of cultural-movies, and air transport. The corresponding industries that Taiwan will permit Chinese enterprises to invest in are R&D services, design services, conventions, exhibitions, the importing of cultural-movies, sporting and recreational services, air transport, and the services of distribution-commission agents. In the financial sector, Taiwan will open its banking sector and China will increase access to its banking, securities and futures, and insurance industries.

3.3 Characteristics of ECFA

¹⁶ which are closely related to investment, including FDI

In summary, the ECFA has the following characteristics. First, there is no definite content or timeline other than the “early harvest” list. The ECFA is basically “hit-and-run” tactics, as it contains no specific timeline for the implementation of free trade. This differs considerably from the common practice of signing FTAs, which normally define the “plan and schedule” once the negotiations are over. Without a definite plan and schedule, it is difficult to assess the economic impacts of the ECFA.

Second, the ECFA focuses on traditional industries rather than ICT industries. Interests on both sides of the strait are highly integrated in the production of ICT products, most of which are covered by the ITA (Information Technology Agreement, 1997); therefore, the ECFA influences mainly traditional industries. On the other hand, Taiwan’s agricultural sector is completely excluded from the pact—Taiwan still bans the import of some 830 agricultural products from China.¹⁷

Third, post-ECFA negotiations will have a considerable impact on the economy of Taiwan. Following the signing of the ECFA, the negotiations that follow are ultimately intended to open up “substantially all the trade” in the agricultural and service sectors, in compliance with the requirements of the WTO for preferential trading agreements. Therefore, it is reasonable to assume that the post-ECFA negotiations will have a noticeable impact on the economy of Taiwan in terms of industrial structure, employment, and so on. Generally speaking, Taiwan’s domestic-demand-driven industries, small and medium enterprises, and downstream companies in specific industries will be the most vulnerable to the ECFA. Furthermore, as the agricultural sector is supposed to remain largely intact, the pressure of opening up will focus on industrial products.

3.4 Simulation Effects of the ECFA

Normally, liberalizing trade solely in terms of cross-border tariff concessions will have

¹⁷ Taiwan has previously allowed 1427 items for agricultural products from China on the basis of WTO MFN treatment, as the date of 1st February 2010.

only limited effects, but its impact on specific industries – positive or negative – can vary.

According to an empirical study by Chung-Hua Institution for Economic Research (2009), the ECFA will raise Taiwan’s real GDP by 1.03% and China’s real GDP by 0.17%.¹⁸ CIER employed FTAP¹⁹ simulation to assess the effects of the ECFA, in the scenario where Taiwan’s agricultural sector remains frozen but trade in industrial goods and services is liberalized. Actually, the effects of ECFA will be rebated if the utilization rate of the preferential treatment is allowed for due to the preferential rules of origin.

As for the industry sectors, the effect of the ECFA is positive for the textiles, basic iron and steel, petroleum and coal products manufacturing industries, but largely negative for electrical and electronics, transport equipment, and wood products manufacturing industries.

Preferential trade agreements, by definition, involve some degree of discrimination with respect to nonparticipating economies. As such, the ECFA will have minor but negative impacts on Japan, South Korea and the US (see Table 3).

It is noteworthy that the ECFA will result in a worsening of the “terms of trade” for China, mainly because China’s current import tariffs are higher than Taiwan’s.

Table 3 Economic impacts of ECFA (%)

	Exports	Terms of Trade	GDP
Taiwan	6.657	1.766	1.030

¹⁸ The figures are results of accumulation effect for an indefinite period of time derived in a dynamic model of capital accumulation, rather than take place every year. See “The Assessment of Economic Impacts of ECFA” by the CIER (2009).

¹⁹ The FTAP model is a comparative static, computable general equilibrium model of the world economy that includes a treatment of foreign direct investment on a bilateral basis. The FTAP model was developed in stages from the FTAP (Global Trade Analysis Project) model.

US	0.046	-0.013	-0.002
China	2.437	-0.394	0.173
Hong Kong	-0.054	-0.053	-0.008
Japan	-0.214	0.003	-0.003
South Korea and ASEAN	-0.061	-0.046	-0.026
The other regions	0.023	-0.001	-0.003

With respect to the effect of the ECFA on employment, it is difficult to make a reliable assessment²⁰ because the content of the ECFA remains open and there are too many *ad hoc* assumptions in simulation models.²¹

4. The Pros and Cons regarding the ECFA

4.1 The Pros

China has undoubtedly become a crucial emerging market and served as an economic powerhouse for its Asian neighbors. Specifically, when most developed countries, e.g. EU countries, Japan, and U.S., continue languishing under the impact of the financial crisis in 2008-2009, the post-crisis growth in China has remained above 8% that serves as the main export destination of many countries. Both the Chinese and Taiwanese economies have

²⁰ For example, the CIER (2009) suggests that the ECFA can increase Taiwan's employment by 257,000-263,000 employees; Taiwan's Council of Labor Affairs assesses the number to be 105,000-125,000. The opposition camp's assessment is that there will be 230,000 employees in traditional industries losing their jobs.

²¹ Examples are the elasticity of substitution across workers with different skills or in different industries, and possible change in investment location, including moving offshore.

established closer relation in the Asian production network and more highly developed economies are supposed to enjoy a number of advantages in the process of economic integration with other developing countries (Cooper, 1985),²² Taiwan's government believes that the Chinese market is crucial to sustaining long-term economic growth.

In its appeal for public support of the ECFA, the Taiwanese government makes both defensive and constructive arguments on the importance to the Taiwan economy of signing the ECFA.

The most common claim is that the ECFA is a strategic policy to prevent Taiwan from being marginalized in the international trade arena. Specifically, the "ASEAN plus One/China" FTA went into effect in 2010 and there is the possibility of an ASEAN plus Three (Japan, China, and Korea)" in the near future. The ECFA might lead to or contribute to the signing of more FTAs between Taiwan and her major trading partners. On a more constructive note, the ECFA will help Taiwan boost its industrial competitiveness, attract foreign investment, and ensure that its economic development is prompt and closely integrated with the rapidly growing Chinese market. Taiwan shares the same language and a culture similar to that of China, thereby enabling Taiwanese enterprises to enjoy intangible advantages while operating in China. The signing of ECFA adds further to the predominance of early-entry Taiwanese firms, compared with those of other countries. Thus, foreign enterprises may seek Taiwanese enterprises as partners to expand into the Chinese market, leading to increased FDI inflow into Taiwan.

From the perspective of industrial development, the government claims that signing the ECFA will provide certain advantages for petrochemical products, plastics materials, and automobiles, enabling enterprises in Taiwan to exploit the preferential tariff programs in the Chinese market. Taiwanese petrochemical, plastics, and automobile firms have been confronted by severe competition by their counterparts in Japan and South Korea, both of

²² Cooper (1985) claimed that more highly developed countries can pursue a higher degree of economic integration, but maintain a moderate degree of interdependency by increasing product differentiation or lowering the substitution effect of major products.

which have not yet signed FTAs with China.

4.2 The Discontents on ECFA

Due to the special political relationship between Taiwan and China, many Taiwanese residents are opposed to the signing of this agreement and have proposed a number of arguments, summarized as follows. First, signing the ECFA is urgent and necessary for Taiwan. Second, the signing of the ECFA means that Taiwan will adopt a different economic attitude towards China, from discrimination to favoritism, which is controversial considering the sensitive relationship between Taiwan and China. Third, the ECFA might increase the discrepancies in the distribution of income in Taiwan. Fourth, the ECFA will deepen the economic reliance Taiwan has on China and further skew the asymmetric interdependence. Fifth, the worst case scenario is that Taiwan would be unable to sign FTAs with its major trading partners in the future after signing the ECFA.

Is the ECAF so urgent for Taiwan?

The arguments promoting the ECFA have yet to be validated. Specifically, the most overstated point is the degree of urgency attributed to the signing of the ECFA in response to the effects of “ASEAN-China FTA” in 2010. In fact, the real impact of the ASEAN-China FTA on the exports of Taiwan to China is trivial, because the overlapping ratio between products exported to China from Taiwan and those from ASEAN countries is moderate.

What might have a considerable impact on Taiwan is the “ASEAN plus Three” FTA—an FTA between the ten ASEAN member states plus South Korea, Japan, and China—or a Northeast Asian FTA comprising Korea, Japan, and China. These FTAs include not only China, Taiwan’s primary export market, but also Korea which competes with Taiwan in many areas. The “ASEAN plus Three” may result in a substitution effect between Taiwanese and Korean products in the Chinese market, which would have a considerable negative influence on the economic performance of Taiwan. Nonetheless, whether “ASEAN plus Three” can be successfully established remains an open question. In light of the fact that the economic impact of “ASEAN plus One” on Taiwan would be limited, and the prospects for

“ASEAN plus Three” remain uncertain, urgent calls for action on ECFA could be considered alarmist.

ECFA: jumping from discrimination to favoritism

Because cross-straits economic issues have been highly publicized, Taiwan, which has not yet fully fulfilled its WTO commitments, is now under pressure to shorten its timetable for liberalizing its markets following the signing of the ECFA. By politicizing cross-straits economic issues, China plans to achieve its political agenda of “unification via economy”, a strategy that has remained unchanged. China never hesitates to admit that the reason for its willingness to “yield on its interests” in the ECFA negotiations is the fact that the Taiwanese compatriots are its brothers and that the ECFA is constructive to unification.

At the same time, Taiwan has unilaterally adopted a trade policy of “discrimination” against China. Taiwan has banned more than 2,200 Chinese agricultural and industrial items from its list of acceptable imports. Almost all service sectors in Taiwan are restricted to Chinese investors. Restrictions on investment by China were not even partially lifted until June 2009, and the government has been planning to take a gradual, step-by-step approach towards further relaxation. The number of Chinese products prohibited from import into Taiwan accounts for 20 percent of Taiwan’s total import items. This indicates that cross-straits economic and trade relations are yet to be normalized. However, the ECFA is by definition more preferential than WTO MFN treatment.

Taking the trade in goods as an example of further elaboration, when a prohibited item, under “WTO-minus” provisions, become a legal import, its tariff level is reduced from the set tariff ceiling to MFN tariff rates. If it is included in the ECFA, a “WTO-plus” pact, the tariff rate is further cut to zero. That is to say, inclusion in the ECFA of items on the list of prohibited imports to Taiwan will deal a powerful blow to the Taiwanese economy, industry, and labor market. (See Table 4)

Table 4 Taiwan’ import prohibition by category

Taiwan commodity	Code name	Number (HS 10 digits)	As a percentage of total import
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Classification			
code			
01~05	Animal products	318	37.4
06~14	Vegetables	277	39.3
15~24	Foodstuff	287	37.3
Sub-total	Agricultural products	882	38.0
25~27	Mineral products	9	3.8
28~38	Chemicals and allied industries	109	6.1
39~40	Plastics and rubbers	15	3.8
41~43	Raw hides, skins, etc.	0	0.0
44~49	Wood and wood products	5	1.0
50~63	Textiles	480	37.6
64~67	Footwear	0	0.0
68~71	Stone/glass	46	12.7
72~83	Metals	432	32.3
84~85	Electric machinery	132	9.4
86~89	Transportation	97	34.8
90~97	Optical products and miscellaneous	28	4.1
Sub-total	Manufacturing	1353	15.8
Total		2235	20.5

Source: Bureau of Foreign Trade (accessed on January 19, 2011) ²³

The impact is aggravated by the three factors. Firstly, as China has become the largest exporter in the world. (It is also the world's second largest importer.), China holds a global competitive edge in the assembly of products in labor-intensive sectors. Secondly, China has become Taiwan's largest trading partner. In 2009, exports from Taiwan to China, including Hong Kong, comprised approximately 43 percent of its total exports. In addition, China is now the second largest source of imports to Taiwan, with its products accounting for 13 percent of Taiwan's total imports, second only to the 19 percent of imports from Japan. Thirdly, the size of the economy matters in bilateral trade between Taiwan and China. China's

²³http://ekm92.trade.gov.tw/BOFT/OpenFileService?file_id=39da8a70ba471dbb3fb5262c36570000&context=83ee4cf785ad25a257533d1ac7c3b82f

GDP reached US\$ 4.9 trillion in 2009, 13 times that of Taiwan, or US\$378 billion. If GDP is measured on the basis of Purchasing Power Parity (PPP), there is a much bigger difference due to the relatively lower price levels in China.

ECFA: a product of mixture using WTO principles and cross-straits features

The argumentation of previous section indicates that Taiwan might find it difficult to comply fully with the WTO rules imposed on developed members engaging in regional trade agreements,²⁴ particularly the criteria of “substantially all the trade” (SAT) in products originating in the partner’s territory.

This will make room for ECFA to become a mixed product, drawing on WTO principles that Taiwan wants to adhere to and “cross-straits features” as a result of the weakened bargaining power and some people have tried to avoid. As a matter of fact, China is making considerable efforts to modulate the ECFA to make it more like an internal deal rather than an international agreement. So goes the argument that governing cross-straits trade relations on an equal footing according to the clear-cut regulations established by WTO MFN would be a better option for Taiwan. An MFN can eliminate discrimination by precluding favoritism, making the economic and political advantages held by some territories appear somewhat contained. In this manner, the multilateral mechanism of the WTO would guarantee Taiwan’s political status (sovereignty) rather than the ambiguous mechanisms established in cross-strait relations.

Besides, the Taiwanese government has claimed repeatedly that the ECFA was modeled on the ASEAN-China Framework Agreement (2002), but this argument is meant to confuse, as Taiwan cannot enjoy the same flexibility that the China-ASEAN Framework Agreement provides. The main difference is that China and the ten ASEAN member states joined the WTO as developing countries and are thus entitled to sign preferential trade agreements in

²⁴Taiwan is presumptively classified within the WTO as a developed country as it expressed in its WTO accession that it will not use its rights (such as the Enabling Clause) as a developing country. “...The representative of Chinese Taipei stated that his government will not claim any right granted under WTO Agreements to developing country Members....”(WT/ACC/TPKM/18. p.9), see <http://ekm92.trade.gov.tw>.

accordance with the more flexible requirement of the “enabling clause,” usually in the name of “framework agreement”.²⁵

Such kind of flexibility in the Enabling Clause is ECFA cannot retain because Taiwan, as one of the parties, renounced its status as a “developing country” upon its accession to the WTO. That is, the only option of legal basis for the trade of goods under the ECFA shall be Article XXIV of GATT.²⁶ Moreover, since ECFA is conceived by both parties (Taiwan and China) as a framework for progressive rather than immediate elimination of bilateral trade barriers, as stipulated in ECFA.²⁷

“The two parties agreed that gradually reducing or eliminating tariff and non-tariff barriers to trade in a substantial majority of goods between the two parties” (Article 2, ECFA)

ECFA therefore shall be “**interim agreement**” of paragraph 5 of Article XXIV. But how can move the partial liberalization of trade deal from its initial formation to a full-fledged liberalization of trade?²⁸

The paragraph 5(c) of Article XXIV requires that:

“Any interim agreement referred to subparagraphs shall include a plan and a schedule for the formationwithin a reasonable length of time.”

Besides, according to “Understanding on the interpretation of Article XXIV of the General Agreement on Tariffs and Trade/GATT 1994”:

²⁵ “Several of South-South agreements are based on a staged approach to trade liberalization whereby a framework agreement is signed that includes as a first step the inclusion of a partial scope agreement, often accompanied by an “early harvest programme”, and as second step a commitment to future FTA negotiation.”, see The Changing Landscape of Regional Trade Agreements: 2006 Update. By R.V. Fiorentino, L. Verdeja and C. Toqueboeuf, Regional Trade Agreements Section/Trade Policies Review Division, WTO. Discussion Paper No. 12.see http://www.wto.org/english/res_e/booksp_e/discussion_papers12a_e.pdf

²⁶ One can refer the legal text of GATT to WTO or Goode(2005) online, http://www.dfat.gov.au/publications/negotiating_ftas/negotiating_ftas.pdf

²⁷ See the English translation of the text of ECFA, <http://www.ecfa.org.tw/EcfaAttachment/ECFADoc/ECFA.pdf> (accessed on 31 May, 2011)

²⁸ See Bhagwati (2008).

“The reasonable length of time referred to in paragraph 5(c) of Article XXIV shall exceed ten years only in exceptional cases.”

And,

“Should an interim agreement notified...of Article XXIV not include a plan and schedule, contrary to 5(c) of Article XXIV, the working party (of WTO) shall in its report recommend such a plan and schedule. The (contracting) parties shall not maintain or put into forces.”

This implies that both Taiwan and China will have to eliminate barriers on “substantially all the trade (SAT)”²⁹ between the two sides within 10 years (if no exceptional cases) following the signing of the ECFA.

However, the ECFA merely stipulates that the two sides shall conclude consultations on a goods related trade agreement “expeditiously (as soon as possible)”, while the content and timetable for trade liberalization remain uncertain.³⁰

“...on the basis of the Early Harvest for trade in Goods are stipulated in Article 7 of this Agreement, to conduct consultations on an agreement on trade in goods no later than six months after the entry into force of this Agreement,³¹ and expeditiously conclude such consultations.” (Article 3, ECFA)

In other words, there is no “plan and schedule” in the legal text of ECFA, and therefore no guarantee that the ECFA will meet the requirement of “SAT”. From this point of view, ECFA is a pending trade pact. Only if the might-be progress in the subsequent negotiations of ECFA could solve this problem.

²⁹ There are no definite criteria for SAT, normally 90 percent of products in trade. See WTO (2007) and Goode (2005).

³⁰ It causes concerns among some trading partners. As American Institute in Taiwan Chairman Raymond Burghardt said on Nov. 30 last year: “Now that the [ECFA] is in force, we encourage the parties [Taiwan and China] to notify the WTO of the ECFA in a manner consistent with the requirements for agreements that cover substantially all trade.” See US concerned over ECFA notification, <http://www.taipeitimes.com/News/front/print/2010/12/16/2003491059> (accessed on 31 May, 2011)

³¹ ECFA has entered into force on 12 September, 2010.

ECFA might worsen the distribution of income in Taiwan

Trade agreements are by their nature, reciprocal. Because Taiwan wishes to gain greater access to the Chinese market through the ECFA, she must open her market in return. As mentioned previously, the impact on Taiwan might be huge due to its greater exposure to China, as a result of deeper cross-straits integration. This could, in turn, result in an increase in the disparity in income distribution in Taiwan, because Taiwan's economy is abundantly endowed with capital relative to labor compared with the situation in China, according to the proposition of factor price equalization. Such a tendency could well constrain cross-straits economic integration.³²

The specialization process (reallocation of resources) resulting from economic integration is associated with adjustment costs that must be taken into consideration when ascertaining the net effect. Adjustment costs may take the form of reductions in wages or unemployment as well as the expenditures in social security (Jovanovic, 2001). Worse, the Taiwanese government is incapable of taking care of those who emerge as losers resulting from the ECFA, due to the relatively poor fiscal positions in which the "tax burden" (tax revenues/GDP) is currently below 14 percent.³³

Of course, the Angst is based on the condition that the liberalization agenda of ECFA will be comprehensive.

The ECFA might deepen Taiwan's "asymmetric interdependence" on China

The asymmetry in "economic scale" plays a key role in cross-Straits economic relations. A smaller country tends to form an "asymmetric interdependency" with a larger neighboring country. The two sides of the Taiwan Strait offer an example: More than 40% of Taiwan's exports go to China (including Hong Kong), but China's exports to Taiwan accounts for at

³² The potential benefits of economic integration also include the ability to further induce a division of labor, propelling the push towards specialization, and creating economies of scale. Equalization of absolute factor price alone is inadequate to determine whether it is advantageous to initiate economic integration.

³³ The average tax burden of 14 percent in Taiwan is not only far below levels in the US and EU countries but also lower than the rates in East Asian countries, Japan, China, and South Korea. The tax burden was as low as 13.9 percent in 2008 and 12.2 percent in 2009. 「Important Social and Economic Index」, Directorate-General of Budget, Accounting and Statistics.

most 2.3% of China's total exports.

East Asian economies, including that of Taiwan, have been seen to be growing increasingly interdependent over the past two decades. The ECFA *per se* is a kind of FTA, a preferential agreement, resulting in "trade diversion" and bringing Taiwan economically closer to China. That said, the concept of economic interdependence could be conceptualized into two ways (Keohane and Nye, 1977). It could mean "sensitivity interdependence," that is, changes in prices and quantities in different national markets respond readily to one another. Alternatively, economic interdependence could also refer to a power relationship, to what Hirschman [1945] (1980) calls "vulnerability interdependence," which is concerned with the use or threatened use of power as a source of influence.³⁴

To a certain extent, China's engagement of Taiwan fits well with Germany's trade relationships with its smaller European neighbors, particularly Bulgaria, in the interwar period. Hirschman [1945] (1980) argues that a dominant country seeks to cultivate interdependence with smaller countries by granting them trade preferences as a means to exercise greater influence in the future. Once dependency is established, a second application of discrimination then becomes possible, allowing the dominant territory to dictate additional terms by exercising, or threatening to exercise, the option to terminate the preferential bilateral trade agreement (Mathis, 2002).

It sometimes happens that a small country must submit to hegemony to attain peace. In the case of the cross-straits EFCA, it is very likely that China will leverage Taiwan's "asymmetric interdependence" to suppress its sovereignty.

Waiting for FTAs

The worst case scenario would be a situation in which Taiwan were still unable to sign FTAs with its major trading partners after signing the ECFA.

East Asian regionalism has not only opened a channel for China to participate in East Asian economic cooperation, it "inadvertently" gave China a new tool with which to

³⁴ See Gilpin (1987) and Cooper (1985).

suppress Taiwan’s position in international politico-economic arena, and block Taiwan from joining international organizations, resulting in a “cumulative isolation” effect (Lampton, 2008). Taiwan has been excluded from the “spaghetti bowl” proliferation of regional trade agreements in East Asia, where the prevalence of regionalism has pushed Taiwan into signing the ECFA with China. The fear of being marginalized in the trend of regionalism in East Asia has induced Taiwan and its private sector to join existing or developing economic alliances and instilled in them the resolution of “compliance.” In this regard, China has impeccably carried out its economic strategy against Taiwan – relying on economic means to achieve its political ends.

The reasons that Taiwan suffers from “marginalization syndrome” are listed below. Regionalization in East Asia is leading to closer economic and trade relations, and the exclusion of Taiwan from that process would impose considerable costs with potentially dire consequences. Taiwan previously faced marginalization on the political and diplomatic fronts, but with the emergence of regionalism, the specter of being marginalized in global economic and trade issues is particularly evident.

In its pursuit of the ECFA, Taiwan has been motivated by positive incentives to exploit the Chinese market, while being compelled by negative incentives (the degree between coercion and imposition) that see it marginalized if it does not sign the ECFA.³⁵ However, as Krasner (1999) has noted, national welfare is reduced by either coercion or imposition, that is, acting on a negative basis rather than freely choosing to follow this course on the basis of self-interest, as illuminated in Table 5.

Table 5 Modalities of Compromise

		Pareto Improving	
		Yes	No
Contingent	Yes	Contract	Coercion
	No	Convention	Imposition

Source: Krasner (1999), *Sovereignty and Its Discontent*.

³⁵ In the face of coercion by a strong nation, a weak nation can decide whether or not to engage in trade agreements. In the case of an imposition, a weaker nation has no option but to comply with the preferences of the stronger nation.

China has said that it will make “proper and reasonable” arrangements for Taiwan to strengthen its international position under the “one China” principle after the ECFA is in place. As expected, Taiwan and Singapore have recently announced a plan to explore the feasibility of bilateral economic cooperation on par with a free trade agreement, however, it is generally agreed that Beijing will not allow Taiwan to seek FTA negotiations with the US, Japan, the EU, or ASEAN as a whole.³⁶ If this proves to be the case, the benefits the ECFA would provide Taiwan would need to be re-evaluated when the factors related to the mobility of production (such as labor and capital) are taken into account.³⁷

Worse, such a situation might cause Taiwan to fall into a “hub-spoke” trap, with China being the hub and Taiwan the spoke, which would drain additional capital and other economic resources from Taiwan into China.³⁸ For example, a local business, which could expand its operations in Taiwan, might instead decide to install more assembly lines in their Chinese affiliates or move the entire operation to China because products made in China at that time would enjoy greater market access than if it were located in Taiwan. In other words, the ECFA would benefit enterprises looking to relocate to China.

5. A Comparison of ECFA and CEPA

5.1 Background

Immediately after its accession to the World Trade Organization (WTO) in December 2001,

³⁶ Director of Institute of Taiwan Studies, the Chinese Academy of Social Science, Yu Keli, whose remarks are often seen as symbolic of the Chinese government’s attitudes, has said clearly that signing the ECFA does not mean clearing the way for Taiwan to seek closer economic ties with other economies. He said that the signing of the ECFA would create favorable conditions for Taiwan to economically cooperate with member states of ASEAN, but this does not mean that Taiwan would be able join the ASEAN or its affiliated agencies. ECFA to be signed this year at the earliest or next year at the latest , Commercial Times, 2009.10.28.

³⁷Due to the ever-escalating degree of cross-strait economic integration, factors of production become more mobile than ever. This would gradually integrate economies of both sides of the strait into “one region,” and consequently “dynamic” areas would be able to absorb most resources and become economic hubs, while other places could become economic “desertification.”(Capello, 2007) The traditional comparative advantage theory will be gradually replaced by absolute advantage theory. What is worse is that it’s easier for factors of production (labor and capital) in Taiwan to move to China, than vice versa, because the impacts on national security of inflows of Chinese capital and labor are still issues of concern to Taiwan side. Therefore, the above-mentioned disadvantages could happen to Taiwan after its economy is closely integrated with China.

³⁸ See Schiff and Winters (2003).

China adopted a regional trade strategy. China has concluded six free trade agreements, two Closer Economic Partnership Arrangements (CEPAs) with Hong Kong and Macau in 2003 respectively (Yunling Zhang, 2010),³⁹ and Economic Cooperation Framework Agreement (ECFA) with Taiwan in 2010.

The ECFA has been often compared with the CEPA, mainly for the public's suspicion that whether signing the ECFA will drop into the trap of "one country, two systems"⁴⁰ that has been confirmed in CEPA.

From the political perspective, Hong Kong is a semi-autonomous, special administrative region of China. In contrast, Taiwan enjoys its "de facto" independence while regarded by China as a "renegade province".

As to the economic structure, Hong Kong's economy has moved away from manufacturing and is now services-based. The services industry in Hong Kong comprises 92.6 % of GDP in 2009. The region is a major corporate and banking centre as well as a conduit for China's burgeoning exports. Though the services in Taiwan amount nearly to 70% of GDP, its manufacturing plays a vital role in the economic activities as a percentage of 24%.

The main contents of CEPA are as follows:⁴¹

³⁹ Beijing and Hong Kong originally signed this trade accord in 2003 after the Sars epidemic had left Hong Kong's economy in the doldrums. A China-Macau CEPA was signed in 2003 after the model of the China-Hong Kong CEPA.

⁴⁰ The former British colony became a special administrative region of China in 1997, when Britain's 99-year lease of the New Territories, north of Hong Kong island, expired. Hong Kong is governed under the principle of "one country, two systems", under which China has agreed to give the region a high degree of autonomy and to preserve its economic and social systems for 50 years from the date of the handover. See "**Regions and territories: Hong Kong**", http://news.bbc.co.uk/2/hi/asia-pacific/country_profiles/3650337.stm; **under such principle**, China controls Hong Kong's foreign and defence policies, but the territory has its own currency and customs status.

⁴¹ According to China's liberalization commitments under CEPA in services include the early liberalization of market openings already committed to under the WTO, in effect giving

- Hong Kong will continue to apply zero tariffs to all imported goods of Mainland origin.
- From 1 January 2004, the Mainland will apply zero tariffs to the import of 273 items of goods of Hong Kong origin.
- No later than 1 January 2006, the Mainland will apply zero tariffs to the import of remaining goods of Hong Kong origin.
- New supplement to the CEPA, first signed in 2003 and expanded each year, will increase the sectors open to Hong Kong investors on the mainland and all products of Hong Kong origin will be tariff free and Mainland will allow preferential treatment to Hong Kong suppliers in the service sectors. The total number of services sectors covered by the CEPA and its 7 supplements as of 2010 has thereby been expanded over 40.

In parallel to CEPA, China introduced an **Individual Visitors Scheme** allowing visitors from Guangdong province to visit Hong Kong for several days. The scheme was extended to inhabitants of all 21 cities of Guangdong and 9 other cities in Jiangsu, Zhejiang and Fujian province in 2004 (Dreyer et al., 2010).

In 2010, the number of Mainland tourists arriving into Hong Kong reached 22.7 million, accounting for 60% of all tourists – triple Hong Kong’s population.⁴² It’s believed that the economic benefits of tourists from Mainland China are greater than those of CEPA.⁴³

Hong Kong a time advantage over other economies. This time advantage ranges from one to four years, depending on the sector. Another type of preference under CEPA is the lowering of thresholds, facilitating the entry of small and medium-sized firms into the mainland in sectors including banking. CEPA also commits China to some preferential regulatory changes such as mutual recognition and an easing of pre-existing restrictions on Hong Kong professionals. CEPA also includes some new liberalization provisions that do not have counterparts in China’s WTO Protocol of Accession; for example, in the exhibition services and audio-visual sectors. See Enright et.al. (2005).

⁴² Mainland Tourists Tripling Size of Hong Kong Population, see http://www.chamber.org.hk/en/committees/committee_news_detail.aspx?cid=18&type=NewsAndEconomicUpdate&nid=1787 (accessed on 31 May, 2011).

⁴³ In 1995, only 4.5 million Chinese tourists traveled overseas. Ten years later, that number had rocketed to 31 million and continues to climb sharply. The World Tourism Organization

5.2 What makes a difference?

To compare ECFA and CEPA (See Table 6), we start from both the procedural and substantive issues in terms of WTO's relevant regulations since China, Hong Kong, and Taiwan are all Members of WTO.⁴⁴

Table 6: Comparison of ECFA and CEPA

	CEPA	ECFA
Principle/Model	“One Country, two systems”	Modeled on “China-ASEAN” Framework Agreement(2002)
1. Procedural issues	2003.06.29 by the Chinese government and Hong Kong (SAR) ; 2004.01.01 took effect and implemented	2010.06.29 by semi-official SEF (Taiwan) and ARATS (China); 2010.09.12 took effect, 2011.01.01 implemented.
A. Signatory subjects		
B. Notification	A joint notification on the CEPA to the World Trade Organization (WTO) on 27 December 2003; Provisions: GATT §24; GATS §5	”Early Announcement “ ⁴⁵ (2011.05.06) but not yet notified. GATT §24; GATS §5
C. Clause of Withdraw	No	Yes

estimates that the volume of Chinese travelers is expected to hit 50 million by 2010 and 100 million by 2020, making China the world's fourth largest source of outbound tourists. By comparison, 17 million Japanese traveled abroad in 2004 (Frost, 2008).

⁴⁴ The status of Hong Kong, Macau, and Taiwan is Separate Customs Territory in the WTO. The WTO officially refers to "Separate Customs Territory of [Taiwan](#), [Penghu](#), [Kinmen](#), and [Matsu](#)" as Taiwan.

⁴⁵ See WTO Procedures on RTAS, http://www.unescap.org/tid/projects/rtaap_transparency.pdf (accessed on 30 May, 2011)

2. Substantive issues

A. Market access	With "plan and schedule" Focus on services; Relatively strong/WTO plus	No "plan and schedule" except for the "early harvest"; trade-light, driving more by politics
B. Trade rules		
-trade remedies	No anti-dumping or countervailing measures but has safeguards	Under negotiation
-dispute settlement mechanism	Strictly speaking, "No" Or by the "Joint Steering Committee"	Under negotiation
-rules of origin	Liberal	Relatively Strict
C. Institutional arrangement	"Joint Steering Committee" Decision-making by consensus	"Cross-Strait Economic Cooperation Committee (CSECC) ; heavy in tasks but no clear rules for decision-making
D. Mutual recognition of qualifications	Yes	No

Source: by author

The CEPA was signed by the "governments" of China (Ministry of Commerce) and Hong Kong (SAR). As Hong Kong is a special administration region belonging to China, it is clearly that the CEPA is a domestic "arrangement" between central and local governments. Alternatively, the ECFA is an "agreement" despite signed by SEF and ARATS that both of them are semi-official institutes.

According to the rules of WTO, the notification will occur no later than the parties' ratification of the RTA or any party's decision on application of the relevant parts of an agreement, and before the application of preferential treatment between the parties (JOB (06)/59/Rev.5). China and Hong Kong (SAR) have submitted a joint notification on the CEPA to the World Trade Organization (WTO) on 27 December 2003. However, the notification of ECFA is late for the "early harvest" of preferential treatment between China and Taiwan has begun in January, 2011. Moreover, the ECFA stipulates that the two sides have the right to terminate⁴⁶ the deal in which the CEPA lacks in.

Regarding to the comparison of substantive issues, we discuss three dimensions, including market access, trade rules, and institutional arrangement.

Compared with the "WTO plus" of CEPA, the liberalization of ECFA is very partial or "trade-light". As mentioned above, the coverage and extent in goods and services of the ECFA is quite limited. Even if fully implemented, the early-harvest list which came into effect on Jan. 1 only accounts for about one-seventh of cross-strait trade. The most important thing to pay attention to is whether the two sides will allow further liberalization of "substantially all trade" as the WTO terminology is worded. However, the extent of the potential benefits and actual impact of the ECFA will depend on the results of subsequent negotiations.

Roughly speaking, both sides have market access each other in a reciprocal way. Alternatively, as Hong Kong is a well-known free port, suggesting that the CEPA is in effect unilateral "grants" by China to Hong Kong.

As for the trade rules, the CEPA specifies clearly that the parties will not apply the provisions of China's WTO accession that allow countries to (a) subject China to non-market economy status in the application of anti-dumping; and (b) impose special safeguards on all trade until 2012 and on textiles through 2008. Both sides eliminate the application of

⁴⁶ See <http://www.ecfa.org.tw/EcfaAttachment/ECFADoc/ECFA.pdf> (accessed on 2011.01.16)

anti-dumping measures or countervailing measures although they can apply safeguards (Lawrence, 2008). However, the potential use of safeguards must be previously notified and be accompanied by a consultation procedure. This makes little difference to Hong Kong since—unlike Taiwan—it has a vestigial industrial base (Dreyer et.al. 2010).

How to solve the possible trade disputes? The CEPA stipulates that both sides “shall resolve any problems arising from the interpretation or implement of the CEPA through consultation in the spirit of friendship and cooperation”, particularly by the institution arrangement of the “Joint Steering Committee” with officials designated by both sides which will make decision by consensus.

To avoid the “trade deflection”, all FTAs shall specify preferential rule of origins (ROOs), taking mainly the change in tariff classification (CTC) or/and regional value content (RVC). The CEPA (30%) has definitely more liberal ROOs than that of ECFA (40%, 45% or 50%) in terms of RVC.

As for the ECFA, a “Cross-Strait Economic Cooperation Committee (CSECC)” modeled on “Joint Steering Committee” has been established on 6 January, 2011. However, the CSECC differs from “Joint Steering Committee” mainly in the following aspects. First, the CSECC is given more tasks than that of “Joint Steering Committee”. It handles not only the further negotiations for market access, but also the trade rules, in particular the trade remedies and dispute settlement mechanism. However, there are no clear rules for the terms of operation and decision making of the CSECC. For example, the CEPA clearly defines the steering committees’ role using the word “including,” while the CSECC text says “including, but not limited to” — giving it almost no restrictions.

Second, CSECC handles disputes through cross-strait negotiation until the ECFA dispute settlement agreement is signed. Third, while there are temporary bilateral safeguards for the items on the early-harvest list, the related regulations are unclear until future agreement on trade in goods is completed.

The CEPA contains agreements on the mutual recognition of qualifications, highlighting the

possibility for Hong Kong professionals to take mainland examinations. In contrast, the ECFA does not cover mutual recognition of qualifications. Such kind of issues remains controversial in Taiwan despite recent thaw in ties with China.

6. Concluding Remarks

Since the ECFA is a trade deal, an FTA by nature, it has added regional and international aspects to the already complex state of cross-straits relations.

The rapprochement of Taiwan and China led to the signing ECFA in June 2010 and 14 other agreements related to functional issues since May 2008. However, the ECFA remains controversial and contains complicated economic and political implications

In a summary:

“Marginalization syndrome”

Taiwan has been excluded from the “spaghetti bowl” proliferation of regional trade agreements in East Asia, where the prevalence of regionalism has pushed Taiwan into signing the ECFA with China. Lampton (2008) was keen to describe it as “cumulative isolation” effect. So the ECFA is a not a fairy tale from the beginning.

China has said that it will make “proper and reasonable” arrangements for Taiwan to strengthen its international position under the “one China” principle after the ECFA is in place. However, Taiwan’s prospective FTAs with other countries for keep vague except for Singapore.

“Natural Trading Partner” leading to over dependence?

In addition, the Taiwanese government believes that a closer economic integration with the rising China through ECFA would enhance economic prosperity. One the one hand, the preferential nature of the ECFA might accomplish this goal. On the other hand, some opposes ECFA on economic grounds, fearing for vulnerable production an employment in Taiwan if the trade deal obliges the sectors to open to Chinese competition; and more importantly, the overdependence as a result of ECFA could do harm to Taiwan’s political status.

Of course, both the great expectation and the Angst of ECFA are based on the condition

that the liberalization agenda will be comprehensive.

“ECFA: A Pending Trade Agreement?”

As a matter of fact, ECFA is a “Framework Agreement” setting out the objectives and principles of the prospective negotiations plus “Early Harvest Program” with a list of limited products to apply preferential treatment.

According to this list which will be implemented in three phases over two years, China will lower tariffs on 539 items, accounting for 16.1% of China’s total imports from Taiwan. In contrast, Taiwan will cut tariffs on 267 manufacturing items, accounting for 10.5% of Taiwan’s overall imports from China. A limited number of services including banking services are also on the early harvest list.

This implies firstly that ECFA so far fall well below the standard of a serious FTA and it’s the potential economic benefits and the corresponding adjustment costs might not be validated. The economic impact of ECFA will depend on the outcomes of the subsequent negotiations. One of tough issues is that Taiwan has unilaterally adopted a trade policy of “discrimination” against China, banning more than 2,200 Chinese agricultural and industrial items (about 20 percent of Taiwan’s total imports) from importing.

So goes the argument that Taiwan might find it difficult to comply fully with the WTO rules imposed on developed members engaging in regional trade agreements, particularly the criteria of “substantially all the trade” (SAT) in products originating in the partner’s territory since there is no “plan and schedule” in the legal text of ECFA.

Without “plan and schedule”, ECFA stipulates only that the two sides shall conclude consultations on a goods related trade agreement “expeditiously (as soon as possible)” that might not be GATT and GATS-consistent.

“ECFA and CEPA”

In a report by the National Development and Reform Commission of China it was suggested that signing an FTA with Taiwan is an important strategy in the promotion of “national unification”, echoing the FTA strategy proposed by Hu, Jintao in 2007. Based on the

experience of signing the Closer Economic Partnership Arrangement (CEPA) with Hong Kong in 2003, the political authority of China was inclined to sign a PTA with Taiwan, to foster closer economic relations, and in turn political cooperation. The ECFA has been often compared with the CEPA, mainly for the public's suspicion that whether signing the ECFA will drop into the trap of "one country, two systems" that has been confirmed in CEPA. However, both sides of ECFA have market access for each other in a reciprocal way. Alternatively, as Hong Kong is a well-known free port, suggesting that the CEPA is in effect unilateral "grants" by China to Hong Kong.

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