Introduction

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Since the mid-1980s, East Asia’s dynamism has been characterized by a significant trade-investment nexus with active de facto economic integration within the region (Ozeki, 2008) and active participation in the global production network (Chow, 2012a). After the 1997–98 Asian financial crisis, the de facto economic integration led to the proliferation of regional trading arrangements and the emergence of trade blocs (Kawai and Wignaraja, 2009). In particular, the de facto economic integration between the two politically competitive regimes of China and Taiwan has stimulated much literature on trade and the political economy. China, rising as a powerhouse in the global economy, has inevitably affected its neighbors. But because Beijing’s claims of sovereignty overlap those of Taipei, China’s rise has had strong repercussions in the economic development and democratization of Taiwan.

On the one hand, Taiwan, having experienced an economic miracle between 1960 and 2000, as measured by an annual economic growth rate averaging about 7 percent, faces a strong challenge of industrial restructuring in its pursuit of globalization. China, as the second largest economy in terms of total GDP, is a market that none of its neighboring countries, including Taiwan, can ignore. On the other hand, the trade-investment nexus and the de facto economic integration across the Taiwan Strait, though it has reduced the political tensions between the two rival regimes, has made Taiwan’s trade dependency vulnerable to China. China’s leaders for generations have been claiming Taiwan as a renegade province, despite the fact that Taiwan has been a de facto independent country since before the establishment of the People’s Republic in 1949.

Deepening economic integration between China and Taiwan, though it has substantially reduced the mutual distrust between the Communists in China and the Nationalists in Taiwan, has not led to mutual recognition of each other’s existence in the international community.1 Several scenarios can be speculated about the developments from de facto to de jure economic integration between the two economies across the Taiwan Strait, because any form of ‘de jure’ economic integration
must be ‘a political establishment,’ as William Wallace (1982) argued decades ago. Essentially, mutual recognition among the signatories is the fundamental principle that underlies any trade pact. Despite the fact that both China and Taiwan are members of the WTO, many of the trade pacts signed by Beijing and Taipei after the Nationalist Party (Kuomintang) came back to power under the leadership of President Ma Ying-jeou in May 2008, notably the Economic Cooperation Framework Agreement (ECFA), are still not registered under the WTO trade framework. Whether the signing of the ECFA in June 2010 will lead to what the Ma administration has claimed will be determined by future developments.

This book is a collection of the wisdom of a group of scholars from the US, Europe, Taiwan, and Hong Kong who are experts on various subjects in economic integration across the Taiwan Strait and, to a greater extent, the emerging ‘Greater Chinese Economic Zone.’ Aside from political considerations for autonomous political sovereignty, this book addresses the extent to which an integrated economy between China and Taiwan will affect various sectors of the economy such as the high-tech industry, banking, the financial markets, and industrial clusters. It then analyses those developments in the greater context of regional economic integration in East Asia.

In Chapter 1, Richard C.K. Burdekin, Yijing Shen, and Hsin-hui I.H. Whited address the historical perspective on the economic interactions and present some empirical evidence of the ongoing economic integration. Cross-Strait economic ties have developed rapidly since Taiwan’s government announced a policy of non-interference with indirect exports to the mainland in 1985. China quickly adopted new measures to attract Taiwanese investment, including the setting-up of two special economic zones in Fujian province in May 1989 that offered special tax privileges for Taiwan-invested enterprises. Despite the disallowance of direct trade links, China became Taiwan’s second largest export market by 1993 and has been its top export market since 2002. Taiwan’s overall positive trade balance in recent years has, in fact, been very much dependent upon its surpluses with China. Officially-reported figures continue to understate the importance of the Cross-Strait economies ties, however, by failing to fully account for re-exporting from Taiwan to China via Hong Kong and also by ignoring substantial Taiwanese investment via holding companies in tax-exempt areas like the British Virgin Islands and the Cayman Islands. In this chapter, the authors detail the evolving economic ties between China and Taiwan and provide an up-to-date picture of the trade and investment flows between the two economies.

Moreover, macroeconomic interdependence between China and Taiwan
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is assessed in terms of an array of output, price, money, stock market, and interest-rate measures for each economy. This enables the authors to determine the extent to which the trade and investment nexus has been reflected in measurable economic symbiosis. The transmission of money supply movements across the Taiwan Straits is perhaps the most striking feature of the econometric analysis and is evident in both the Ganger-causality testing and the co-integration analysis. Such interdependence suggests possible gains from monetary policy coordination. Whereas recent initiatives have led to a valuable easing of the impediments to trade and investment flows between China and Taiwan, this has not so far extended to any formal cooperation in the monetary policy arena. The chapter’s empirical findings suggest that, even if actual monetary union between China and Taiwan remains out of the question for the foreseeable future, simply taking the effects of money supply movements on the other side of the Taiwan Straits into account when setting policy could be beneficial for the central banks of both China and Taiwan.

Will the ECFA become a trade pact under the WTO framework or one with unique ‘Cross-Strait characteristics?’ In Chapter 2, Yun-Wing Sung compares the two trade pacts signed between China–Hong Kong and China–Taiwan. The Closer Economic Partnership Arrangement (CEPA) between China and Hong Kong, and the ECFA between China and Taiwan are landmarks in the history of free trade agreements (FTAs). The economic integration of the Chinese Economic Area (CEA), which has developed rapidly since the opening of China in 1979 and was arguably market-driven initially without much governmental coordination, soon called for more formal coordination that cumulated in the CEPA and the ECFA.

This chapter covers the events leading to the CEPA and the ECFA, and their provisions in terms of market access for goods and for services. Sung examines the economic impact of the two agreements on trade in goods and services and on bilateral investments in the CEA. The CEPA and the ECFA are also compared in terms of legal issues such as intellectual property protection, dispute settlement mechanisms, and compliance with the WTO framework. In particular, the chapter examines the impacts of the ECFA and the opening of Cross-Strait direct links on Hong Kong’s position as an intermediary in Cross-Strait trade, investment, shipping and passenger traffic.

Besides economic factors, political considerations are always important in FTAs. The chapter covers the impacts of the two agreements on the relations of Hong Kong and Taiwan with China as well as with other economies outside the CEA, focusing on the efforts of Hong Kong and Taiwan to cultivate FTAs with other economies. Lastly, it discusses the
prospects of a pan-CEA FTA and the future of the two agreements in the context of the rivalry between the US-backed Trans-Pacific Partnership (TPP) and the China-centered network of East Asian FTAs.

Fragmentation of the manufacturing production process becomes prevalent in the drive for globalization. Cross-border production at different stages of the manufacturing process is especially significant in the information and communication technologies (ICT) industry. Will sector integration with China benefit Taiwanese firms? In Chapter 3, Winston T. Lin analyses with rigorous econometric methodology whether Taiwan’s investment in the ICT sector in China has generated benefits. Based on the theory of production, Lin’s research proposes to answer the critical question of whether the integration of the ICT investments of Taiwan and China has positive effects on productivity and economic growth in Taiwan. Lin applies a two-stage sequential procedure consisting of: (i) the two-equation time-varying stochastic production frontier approach derived from the theory of production and the productive efficiency derived from the frontier approach as the performance metric (Stage 1); and (ii) the concept of total factor productivity or Malmquist productivity index (Stage 2). Having followed the two-stage process, the study fits a panel data-set covering the period from 1990 to 2010 into four with the proposed models. Empirical evidence from Lin suggests that the answer to the research question is negative. Lin’s contributions in this chapter will offer important implications for firms from Taiwan as well as policymakers in mapping out the globalization strategy.

Economic interactions across the Taiwan Strait are not limited to the trade-investment nexus but also extend to the service sector. In Chapter 4, Hong-Jen Abraham Lin addresses the banking sector. He begins by reviewing and summarizing the literature on Taiwan and China’s commercial banks. Furthermore, based on the experience of geographic deregulation on the European continent and in the US, he discusses the trends of integration after Taiwan and China signed the ECFA.

From the existing literature of empirical studies on cost and profit efficiencies of the banking industry, the author has found that a scale economy is not the motivation for Taiwanese and Chinese banks to expand. No evidence implies that the acquisitions of banks could help major banks in either Taiwan or China to improve cost and profit efficiencies. In the experience of China, the gain from improved cost efficiency is mainly caused by minor foreign ownership and outside monitoring. The banking markets in the European Union and most of the states of the US are monopolistic competitive after deregulation and integration. Thus, the banking markets of Taiwan and China are expected to be monopolistic competitive after integration. Henceforth, when the banking industry is
monopolistic competitive and the equity market is well developed, quality of services or relationships is the key to success for the integration of the banking industry across the Strait.

Financial integration accelerated after the Uruguay Round of trade liberalization. How extensive is the integration of equity markets in the ‘Greater Chinese Economic Zone?’ Wan-Jiu Paul Chiou, Chun-Pin Hsu, and Chin-Wen Huang study the equity markets of China, Hong Kong, and Taiwan in Chapter 5. Due to continuing wealth accumulation and economic integration in the region, understanding the development and cost–benefit of international diversification in China, Hong Kong, and Taiwan is an indispensable element of global asset management. The effectiveness of international diversification has been well documented in developed economies. However, the potential economic value of international diversification to investors in developing countries has not yet received the attention it deserves from academia. China, Hong Kong, and Taiwan differ especially from other emerging economies in terms of the development and interactions of their financial markets. Since the late 1980s, there has been increasing economic integration between China and Taiwan. China, with its swiftly growing economy and its substantial role in the global production network, drives the economy of East Asia, particularly the ‘Chinese region,’ within which countries are increasingly interdependent. On the other hand, the dynamics of economic interdependence in this region have been accompanied by periodic military and political tensions. Thus, several critical issues emerge. How would international diversification benefit local investors in the Sino market? Would the benefits of the regional diversification vanish in their home area? Would the economic values generated by the internationally diversifying portfolios shrink as the economy was increasingly integrated? If the benefits still existed, how would the effectiveness with respect to local investors diverge across China, Hong Kong, and Taiwan? Because of China’s rising economic importance and wealth accumulation, an understanding of diversification strategies and cost–benefit analysis in this Chinese-cultural region has become an indispensable element in global asset management.

In this chapter, the authors first present the development of the economies and equity markets of this region and show that economic integration is associated with Taiwan’s investment in China. They then discuss the roles of these countries in the international optimal portfolio. Using the mean-variance efficient frontier proposed by Markowitz, they analyse the benefits of international diversification from the perspective of local investors. The empirical findings suggest that the domestic investors, particularly those in Hong Kong and Taiwan, will benefit more if they consider diversifying their portfolios with the assets of developed countries.
in outside regions. The time-varying benefits of diversification exist even when the economy in this region is increasingly integrated. The same conclusion holds when various levels of home-bias are considered.

During recent decades, after piling up its foreign exchange reserves, China began to engage in outward foreign direct investment (FDI), including mergers and acquisitions. In Chapter 6, Monica Yang presents an analysis on cross-border mergers and acquisitions (CBMAs) made by China in Taiwan. According to *World Investment Report* (UNCTAD, 2010), emerging and transition economies accounted for a quarter of global FDI outflows in 2009. Take China as an example: by 2009, its outward FDI reached US $229.6 billion, an eight-fold increase over the year 2000 (UNCTAD, 2010). Sixty-two percent of China’s outward FDI in 2008 was in the form of CBMAs (MOFCOM, 2008). Although emerging market firms have assumed a critical role in outward FDI, prior management literature has not given sufficient attention to these firms. Yang proposes two main questions in this chapter: what is the composition of CBMAs initiated by China in Taiwan from 1997 to 2010, and what is the major motivation for these CBMAs? Yang focuses on CBMAs by China in Taiwan because Taiwan, with its unique political and economic background, can provide an understanding of how emerging market firms (for example, in China) undertake international expansion strategies in emerging markets. The observation window of this study, 1997 to 2010, allows one to observe Taiwan’s attitude toward CBMAs from China from closed to open. Yang specifically examines ninety completed CBMAs (twenty initiated by China and seventy by Hong Kong). Her findings show that the number of CBMAs increases over time despite the fact that the Taiwan government holds restrictive policies toward direct investment from China. Moreover, target firms are primarily from the financial sector, service, and manufacturing industries. Acquiring firms from Hong Kong are more willing to undertake unrelated deals than those from China. Finally, the major payment method in these deals is cash-only.

This chapter also has several implications for Taiwan and China. First, in terms of the number of CBMA deals from China and Hong Kong between 2008 and 2010, the Taiwanese government’s positive attitude toward direct investment from China did not stimulate more CBMA deals. Therefore, if this trend continues, this finding will alleviate some concern that more Taiwanese firms will be merged with or acquired by Chinese firms after recent economic policy changes like the signing of the ECFA. Second, compared to the number of CBMAs by China in other countries, Taiwan is not a major target for Chinese firms. However, the motives behind those CBMAs from China are very similar to those by China in other developed markets (such as the United States and
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European countries). When developed markets like the USA and the UK continue to raise security concerns over Chinese CBMA proposals and reject them (for example, the 3Com–Huawei merger in 2008 or the Huawei–Marconi merger in 2005), Taiwan may become an important target market for Chinese firms that want to obtain critical implicit assets (for example, brand name, management or marketing knowledge and skills). The Taiwanese government thus needs to prepare and consider how to manage these types of CBMA deals in the future.

While many multinational enterprises (MNEs) make direct investment in China, not all of them can successfully penetrate China’s domestic market. China’s ‘socialist market economy with Chinese characteristics,’ which is predominated by party–state rule of man rather than being ruled by law, caused many hazards for many MNEs in their efforts to penetrate China’s domestic market. In Chapter 7, Chen and Hsieh analyse the strategic alliance between Japanese and Taiwanese firms by classifying them into various formats such as joint ventures, original equipment manufacture (OEM), and technological cooperation. They discuss how various formats of strategic alliances could complement their comparative advantages in the Chinese market, and how business enterprises between Japan and Taiwan could collaborate with each other on respective exports to China.

Their study focuses on the information technology (IT) industry by comparing Japan–Taiwan strategic alliances with non-allied Taiwanese enterprises in terms of operating performances. It provides a better understanding about the market competitiveness of Japan–Taiwan strategic alliances. The authors examine strategic alliances by questionnaires to study Taiwanese enterprises located in Kunshan city and Dongguan city as a case study, then proceed to survey the results with regression analysis. The results show that those firms which acquired technologies through strategic alliance or technical cooperation performed better than the non-allied ones. And the longer the cooperation duration was, the more productive it would be for their performance. The finding contributes to important information in international management and may offer some lessons for other multinational enterprises interested in exploiting the Chinese market.

Due to agglomeration effects, Taiwanese investment in China has generated several industrial clusters in China, especially in the Yantze River Delta and the Pearl River Delta. By using the concept of global production network, Chen and Ku study the rise and evolution of the Kunshan ICT cluster in the Jiangsu province of China in Chapter 8. They attribute the rise of Kunshan to three advantages: geographical proximity to Shanghai, a set of local institutions that are loosely coupled with national
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institutions, and an intimate connection to Taiwanese multinational corporations (MNCs). They highlight the interactions between local institutions and Taiwanese MNCs under a global production system. Essentially, Kunshan offered a set of investment-friendly institutions that allowed Taiwanese MNCs to reconstruct their production networks so as to cope with the changing conditions in the global ICT industry. These conditions, which began in the mid-1990s, necessitated more concentrated, more flexible, faster, and larger-volume production. The emergence of Kunshan created a cross-border linkage between ICT clusters in Silicon Valley in California, Hsinchu in Taiwan, and Kunshan in China. With this triangular connection, Taiwanese firms in Hsinchu Science Park were able to upgrade their position in the global production network.

Among the high-tech industries, semiconductor production is one which has dual usage for civilian and military purposes. In general, the semiconductor industry consists of three or four major stages – design, fabrication, testing, and assembly and shipment – with various factor intensities at each stage. With globalization, these production stages became fragmented across national boundaries in accordance with the comparative advantages of the host countries. In Chapter 9, Ming-chin Monique Chu addresses the subject by examining that industry’s linkage between China and Taiwan. The territorial distribution of semiconductor manufacturing activities across national borders, often as a result of pertinent sectoral globalization, can potentially change the international balance of economic and military powers. This chapter adopts a firm-level case-study approach in order to conduct a nuanced analysis of one aspect of the sectoral globalization in the Cross-Strait context, namely the under-studied migration of the strategic Taiwanese semiconductor sector to China. Eight cases in integrated circuit (IC) design and fabrication are analysed. It is noteworthy that the author conducted more than 160 rounds of interviews with officials and industry insiders in the US, Taiwan, and China between 2004 and 2005 as well as in 2009 for her research project. In particular, senior executives at seven out of the top eight chip makers in China and Taiwan were interviewed. The conclusions are twofold. First, some non-state actors spearheading the migration have done so by circumventing or violating Taiwanese regulations, thereby eroding the capacity and autonomy of the Taiwanese state vis-à-vis non-state actors. Second, case analyses indicate a gradual shift in IC design and fabrication capability from Taiwan to China. Given the dual-use nature of semiconductors, such a trend is expected to contribute to the growth of China’s comprehensive power and security, to the detriment of Taiwan’s long-term survival.

The last chapter, written by Peter C.Y. Chow, addresses the emerging
trade bloc and economic integration across the Taiwan Strait from both regional and global perspectives. The ECFA was signed just as FTAs were proliferating and economic integration was unfolding in East Asia. To some extent, the emerging trade bloc and the ‘Greater China Economic Zone’ can be considered as a subset of regional economic integration in East Asia. Chow points out that, unlike in the European Union, which is mainly based in intra-regional trade among member states, countries experiencing economic integration in East Asia rely heavily on external markets, mainly the US and EU, to sell their final products. The worldwide economic recession of 2007–2008, triggered by the global financial crisis, offered two important lessons for trade-dependent economies in East Asia: that economic integration through the trade-FDI nexus on only the production side is not durable, and that creating a trade bloc dependent on external markets as destinations for exports of final consumption goods is not sustainable. To rebalance the global economy, East Asian countries would need to redirect their exports to alternative markets, a process which will not be feasible in the near future.

Having examined the trade structures of the economies of East Asia and the OECD, with a focus on the US, Chow applies the hub–spoke model à la Krugman–Baldwin to identify three potential hubs – that is, the China-centric, Japan-centric and US-centric hubs – for the economic integration of East Asia. Chow analyses Taiwan’s policy options and its future in pursuing globalization, and he strongly advocates that Taiwan not limit itself to the China-centric hub. Instead, Taiwan needs to sign bilateral and multilateral FTAs to reach the ‘near-hub’ status. Especially important for Taiwan’s development is to join the Trans-Pacific Partnership Agreement to expand its international horizon and to diversify its current trade dependency on the single market of China. Other than the cost–benefits of economic integration, Taiwan’s success or failure in its pursuit of globalization has strong political implications for its political autonomy, which will significantly affect the growth, stability and balance of power in the Asia-Pacific region. As Taiwan is an emerging young democracy, future relations between Taipei and Beijing will affect the trend of global democracy as well.

NOTES

1. For the topics of economic interests and national identity, see Chow (2012b).
2. Taiwan sent an ‘early announcement’ of the ECFA to the WTO 8 months after it took effect – see Taipei Times (2011). But early announcement is not an official registration as required by the WTO.
REFERENCES


