

AEC, ECFA and Vietnam-Taiwan Economic Relations

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In the last two decades, as the center of the world's economy has shifted to the Asia-Pacific region including over 20 economies and its GDP in 2010 reached 17.7 trillion USD surpassing the world's two largest trade blocs namely the North American Free Trade Agreement (NAFTA) and the *European Union* (EU), the process of the trade liberalization and regional economic integration has also been booming in the two following directions:

i) The Bottom-up direction with the formation of production networks and supply chains connecting firms to markets. The evidence is that the trade in intermediate and semi-finished goods accounted for 65% total trade value of the economies in this area. These supply chains have been growingly directing at the consumer markets in the region instead of mostly focusing on other market such as the U.S. and EU markets as before, the intra-regional trade taking account of 63.9% the whole region's total trade surpassed that of the North American Free Trade

Agreement (40%) and of the *European Union* (53.2%)¹.

ii) The Top-down direction with the lifting of barriers restricting the movement of production factors, and the formation of free trade areas as well as economic communities or other various association forms among the economies. According to the Asian Development Bank (ADB), the economies in the whole region have currently taken part in 220 free trade agreements (while there were only 54 agreements before 2000), in which there are 115 signed agreements with 58 ones only within the countries in this region, and there are 48 agreements under negotiation and 49 agreements in the form of feasibility study².

As the important economic partners of each other, Vietnam and Taiwan does not stand outside that general trend. Within the last decade, two economies made a great attempt to

¹ Makoto Shiota (2010).

² Chia S.Y. 2010, Regional Trade Policy Cooperation and Architecture in East Asia. ADBI Working Paper 191. Asian Development Bank Institute.

participate in the international economic integration process.

- Vietnam signed the Economic Partnership Agreement with Japan (VJEPA), and the Trade and Investment Framework Agreement (TIFA) with the United States; Vietnam is also negotiating a free trade agreement with the EU and the Trans-Pacific Strategic Economic Partnership Agreement with the United States and other several economies; Vietnam joined 6 multilateral FTAs, namely the ASEAN Free Trade Area (AFTA) which will be upgraded to the ASEAN Economic Community (AEC) by 2015 and 5 FTAs between ASEAN and China, Japan, South Korea, India, Australia-New Zealand, and the WTO.

- Taiwan also jointed the WTO, signed FTAs with the Latin American partners viz. Panama, Guatemala, Honduras, Nicaragua, El Salvador, and the Economic Cooperation Framework Agreement (ECFA) recently with mainland China which is actually an “FTA-”. Besides, Taiwan started discussing the possibility of signing a bilateral FTA with Singapore.

How will the integration of these two economies into almost non-intersected economic spaces affect Vietnam-Taiwan economic relations? This paper will analyze the impacts of two main regional integration processes, namely the formation of the ASEAN Economic Community and the signing of the Economic Cooperation Framework Agreement between two

sides of Taiwan Straits on Vietnam-Taiwan economic relations.

The core of AEC is the ASEAN Free Trade Area (AFTA). Shortly after ASEAN announced the establishment of AFTA in 1992, Taiwan’s Ministry of Economic Affairs and other Taiwan’s research organizations such as Chung Hua Institution for Economic Research (CIER), Taiwan Institute of Economic Research (TIER), etc. evaluated the risk of Taiwan’s being isolated from the process of economic integration in East Asia. In the context that, on the one hand, Taiwan has been growingly narrowed its external space and extremely sensitive to international issues; and on the other hand, the process of Taiwan’s economic structure shift has been done in the direction of services, and its labor cost has become increasingly less competitive, as well as a no less important factor is the appreciation of the New Taiwan dollar against the U.S. dollar since the second half of the 1980s, Taiwan has been put under pressure of strengthening the expansion of external markets for Taiwanese enterprises’ goods and investment capital. This has prompted Taiwan to issue its “Go South” policy with the aim of tightening closer economic-trade-investment relations between Taiwan and Southeast Asian countries as well as strengthening Taiwanese businessmen’s confidence, including a series of measures such as enhancing the bilateral channels, supporting the trade and investment promotion activities, establishing special task groups to promote its

trade and investment with Singapore, Philippines, Indonesia, and Vietnam³. The “Go South” policy generated a climax in signing a series of trade and investment agreements, avoiding double taxation, simplifying customs procedures, boosting cooperation in the fields of agriculture, science and technology, tourism. Simultaneously, this has facilitated the quick development of trade and created a new wave of investment from Taiwan to Southeast Asia, especially in labor-intensive industries such as textiles, leather and shoes, so forth which Taiwan has been losing its comparative advantage.

In reality, in spite of the agreement on AFTA with the roadmap to implement the tariff reduction (CEPT: Common Effective Preferential Tariff), the integration process of ASEAN members took place rather slowly, many non-trade barriers were not removed, the proportion of the intra-regional trade and investment remained low and made no significant improvement during the 1990s and early 2000s⁴. Moreover, the Asian financial crisis of 1997-1998 made many ASEAN core members such as Thailand, Indonesia, and Malaysia weakened, and let the regional integration dynamics fall. Many members individually seek other trade and investment agreements with other partners

outside ASEAN, which are mainly the major economies including China. Hence, the impact of AFTA on the economic relations between Taiwan and ASEAN in general, and Vietnam in particular is not significant.

After achieving WTO accession agreement, China actively promotes the East Asian economic integration. In April 2002, ASEAN agreed with China to establish the China-ASEAN Free Trade Area (CAFTA) which comes into effect from January 2010. The effect of this agreement took place very quickly: China in turn surpassed Japan, EU, and US to become the largest trading partner of ASEAN.

The CAFTA once again put new pressure on Taiwan. The Taiwanese have been concerned that their economy will be isolated, the supply chains led by Taiwanese corporations will be broken, and Taiwan will lose its comparative advantage as well as its market shares in both mainland China and ASEAN. In response, Taipei launched its second “Go South” policy. This second “Go South” one focused on the measures supporting trade and investment such as the promotion of opening Taiwan’s bank branches, the establishment of business-to-business channels, the construction of web pages providing information about the business environment. A specially important point of this second policy is based heavily on the provisions of the WTO that both Taiwan and mainland China joined in 2001 so as to seek opportunities of signing bilateral FTAs with Southeast Asian

³ In 1995, Vietnam became the seventh member of ASEAN and simultaneously participated in AFTA with the extension period lasted until 2006.

⁴ The intra-regional trade still remains at just 25% of total ASEAN trade. The intra-regional investment is only 15% of total FDI inflow to ASEAN on average.

partners, especially Singapore. India has been also brought into focus as a partner to promote strong relationship. Besides, Taipei has placed a focus on fostering “track two” activities such as cultural exchanges, academic and educational exchanges, non-governmental organizations, religion, and so forth. These activities help to maintain the economic, trade, and investment relations between Taiwan and ASEAN partners. However, the growth rate of the trade and investment between Taiwan and ASEAN in general and between Taiwan and Vietnam in particular are respectively lower than that between China and ASEAN as well as between China and Taiwan. Especially, China-Taiwan relations received a very powerful push when both joined the WTO in 2001 which caused Cross-Strait trade and investment to soar (Figure 1) because tariff barriers were diminished, along with restrictions on Cross-Straits direct Air and Shipping services were gradually removed. Even the flows of Taiwan’s trade and investment tend to gravitate towards mainland China.

The competition of the regional integration enters into a drastic stage. Because the competitive advantage of ASEAN lags behind China, in 2003, ASEAN in turn had to push the intra-regional integration process to higher economic unity extent - establishing the ASEAN Economic Community (AEC) in 2015 in order to enhance the competitiveness, improve the bargaining position through accelerating the integration, and create the advantage of scale for

the purpose of not sinking into the influence of fast-growing giant partner namely China. The AEC is a higher development step than the ASEAN Free Trade Area (AFTA) through the two directions of the unification extent: unifying the markets and consolidating the manufacturing facilities under the motto of “a single market and production base”. The main measures that ASEAN will need to implement to establish a single ASEAN market consist of harmonizing of product standards and regulations; settling customs and trade procedures faster; completing the rules of origin, especially the provisions for allowing free movement of high-skilled labor and freer movement of capital. The measures for establishing a single production base are mainly based on strengthening the regional production network through upgrading and interconnecting the infrastructures, especially in the fields of energy sector, transportation, information technology and telecommunications. The first step of the AEC blueprint is to implement the ASEAN Framework Agreement for the Integration of Priority Sectors – eliminating tariffs 3 years earlier than the Common Effective Preferential Tariff (CEPT) for 12 priority sectors⁵

⁵ Including 7 manufacturing industries namely agricultural products, fisheries, rubber products, wood products, textiles, electronics, automobiles, and 5 service industries viz. aviation, e-commerce, health services, information technology and logistics. Brunei, Indonesia, Malaysia, Philippines, Singapore, and Thailand will reduce tariffs on products of the 12 priority sectors to 0% in 2007, while the extension time for the other ASEAN members will be in 2012.

to create a breakthrough and generate spill-over effect to other sectors.

As for Taiwan, the studies done by some Taiwanese scholars such as Tu Chaw-Hsia (2007), Chen Hurng-Yu (2007), etc all show that the economic impacts of the AFTA and AEC, even if successful, on Taiwan's economy is relatively small. Thus, Vietnam-Taiwan economic relations will be not much influenced by these regional integration mechanisms.

In the 2000s, Korea, Japan, Australia and New Zealand, and India in turn signed FTAs with ASEAN, which forms a dense network of "ASEAN+1" FTAs in the ASEAN-centered direction(Figure 2).

Ye Yi-Lun (2008) calculated that the impact of CAFTA (ASEAN+China) is relatively small, which makes Taiwan's real GDP decline by 0.151%, commercial conditions decrease by 0.256%, and total products go down by 1.24 billion USD. Nevertheless, the bigger danger is that Taiwan will be isolated from the economic unity process in East Asian once FTAs between ASEAN and Japan, Korea, India, Australia and New Zealand come into effect.

Simultaneous with the process of ASEAN-centered integration in East Asian; in Northeast Asia, China-South Korea-Japan Tripartite Summit mechanism was set up in 2008, in which one of its main objectives is to foster the signing of the tripartite FTA.

Under these circumstances, the Ma Ying-jeou Administration changed the strategic

priorities of integration – shifting to first improving Cross-Strait relations as a base of expanding its external space, consisting of signing FTAs with other partners. The signing of the ECFA with mainland China in June 2010 as an "FTA-" has upgraded the process of Cross-Strait economic integration to a new level.

According to Peterson Institute, as of late 2009, the Chinese market attracted over 80% of Foreign Direct Investment (FDI) abroad, which is around 103 billion USD but actually is about 150 billion USD, of Taiwan's total investment capital abroad of 175 billion USD with more than 70,000 Taiwanese firms, taking account of 15-17% of total FDI in China. Taiwan's exports are also shifted towards increasingly focusing on the Mainland market, which accounted for 59.78% of total export turnover at the end of 2009, while the export proportion decreased in the traditional key markets such as the U.S. and Japan market. The ECFA agreement will certainly further accelerate this trend, stronger connecting the supply chains of Taiwan's firms with the Mainland market.

Nevertheless, the ECFA will also pose growing challenges for Taiwanese businesses in spite of many Taiwanese enterprises having their currently certain competitive advantage in the Mainland market. The discussion between the author and many Taiwanese scholars suggest a "dilemma" situation which can be compared with "Siberian dilemma". This means that while taking the advantage of penetrating into the

massive-scale market as China, the competitiveness of Taiwanese businesses can be falling by degrees⁶, since the higher chains in the supply chains have to shift to the Mainland where there is the very high possibility of “catching-up” and imitation.

Since the mid-2000s, the “China+1” trend has occurred in the investor community due to their concerns of “put all your eggs in one basket” – too emphasized Chinese market as this market shows some signs of moving towards “Lewis turning point” (Lewis’s point) i.e. wages begin rising faster than labor productivity. The tightening of the regulations on the standards of technology and environment, as well as the trend of China’s currency- Renminbi appreciation, and so forth also put pressure on FDI firms in China to seek new investment destination. Regarding Taiwan’s FDI into the Mainland, especially in the industrial sector which attracted up to 80-85% of FDI from Taiwan, the pressure of shifting the investment gradually from the labor-intensive fields such as textiles, footwear, foods, plastics, electronics assembly, construction materials, and so on to the capital-intensive and high technology fields such as semiconductors, computers, telecommunications, optical products, engineering, pharmaceutical as well as service sectors such as retail, finance and banking, etc will be further strengthened. If Taiwan does not

want to depend too much on Chinese market, it is important to continue to take part in the regional FTA network. Furthermore, The Taipei administration also faces pressure to promote FTAs with other economies by all means to demonstrate that the ECFA will help Taiwan expand its external economic space as expected when it was signed.

As an island territory, the external economic relations have a vital importance for Taiwan. The ECFA agreement opens new opportunities for Taiwan to break out the isolation situation and take part in the economic cooperation network that is booming in East Asia. Some economies which achieved FTA with China such as Singapore, Chile, Peru or New Zealand, now have the advantage of signing FTA with Taiwan without violating the “One China” principle. One of the positive moves in this direction has been recorded when China does not oppose that Taiwan and Singapore officially discuss a bilateral FTA. Hence, the connection of the ECFA with the CAFTA is not entirely unfounded. Taiwan may consider the Trans-Pacific Partnership (TPP) as a strategic choice because this contains Taiwan’s leading economic partners such as the United States, Singapore, Chile, Peru, etc and might be Japan in the near future. Nevertheless, it should be noted that the precedent, which was repeated twice at the APEC in 1991 and the WTO in 2001, that Taiwan will integrate into a regional mechanism much easier if it joints along with China.

⁶ Chien Chen-Lin, Lee Yu-Ji. A Study of Taiwan’s Export Competitiveness Based on the CMS Model (2009).

The research by Daniel H. Rosen and Zhi Wang (2011) showed that the ECFA can have positive effects on less developed economies in the region such as Vietnam. Because Vietnam, China and Taiwan currently stay at different stages of development and international integration, they can take advantage of each economy's competitive advantage if they are linked to the appropriate manufacturing network. Nonetheless, in the next 1-2 years, it is much likely that the ECFA will reduce the growth rate or even slow down the investment flow from Taiwan to Vietnam. China's fostering investment promotion activities recently with many preferential and fascinating policies towards Taiwanese enterprises, as well as the currently unstable macroeconomic situation and strikes in Taiwanese-invested enterprises in Vietnam have becoming troublesome factors for Vietnam-Taiwan economic relations. In particular, the trade deficit of Vietnam with Taiwan can fall, but that of Vietnam with China may rise.

It can be said that the regional and global economic integration process always pose new challenges for both Vietnam's and Taiwan's economies. In fact, both sides' efforts have produced substantial results: for many years Taiwan has always been Vietnam's leading investor and large trading partner with the total Taiwan's FDI of up to 23 billion USD and the two-way trade turnover of over 8 billion USD in 2010.

In the coming years, the development targets will put forward two very difficult tasks for both Taiwan and Vietnam: i) Restructuring the economy and changing the current growth patterns to create new comparative advantages, ii) Empowering the position of the enterprises and economy in the trans-national value chains and production networks. The tight cooperation between two sides' leaders and business communities will be a necessary condition for both sides to resolve successfully the tasks mentioned-above.

One of the important issues to maintain and strengthen the economic-trade-investment relations between Vietnam and Taiwan is soon to upgrade the institutional framework of the bilateral cooperation, in which the key is to study the ability to sign a cooperation agreement between the two sides to lower the barriers and provide more certain assurance. Under the impact of the ECFA, both Vietnam and Taiwan can further accelerate this process.

Figure 1. Taiwan-China Trade, billion USD.

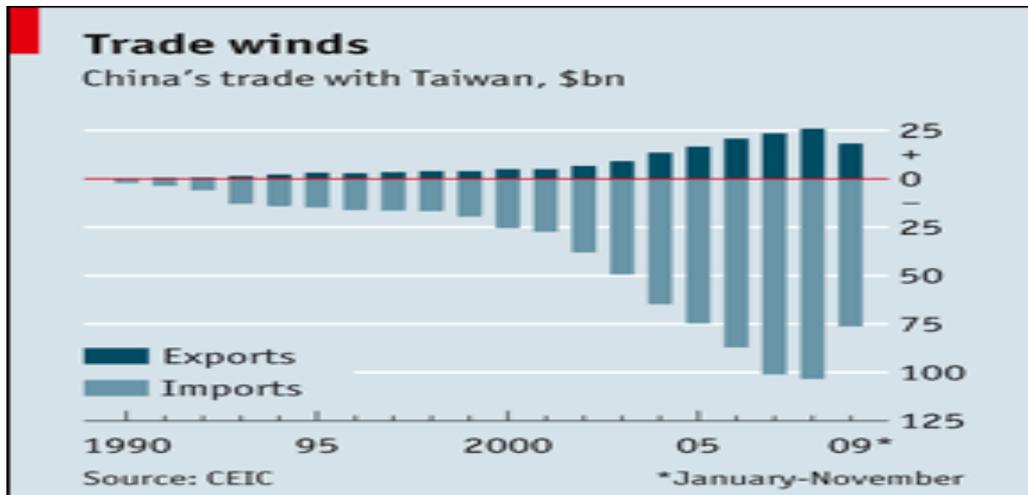
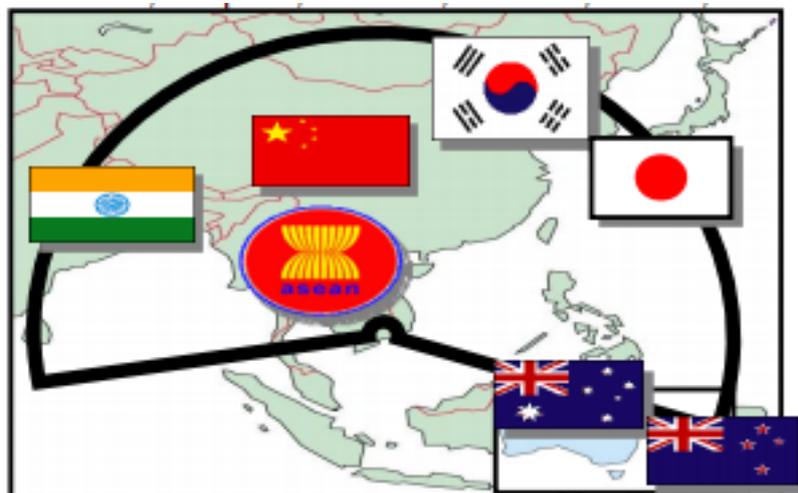


Figure 2. Integration of "ASEAN + 6"



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