Reglobalizing Taiwan

Reform the domestic market, draw closer to China and launch more free-trade agreements.

By IANA DREYER AND RAZEEN SALLY

Taiwan's new trade deal with China, the Economic Cooperation Framework Agreement, has generated a lively debate on the island about its merits. Yet this deal provides President Ma Ying-jeou's administration with a unique window of opportunity to "reglobalize" Taiwan and boost its flagging competitiveness. This requires a clear economic and political strategy.

Mr. Ma faces grave political challenges before he contemplates more trade action. The opposition Democratic Progressive Party mounted rallies and is still caterwauling about the deal, known as ECFA. Meanwhile, China maintains its claim to sovereignty over the democratic island. Clearly Mr. Ma faces a delicate balancing act.

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Taiwan President Ma Ying-jeou

Taiwan is already a highly globalized economy. It occupies a distinctive niche in global information and communication technology production chains, especially in parts and components. With only 23 million inhabitants, it boasts 19 firms in the Organization of Economic Cooperation and Development's list of top 250 global information technology firms. Its production is increasingly research-and-development intensive. Taiwanese firms account for roughly 80% of the global production of laptops, which are mainly exported via mainland China, where the bulk of their production takes place.

Taiwan also has rather liberal trade policies, anchored in strong World Trade Organization commitments. Its tariffs are low by regional standards, averaging about 6%, and the island is fairly open to foreign-direct investment, save in a few key industries such as telecommunications, water, electricity and transportation.

But the Taiwanese economy still suffers from several weaknesses. Under the previous government, hostile relations with Beijing prevented "normal" cross-Strait commerce and increased Taiwan's global isolation. Fearful of Beijing, other countries shut Taipei out of bilateral and regional free-trade agreements. At home, much-needed domestic structural reform was neglected.

This isolation hurt an already-uncompetitive economy, save in a few sectors. This is particularly true of services: Regulatory hurdles cramp financial services, telecommunications, business services and utilities. Double-testing requirements and Taiwan-specific standards hinder imports of electronics, electrical equipment, automobiles, pharmaceuticals and medical equipment.

This isn't new news. Taiwan is 46th in the World Bank's Doing Business rankings, doing particularly badly in the "protecting investors," "paying taxes," "enforcing contracts," "getting credit," "employing workers" and "dealing with construction permits" categories. Its overall business-climate ranking is worse than Japan, South Korea, Hong Kong and Singapore.

Given all that, it is vital for the Ma administration to diversify Taiwan's economy further, bolster its already-competitive IT sector and diversify strongly into services. Only overdue structural reform can achieve these goals. But they should be reinforced by closer economic ties with key trading partners.

Start with China: The Ma administration has unleashed a barrage of initiatives to liberalize cross-Straits commerce since 2008, especially last month's ECFA deal. But these initiatives must go further. Taiwan still bans imports from mainland China on 2,249 products. Mainland Chinese investments into Taiwan remain tightly controlled. And there are restrictions on Taiwanese investment into the mainland, although these have been eased.

ECFA's "early-harvest" is modest, mainly due to political divisions within Taiwan, and its centerpiece is phased tariff elimination on about 800 items. That falls below the standard of a "serious" FTA, but the deal should be seen as a framework for the progressive elimination of bilateral trade-and-investment barriers.

The next priority should be to ink deals with other trading partners. There are no major legal obstacles to this strategy, since Taiwan is a separate customs territory, a member of the WTO, the Asia-Pacific Economic Cooperation grouping and the Asian Development Bank. Taipei has bilateral agreements on taxation, investment and other matters with a wide range of countries which do not recognize Taiwanese sovereignty. Geopolitics is the main obstacle, but Mr. Ma's cross-Strait rapprochement could make it easier to negotiate FTAs with other nations. A Chinese "green light" would send the signal to other governments—all committed to the One China policy and without formal diplomatic relations with Taiwan—to respond to Taipei's free-trade overtures.

Finally, Mr. Ma should be selective about his priorities. Rather than launching initiatives indiscriminately, he should target key trading partners, meaning East Asian neighbors, the European Union and the United States. These deals should be comprehensive and ambitious, not "trade-light," Asian-style FTAs, which often protect domestic industries most in need of global competition.

New Taiwan FTAs, seen in isolation, would deliver modest aggregate gains, given the limited size of the iland's market. But they could potentially deliver larger gains in the context of greater Taiwan-China economic integration. American, European and East Asian multinationals—particularly in information communication technology—could use Taiwan as a high-value hub in greater China and wider regional supply chains.

The deal Mr. Ma struck last week with China opens the door to all these possibilities. But cross-Strait links must be seen as complements, not substitutes, for domestic, nondiscriminatory and unilateral pro-market reforms to improve the business climate. That will be the foundation for Taiwan's reglobalization.

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