

FREEMAN REPORT

MORE IN THIS ISSUE

Publication

“Obama’s Decision on Tariffs is Calculated Cynicism” by **Charles W. Freeman III**

Conference

October 7 “Red Guards Carrying Credit Cards: U.S.- China Relations and the Future”

Freeman Facts

Solar Energy in China (see p. 5)

QUOTE OF THE MONTH

“Due to their low development level and shortage of capital and technology, developing countries have limited capability and means to deal with climate change...Developing countries need to strike a balance between economic growth, social development and environmental protection.” ~ Chinese President **Hu Jintao**, speaking at the United Nations Climate Summit on September 22. President Hu said that while China had made great strides in development, it still lagged relatively in terms of its wealth per individual, and that had to be taken into account in fighting emissions.

Source: *The New York Times*,
September 23, 2009

The *Freeman Report* provides an open forum for individual opinions and commentaries on China. All opinions expressed in the feature essay of the report are those of the author.

Feature Article

WHAT ARE THE IMPLICATIONS OF
TAIWAN-CHINA ECONOMIC LIBERALIZATION?

Daniel Rosen

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Observers of cross-strait relations between Taiwan and mainland China are getting past their skepticism that a breakthrough in the pair’s economic relationship is afoot, and starting to examine the significance for the two and – directly and indirectly – for the United States. This is tricky analysis for a couple of reasons. First, both Taipei and Beijing have been publicly coy on the extent of the liberalization they are contemplating. Then, the economic consequences of not pursuing cross strait economic opening requires clarification in order to make clear the net value to all parties to an economic agreement.

It is reasonable to expect that a Taiwan-China economic undertaking, currently discussed under the term Economic Cooperation Framework Agreement, or ECFA, will take the shape of a comprehensive free trade agreement (FTA) such as the ASEAN+China agreement. That describes it in terms of *endpoint*, but not in terms of action to get there. Most economies undertaking an FTA start from normal trade relations. Taiwan’s relationship with China is not normal: it maintains a broad array of unilateral protectionist measures plainly in violation of WTO obligations. So an ECFA means committing both to normalization and liberalization, and hence more tumult than might be expected in moving to the same level of integration between two parties with a less complicated relationship.

While China professes little concern with the economic implications of such an undertaking, Taiwan President Ma Ying-jeou argues that ECFA is entirely about maximizing Taiwan’s economic position; that is, it has nothing to do with political integration. However, Taiwan did not undertake a considered economic analysis of ECFA until late in the game, in the spring of 2009, well after public debate was heating up. With

(continued on p. 2)

research now under way, including a forthcoming study by a colleague and me for publication this fall, a clearer picture of the economic implications is emerging.[1] Our findings confirm that the economic impact for China will be minimal in the aggregate, though important for specific industries and key provinces closely involved with Taiwan trade and investment. If China opens further to Taiwan financial services providers, the scrappy banks from across the Strait can help patch the lack of capacity China's state banking behemoths seem to have for servicing small and medium enterprise clients. Taiwan, on the other hand, sees very large aggregate gains from an ECFA. But these are misunderstood: they mostly arise from dynamic adjustment inside Taiwan due to dismantling barriers to China, not from increased market access in China – where Taiwanese goods already enjoy largely unfettered access.

The implications of Taiwan remaining aloof from liberalization with the mainland (and also the region, which has been wary of agreements with Taiwan due to Chinese pressure) are severe. Taiwan will suffer in terms of domestic investment, productivity growth, and national income. In contrast, by undertaking an ECFA agreement Taiwan will generate significant GDP and welfare gains through 2020, and likely re-establish its competitive momentum in the region, momentum which has eroded as obvious political risk considerations about Taiwan's future were left unresolved. Once the policy impediments to Taiwan's economic intercourse with China are removed, most of the disruption to Taiwan's potential growth is likely to be remedied.

Taiwan would enjoy additional, though modest, gains in economic performance through 2020 if it could then proceed to conclude other FTAs in the region after cross-strait economic flows are opened. Economic deepening with the mainland generates the lion's share of gains for Taiwan; but if Beijing impedes Taiwan's progress toward a level economic playing field and does not allow it to join in the regional trade integration festival that China is helping inspire, it will be altering the situation significantly. The status quo in Asia is to keep to the bicycle of trade integration rolling. For Taiwan to be forced to walk while other's bike is to change that status quo.

IN THE NEWS

PITTSBURGH ---- Leaders of the Group of 20 met on September 24 and 25 to find solutions to the current sagging global economy, which were reflected in decisions by the G-20 to reform aspects of the International Monetary Fund in order to accommodate rising economies such as China. The summit aimed to facilitate the inclusion of emerging economies, which could point to a significant change in the world economic order and the possibility of a diminishing role of the Group of 8 industrialized countries. Many expect that China is poised to take the stage as an economic co-leader should this shift occur.

BEIJING ---- The CCP's annual party plenum closed on September 25 with no mention of an expected promotion for Vice President Xi Jinping to the position of Deputy Chairman of the Central Military Commission. Many speculate that a promotion for Xi would have indicated that President Hu Jintao had chosen his successor. It is still possible for Xi to be promoted at a later date. However, President Hu's actions demonstrate an undercurrent of democratization within the Party ladder, and a slight shifting of the Party system. Other potentials for Hu's position include Vice Premier Li Keqiang and Party leader Bo Xilai.

For the United States, two questions about the economic implications of an ECFA stand out. First, are there economic side-effects for the United States? In the first instance there are likely some economic costs in terms of trade diversion, but these will be minor and in some cases just represent a switch from sales from a US company's domestic operations to their China facilities. Looking ahead, however, the dynamic implications are major. If even China and Taiwan are moving ahead with trade deepening, the U.S. failure to ratify FTAs, long since completed and now gathering dust, truly does represent abdication of Asia Pacific economic leadership. As Rupert Hammond-Chambers of the US-Taiwan Business Council recently observed,

(continued on p. 3)

if the United States does not have a trade policy for Asia, then it does not have an Asia policy – period.

Second, what difference does ECFA make to America’s long-standing interest in Taiwan’s security? No doubt the opening of Taiwan to additional imports, investment, and human resources from China will elicit concerns about exposure to mainland influence. But the larger consideration is that Taiwan’s *competitiveness and long term prosperity are the wellspring of its security*. The business as usual outlook for Taiwan’s economy is not healthy. The evolution of comparative advantage and industrial value chains in the region is profound, and Taiwan will not maintain its place in key industries if it is not on equal ground with regional peer competitors. A Taiwan with robust domestic business investment, continuing preeminence in cutting edge technology clusters, and an economy that adjusts to the new reality of the Asian economy is vastly preferable from a US security commitments-perspective than a marginalized economy to which international investment is allergic. Whatever choices Taiwan’s people embrace in the future with regard to political and security relations with the mainland, they will be in a demonstrably stronger position to pursue those preferences if their economy is vital, growing and productive.

Daniel Rosen is Partner of Rhodium Group and Visiting Fellow of the Peterson Institute for International Economics.

Footnote:

[1] Daniel Rosen and Zhi Wang, “*The Implications of China-Taiwan Economic Liberalization*”. Peterson Institute for International Economics, forthcoming (Fall 2009).

PUBLICATIONS

- “China’s eye on African agriculture,” *Asia Times*, October 2, 2009

By **Carl Rubinstein**, Research Assistant, Freeman Chair in China Studies, CSIS

The latest iteration of Chinese investment in Africa involves agricultural resources. China is investing billions in irrigation projects, agricultural education centers, and cooperatives with African farmers. While the Chinese leadership claims this investment is benign, some have accused China of participating in a massive land-grab by wealthy countries. This article discusses the details and implications of China’s agricultural investment in Africa in an effort to compare it to other non-agricultural Chinese investments on the African continent.

- “Obama’s decision on tariffs is calculated cynicism,” *Financial Times*, September 13, 2009

By **Charles W. Freeman III**, Chairholder, Freeman Chair in China Studies, CSIS

President Obama’s recent decision to enforce a three-year tariff on Chinese-exported tires has irked Beijing and led to speculations of a future trade war between the two trade giants. The author argued the current administration’s imposition of tariffs is a calculated concession towards Obama’s labor support base. These political gestures are not only hindering U.S.-China trade relations, but also will have little positive long-term effects on the U.S. tire market unless a serious reorganization of the industry is implemented.

- “A Blowout in U.S.-China Trade?” *Critical Questions*, CSIS, September 14, 2009

By **Charles W. Freeman III**, Chairholder, Freeman Chair in China Studies, CSIS

President Obama’s new tariff on Chinese-exported tires has led to concerns over trade relations between the United States and China. Obama’s use of Section 421 of the Trade Act of 1974 has been seen by China as discriminatory. The author believed that the tariffs would provide only temporary assistance to jobs in the U.S. tire market, and that without a significant reworking of the tire industry, would have little positive effect in boosting employment and sales in the United States. The move to tax Chinese tires may only result in the United States importing tires from other low-cost manufacturing countries.

Publications from the Freeman Chair 2009*

*Please visit our Web site to access archived publications dating back to 2002.

September

- “China’s eye on African agriculture,” *Asia Times*, October 2, 2009. By **Carl Rubinstein**, Research Assistant, Freeman Chair in China Studies, CSIS
- “A Blowout in U.S.-China Trade?” *Critical Questions*, CSIS, September 14, 2009. By **Charles W. Freeman III**, Chairholder, Freeman Chair in China Studies, CSIS
- “Obama’s Decision on Tariffs is Calculated Cynicism,” *Financial Times*, September 13, 2009. By **Charles W. Freeman III**, Chairholder, Freeman Chair in China Studies, CSIS

July

- “China’s Policy in the Wake of the Second DPRK Nuclear Test,” *China Security*, Issue 14, 2009. By **Bonnie S. Glaser**, Senior Fellow, Freeman Chair in China Studies, CSIS
- “The U.S.-China Strategic and Economic Dialogue,” *Critical Questions*, CSIS, July 17, 2009. By **Charles W. Freeman III**, Chairholder, Freeman Chair in China Studies, CSIS
- “U.S.-China Relations: Laying the Groundwork for Greater Cooperation,” *Comparative Connections*, CSIS Pacific Forum, July 14, 2009. By **Bonnie S. Glaser**, Senior Fellow, Freeman Chair in China Studies, CSIS
- “Chinese perceptions of U.S. Decline and Power,” *China Brief*, vol. 9, issue 14, Jamestown Foundation, July 9, 2009. By **Bonnie S. Glaser**, Senior Fellow, Freeman Chair in China Studies, CSIS, and **Lyle Morris**, Research Intern, Freeman Chair in China Studies
- “The G-8 and Hu Jintao’s Absence,” *Critical Questions*, CSIS, July 8, 2009. By **Steven Schrage**, Chairholder, Scholl Chair in International Business, CSIS, and **Charles W. Freeman III**, Chairholder, Freeman Chair in China Studies, CSIS

April

- “U.S.-China Relations: A Good Beginning is Half Way to Success,” *Comparative Connections*, Pacific Forum CSIS, April 2009. By **Bonnie S. Glaser**, Senior Associate, Freeman Chair in China Studies, CSIS

March

- China’s Capacity to Manage Infectious Diseases: Global Implications, CSIS Freeman Chair in China Studies, March 31, 2009. Project Director: **Charles W. Freeman III**, Chairholder, Freeman Chair in China Studies, CSIS. Project Editor: **Xiaoqing Lu**, Research Associate, Freeman Chair in China Studies, CSIS
- Critical Questions: A “G-2” Summit? Barack Obama and Hu Jintao on the Sidelines of the G-20, CSIS, March 25, 2009 By **Charles W. Freeman III**, Chairholder, Freeman Chair in China Studies
- “Soft Power with Chinese Characteristics: The Ongoing Debate,” in *Chinese Soft Power and Its Implications for the United States: Competition and Cooperation in the Developing World*, edited by **Carola McGiffert**, CSIS, March 2009. By **Bonnie S. Glaser**, Senior Associate, Freeman Chair in China Studies, CSIS, and **Melissa E. Murphy**, Fellow, Freeman Chair in China Studies, CSIS
- *Smart Power in U.S.-China Relations: A Report of the CSIS Commission on China*, co-chaired by **William S. Cohen** and **Maurice R. Greenberg**, and directed by **Carola McGiffert**, CSIS, March 2009. **Charles W. Freeman III**, Chairholder, Freeman Chair in China Studies, CSIS, is a commissioner; **Bonnie S. Glaser**, Senior Associate, Freeman Chair in China Studies, CSIS, and **Melissa E. Murphy**, Fellow, Freeman Chair in China Studies, CSIS, contributed to the report.

Conferences and Events

- **October 7** “Red Guards Carrying Credit Cards: U.S.-China Relations and the Future”

CSIS will host an event to discuss U.S.-China relations and the future. **Laurence Brahm**, author of “*The Anti-Globalization Breakfast Club: Manifesto for a Peaceful Revolution*” will present his talk. **Douglas Paal**, Vice President for Studies at the Carnegie Endowment for International Peace, will serve as a discussant. The event will be moderated by **Bonnie S. Glaser**, Senior Fellow at the CSIS Freeman Chair in China Studies. For more information, please contact Savina Rupani at (202) 457-8719 or srupani@csis.org.

- **June 8** *Congress and the U.S.-China Relationship: Two key policymakers discuss their recent trip to China and their legislative agenda*

CSIS hosted a bi-partisan congressional dialogue featuring the **Honorable Rick Larsen** (D-WA) and the **Honorable Mark Kirk** (R-IL), Co-Chairs of the U.S.-China Working Group. **John J. Hamre**, President and CEO of CSIS, delivered opening remarks. The discussion was moderated by **Charles W. Freeman III**, Freeman Chair in China Studies, CSIS.

If you would like to be added to the *Freeman Report* listserv, please e-mail FreemanChair@csis.org or visit <http://www.csis.org/china/>.

FREEMAN FACTS

Solar Energy in China

1. To encourage domestic investment in solar energy, the Chinese government has pledged to subsidize 50% of the investment in most areas.
2. China aims to generate 20,000 megawatts of solar energy by 2020, which are expected to replace almost half of the energy currently fueled by coal-fired plants.
3. 2/3 of China’s surface area receives over 2,000 hours of sunlight per year, making China one of the best candidates for the effective utilization of solar technology.
4. China exports most of its solar technology – one of its leading solar-tech companies, Suntech, exports nearly 98% of its products.

Source: *China Daily, The New York Times, Xinhua*

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FREEMAN CHAIR IN CHINA STUDIES

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