



## ECFA MAKES TAIWAN A NEW GATEWAY TO CHINA

On June 29, 2010, Taiwan and China signed the Economic Cooperation Framework Agreement (“ECFA”), a landmark bilateral trade agreement that will make Taiwan a new gateway to China. The ECFA, which came into effect on September 12, 2010, is the latest, and the most significant, installment in a series of cross-strait agreements signed between Taiwan and China over the past few years to foster closer economic relationships between the two sides of the Taiwan Strait.

### WHAT IS THE ECFA?

The ECFA seeks to provide a framework for Taiwan and China to gradually reduce tariffs on goods, remove non-tariff trade barriers, open up service sectors, and lift investment restrictions, thereby promoting closer cross-strait economic cooperation and interaction. The ECFA is essentially a free trade agreement (“FTA”), encouraged by the World Trade Organization (“WTO”) to be entered into among its members.

The ECFA is prompted by many reasons. Politics plays a part, especially from China’s perspective, as this could be seen as another effort to bring Taiwan closer to its fold. As for Taiwan, economic reasons are the primary motivation for it to enter into the ECFA as a first step to counter the mounting regional integration pressures that increasingly threaten Taiwan’s economic prosperity, or even survival.

### CROSS-STRAIT ECONOMIC TIES

During the last decade, China has swiftly overtaken Japan and the United States to become Taiwan’s largest trading partner, with an annual trade volume of US\$129 billion in 2008 and US\$106 billion in 2009. At the same time, Taiwan has also consistently ranked among China’s top five trading partners, along with the United States, Japan, Hong Kong, and Korea.

As of the end of 2009, Taiwanese investments in China totaled more than US\$49 billion based on government

official statistics, accounting for around 5 percent of total foreign direct investments into China, although the actual invested amounts from Taiwan in China are generally considered to be much bigger, probably at least twice as much. As a result of such volume of trade and investment, about one million Taiwanese nationals are believed to be residing in China now, while another million or even more travel back and forth, engaged in a wide variety of businesses across almost all industry sectors and all over China's big or small cities and provinces.

Taiwanese-invested companies have consistently accounted for a majority of the top 10, or top 50, manufactured exporters in China. Over time, many Taiwanese businessmen are now very skilled at penetrating China's domestic market, and beyond just first-tier cities, far more effective than most of the Western multinationals.

Ironically, to date, all such remarkable Taiwanese economic success in China has largely been achieved despite the periodic political tensions, and the lack of bilateral trade agreements, between the two sides of the Taiwan Strait for more than half a century. In recent years, with the gradual implementation of the full "Three Links"—direct mail (communication), direct trade, and direct travel (people and goods)—Taiwan-China economic interactions have accelerated by leaps and bounds. The signing of the ECFA will open a new chapter for escalated trade and investment integration between Taiwan and China.

## REGIONAL INTEGRATION PRESSURES

While Taiwan is a major trading partner with many countries, it has yet to enter into any FTA due to its unique political status, except with a few Central American countries. These countries collectively represent less than 1 percent of Taiwan's aggregate foreign trade and are geographically too distant from Taiwan to make economic integration meaningful.

As regional economic integration is becoming the global trend, many FTAs are being signed among WTO members all over the world. In Asia alone, at least 58 FTAs have been signed. The Association of South East Asian Nations ("ASEAN") has been particularly aggressive recently in

promoting the so-called "ASEAN+n" model by pushing for the signing of FTAs with all its significant neighbors, such as Australia, New Zealand, India, Korea, Japan, and China, with most of such FTAs coming into effect in 2010.

The ASEAN-China FTA, effective as from January 1, 2010, is a punch in the face to Taiwan, as this FTA will essentially blend China and ASEAN's 10 member-countries into a single free trade market, within which more than 90 percent of the goods traded will be tariff-free over time. For example, tariffs levied on Taiwan's petrochemical products, machinery, and equipment, and automobiles and parts exported to China, will be 7 percent, 10 percent, and 25 percent, respectively, higher than those imposed on the same products originating in ASEAN countries.

Taiwan, as the odd one left out in the region, is acutely aware of the pressure that it must do something to stay competitive, regionally as well as globally. Compounded with the fact that in 2009, exports accounted for 63 percent of Taiwan's GDP and about two-thirds of such exports were destined for China, it makes a compelling case for signing the ECFA with China. This is a first but crucial step toward maintaining Taiwan's competitiveness.

## ECFA'S STRATEGIC SIGNIFICANCE

The ECFA provides a mechanism pursuant to which Taiwan has an opportunity to be placed on par with, if not more favorably than, ASEAN and other countries having FTAs with China, with respect to exports to China. The Early Harvest List for Export Goods (Schedule 1 of the ECFA) seeks to progressively cut tariffs to zero within three years on hundreds of Taiwanese export goods to China (currently valued at US\$13.84 billion per annum).

Perhaps even more significant than tariff reductions on goods, China is also committed, under the Early Harvest List for Service Industries (Schedule 4 of the ECFA), to immediately open up 11 of its domestic service industry sectors to Taiwan investment, including financial (banking, securities, and insurance), accounting and auditing, exhibition, computing and data services, health care (hospital establishments), and entertainment (motion pictures and audio records).

In some instances, China has offered, or promised to offer, even more preferential treatment to Taiwan investments than to other foreign investments.

## MORE TO FOLLOW UNDER THE ECFA

The ECFA contemplates further cooperation between Taiwan and China in the areas of intellectual property, finance, customs, e-business, small-to-medium enterprises, as well as other major projects to be agreed upon from time to time. A Cross-Strait Economic Cooperation Committee will be established under the ECFA to coordinate efforts and resolve disputes, with official representatives and staff from each side to be actually posted in Taipei and Beijing, respectively. Discussions about further tariff reductions on additional classes of goods and further liberalization on investment restrictions in more service industries are scheduled to kick off within six months and continue periodically thereafter.

In addition, while not part of the ECFA, it is widely expected that, based on the good will and momentum built up through the ECFA discussions, China will likely take a more pragmatic view toward allowing Taiwan to enter into FTAs with other countries of greater economic significance to Taiwan. This will obviously further boost Taiwan's competitiveness and further integrate Taiwan with the regional and global trade and investment. In the first week of August 2010, Taiwan and Singapore announced that FTA discussions between the two are already under way.

The full implementation of "Three Links" will also provide a big leg up for Taiwan in the flow of goods, people, ideas, and business activities. With direct flights between Taipei and dozens of major cities in China, flight time cuts down to about 80 minutes from Taipei to Shanghai and slightly over two hours to Beijing, rather than one whole day's journey as before. Direct flights make Taiwan even more centrally located than Hong Kong in air transportation to most major cities in China.

## SURGE IN CROSS-STRAIT M&A ACTIVITIES EXPECTED

**M&A from Taiwan to China.** Since the mid-1980s, Taiwanese companies have increasingly become important investors in China. The migration of manufacturing operations of Taiwanese IT and other industries to take advantage of China's inexpensive labor and land costs has helped to develop China into the "world's factory." Most of these Taiwanese investments to date have been made in the form of wholly owned or joint venture enterprises, and they have largely been greenfield projects. Now, as China is becoming the "world's market," M&A will be a much more efficient way for Taiwanese companies to gain foothold and penetrate local markets in China. The expected lifting of investment restrictions under the ECFA should further accelerate the pace of such M&A activities.

**M&A from China to Taiwan.** Historically, for national security reasons, the Taiwanese government had prohibited Chinese investments of any kind, whether directly or indirectly, from being made in Taiwan. Such outright ban on Chinese inbound investment was first relaxed by the Taiwanese government in June 2009. Now, Chinese inbound investment is permitted, but only for those industry sectors set forth on the so-called "Positive List" and only with prior regulatory approval of the Taiwanese government. To date, Taiwan has opened up approximately 100 categories of manufacturing and service industries to Chinese investment. More are expected to be opened up in the wake of the ECFA. Many of these Chinese investments are expected to be made by way of M&A.

**Going Global: Taiwanese and Chinese Companies Join Hands.** With its fast economic growth and abundant foreign exchange reserves, China is encouraging its major companies to aggressively go global and make acquisitions all over the world. On the other hand, Taiwanese companies are also going global to remain competitive. Some of these Chinese and Taiwanese companies have already found that they can generate synergy to complement each other by joining hands in going global. These joint efforts, currently still rather limited, are expected to grow with the enhanced cooperation between Taiwanese and Chinese enterprises post-ECFA.

## TAIWAN AS GATEWAY TO CHINA FOR MULTINATIONALS

Thanks to the language and culture affinity, Taiwanese businesses have developed extensive networks of contacts and relationships and have accumulated substantial trade and investment experiences in China over the past 30 years. This unique strength of Taiwanese businesses has not escaped the attention of many multinationals, which have often tapped Taiwanese executives to manage their Greater China operations.

Prior attempts by some foreign multinationals to invest with Taiwanese companies into China, however, had generally not materialized due to China investment restrictions imposed by the Taiwanese government. Now, post-ECFA, with liberalization of such investment restrictions within sight, it is time for foreign multinationals to rethink such an approach.

Many also believe that, like Hong Kong companies under the Closer Economic Partnership Arrangement between China and Hong Kong, Taiwanese companies would likely be treated as if they were Chinese domestic companies for various purposes. If this is indeed true, it would be even more advantageous for Taiwanese companies trying to penetrate China's domestic market.

With the ease of travel due to direct flights, the convenient and central geographical location, and the recent slashing of corporate income tax to 17 percent across the board, plus ECFA, Taiwan is again making itself an attractive gateway to China for foreign multinationals. A number of Korean, Japanese, and European companies have taken heed of this development and have made their moves in this direction. U.S. companies, many of which have been active in Taiwan for decades, should not be far behind.

After all, according to some observers, "the Taiwanese are the foreigners who understand the Chinese best, and also the Chinese who understand the foreigners best." Taiwan, properly positioned, can play a key bridging role for China and the world.

## LAWYER CONTACTS

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