

Creating Win-Win Solutions

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Introduction

- ◆ Economic Complementarity between Mainland and Taiwan
- ◆ Opportunities for Win-Win Economic Cooperation
- ◆ Special Advantages of Fujian
- ◆ Concluding Remarks

Economic Complementarity

- ◆ The economies of the Mainland and Taiwan are at different stages of economic development.
- ◆ Taiwan has a per capita GDP of approximately US\$18,000 compared to US\$2,500 for the Mainland.
- ◆ Taiwan has high real wage rates whereas the Mainland has relatively low real wage rates.
- ◆ Taiwan has a better educated labor force than the Mainland.
- ◆ The Mainland has more savings than can be productively invested on the Mainland.
- ◆ Taiwan and Mainland's exports are not competitive with each other.

Economic Complementarity

- ◆ Taiwan's comparative advantage is increasingly in knowledge-intensive and intellectual property-intensive industries and sectors (e.g., Taiwan Semiconductor Manufacturing Corporation is a major intellectual property producer and accounts for almost half of Taiwan's patents granted by the U.S.) whereas Mainland's comparative advantage remains in labor-intensive light manufacturing and only recently begins to shift to capital-intensive heavy manufacturing.
- ◆ Taiwan's small and medium enterprises (SMEs) are extremely competitive and internationally oriented.

The Comparative Advantages of the Mainland

- ◆ A high national savings rate of currently in the mid-40s. The Mainland is therefore self-sufficient in capital and not dependent on foreign direct investment or foreign loans to maintain its high rate of investment.
- ◆ An almost unlimited supply of surplus labor—almost 40% of the labor force in the primary sector (agriculture and mining) produces approximately 12% of GDP. There will not be any upward pressure on the real wage rate of unskilled entry-level labor for decades to come.
- ◆ A large domestic market allows economies of scale to be realized.

Additional Advantages of the Mainland Economy

- ◆ A large domestic market also allows the economy a significant influence on the development and setting of technological standards for products and services in the domestic as well as the world markets.
- ◆ A large domestic market also enhances the returns to R&D and other forms of intangible capital, including intellectual property and brand names. Economies of scale in the creation and utilization of intangible capital imply that the rate of return increases more than proportionally with the size of the market. The fixed development costs of innovative technologies and products or the promotion of a brand name can be more easily recovered from a large base of domestic demand.

Reputation and Reliability

- ◆ Reputation and reliability are particularly valued in the Mainland markets.
- ◆ Taiwan firms can therefore profit by leveraging their intellectual property and brand names in the Mainland market.

Taiwan Direct Investment in the Mainland Can be Win-Win

- ◆ Taiwan can take advantage of the Mainland economy not only as a manufacturing base for exports but also as a final consumption market on its own, leveraging its intellectual property, know-how, brand names and reputation.
- ◆ Mainland can also benefit from the increase in GDP, employment and productivity resulting from the wider exploitation of Taiwan's intellectual property.
- ◆ The Mainland no longer needs external capital, so Taiwan investment into the Mainland must have an edge other than money. Foreign direct investment accounts for approximately 10 percent of gross domestic investment in Mainland China. The Mainland still welcomes foreign direct investment (FDI), but not because it needs the money, but because FDI brings with it technology, know-how, designs, markets, business models and methods that it does not have.

China as a Continental Economy

- ◆ The "wild-geese-flying pattern" metaphor of East Asian industrial migration over time, first introduced by the Japanese economist Akamatsu, can apply to Chinese provinces and regions. East Asian industrialization started in Japan in the 1950s and successively migrated to Hong Kong, Taiwan, South Korea and Southeast Asia as the real wage rates in these economies rose and sometimes also as export quotas were imposed by developed economies, and then to Mainland China. But industrialization can continue to migrate and spread within Mainland China just as it did before, from the coastal region gradually to the inland region, province by province, region by region, until most of China becomes industrialized eventually.
- ◆ Taiwan entrepreneurs can play the role of the agent of change (as they did in Southeast Asia and in the coastal region of Mainland China) by leading the migration of industries within the Mainland.
- ◆ As labor and operating costs rise in Guangdong, Jiangsu and Shanghai, Fujian is certainly a potential next wild goose especially for Taiwan entrepreneurs.

Direct Links in Transportation and Communication

- ◆ The savings from direct cross-straits passenger flights—approximately US\$500 million a year, not to mention the time saved.
- ◆ The savings from current and future cargo flights are important because of the upstream-downstream relationships between Taiwan and the Mainland.
- ◆ Savings from ocean freight.
- ◆ Xiamen can become a major air and sea gateway to the Mainland from Taiwan for both passengers and freight.

The Growth of Cross-Straits Trade

- ◆ Reduction in shipping costs and liberalization of current restrictions should increase two-way trade.
- ◆ Taiwan exports of agricultural products to the Mainland should increase.
- ◆ Imports of light manufactured products from the Mainland should increase.
- ◆ Possible “Economic Cooperation Agreement” along the lines of the “Closer Economic Partnership Agreement”.
- ◆ Towards a “Free Trade Area” and a “Common Market”
- ◆ Access to “ASEAN + 3” Free Trade Area.

Bi-Directional Investment

- ◆ Mainland looks for investment opportunities offshore
- ◆ It is beneficial for both sides to have fixed investment and assets on the other side
- ◆ It should be controlled access, with transparency and only limited leverage, i.e., with a limited debt-to-equity ratio
- ◆ Investment in tourism-related industries
- ◆ Relaxation of restrictions on Mainland-bound direct investment from Taiwan
- ◆ Tax agreements on the treatment of each other's enterprises and citizens and permanent residents—no double taxation
- ◆ Global consolidated returns for enterprises listed on the Taiwan Stock Exchange so that profits and losses on the Mainland can be properly reflected.

Trade in Services

- ◆ Tourism services--jobs that cannot go away. The “Individual Visit Scheme” is the major generator of employment opportunities among the unskilled and low-skilled workers in Hong Kong. It can bring similar benefits to Taiwan.
- ◆ Educational services--there is a huge demand for university education from the Mainland and an excess supply of university places in Taiwan. So it is natural to consider for the Mainland to consider allowing its students to enroll at universities in Taiwan. The cost is not an issue as many self-financed Mainland students currently study overseas in the U.K., the U.S. and elsewhere. This way Taiwan can also attract additional talents for its R&D activities. However, it requires selective reciprocal recognition of degrees and diplomas and eventually of professional qualifications.
- ◆ Taiwan can provide healthcare services for Mainland residents, especially residents in Fujian.
- ◆ Demand for such services are high. Taiwan has an advantage over other economies in terms of the language, customs and culture.

Global Economic Environment

- ◆ The global environment does not favor the traditional final market of Taiwan products—U.S.A. The United States will be entering a period of very slow growth, if not an outright recession.
- ◆ Fortunately, the fastest-growing economies of the world—the BRIC countries (Brazil, Russia, India and China)—are relatively immune to the slowdown in the United States. This is known as de-coupling of the global economy.
- ◆ Taiwan should take advantage of this opportunity to expand its trade and investment with these economies and to try to take greater advantage of the domestic market on the Mainland.

The Impact of the Sub-Prime Mortgage Loan Crisis

- ◆ The U.S. demand for imports will likely decline with the reduced household consumption, or at a minimum the rate of growth will decline.
- ◆ Such decline will have a negative effect on the rate of growth of Mainland Chinese exports to the U.S. and hence on Mainland Chinese GDP, but the effect is expected to be marginal.
- ◆ The overall economic slowdown in the U.S. will last a while, until more positive and certain expectations are restored for both firms and households, probably after the Presidential election in November.
- ◆ The U.S. dollar will continue to weaken relative to other reserve currencies as the net inflow of capital, especially that of direct and portfolio investment, is reduced.

The Impact of the Sub-Prime Mortgage Loan Crisis

- ◆ Mainland exports to the U.S. constitute between 8% (Mainland estimate) and 12% (U.S. estimate) of Mainland GDP; however, the direct domestic value added content of Mainland exports to the U.S. is quite low, averaging 17.7%. Thus, the Mainland GDP originating from Mainland exports to the U.S. is only approximately 2.2% (12% times 18% = 2.16%).
- ◆ 2.2% of GDP is reasonably significant and will result in hardships in some localities if completely lost. However, even if Mainland exports to the U.S. falls by 10% (which is considered unlikely), it will cause Mainland GDP to fall by only 0.22%, which is clearly tolerable, especially if the remaining 97.8% of the Mainland economy continues to grow.

The Impact of the Sub-Prime Mortgage Loan Crisis

- ◆ If the indirect domestic value added of Mainland exports to the U.S. is also taken into account, a 10% decline in Mainland exports to the U.S. may result in a decline of Mainland GDP of no more than 0.5%.
- ◆ However, the impact may be quite severe on certain localities where most of the economy is dependent on exports, e.g., the cities of Dongguan and Shenzhen in the Province of Guangdong, and Suzhou in the Province of Jiangsu, where the value of exports is greater than the local GDP. Measures must be put in place in these localities to take care of expected lay-offs of workers as a result of the slowdown in export demand.

The Impact of the Sub-Prime Mortgage Loan Crisis—De-Coupling

- ◆ In general, the phenomenon of “decoupling” is expected to be operative. Mainland economic growth is largely unaffected by external developments, including a possible economic recession in the United States. The other so-called BRIC countries—Brazil, Russia and India—are even less dependent on exports. Brazil has recently discovered huge oil reserves and should be entering a new era of rapid economic development, financed by its new found oil wealth instead of foreign loans. Russia has already been benefiting from the high world price of oil and is not a major exporter of manufactured goods and hence will be relatively unaffected by external developments. India is also not a major exporter, except in computer software, and its economic growth is mostly internally driven.
- ◆ The BRIC countries can be expected to maintain their rates of growth, more or less, the rest of the world, including developing East Asia, should be able to manage.

Opportunities for Taiwan

- ◆ With the election of Mr. MA Ying-Jeou as President in Taiwan, cross-straits relations are likely to improve and the risks of instability in East Asia are likely to be significantly reduced.
- ◆ The peaceful election in Taiwan also greatly enhanced confidence in the democratic process—”painfully slow but ultimately sure”.
- ◆ Taiwan is ready to take advantage of its economic complementarity with the Mainland and to create win-win solutions for both. As long as there is goodwill on both sides, politics can be put on a back-burner. Flexibility and mutual respect and consideration are needed for progress to be made.

The Special Advantages of Fujian for Taiwan Enterprises

- ◆ Fujian has not been the major preferred destination of Taiwan direct investment, in part for reasons of national security and the potentially adversary positions of the two sides of the Taiwan Straits, but Fujian's time may have come.
- ◆ Taiwan enterprises that are still focused on manufacturing for exports will find Fujian attractive as a base.
 - ◆ The transportation costs for the importing of raw material, components and parts and the exporting of the finished goods will be minimized (as compared to location in Hunan and Jiangxi).
 - ◆ The labor costs are lower than those in Guangdong, Jiangsu and Shanghai.
 - ◆ The distances between Taipei and Kaohsiung on the one side and Xiamen and Fuzhou on the other side are so short that it is possible to commute between the two sides of the Taiwan Strait every week.
 - ◆ There is the additional advantage of a common dialect and customs.

The Special Advantages of Fujian for Taiwan Enterprises

- ◆ However, in order to realize this potential, Fujian must actively seek the location or the relocation of a cluster of Taiwan-invested enterprises 企业群 to Fujian.
- ◆ It is important to have a cluster of enterprises so that the entire “supply chain is available at the new location in Fujian; otherwise it is almost impossible to persuade individual enterprises to move. This is especially true for the small and medium enterprises which account for the bulk of the Taiwan-invested enterprises in the mainland.
- ◆ Fujian must commit to the provision of up-to-date, high-quality infrastructure including transportation, communication, power and water.
- ◆ Fujian must be prepared to provide trained personnel.
- ◆ The results can be win-win.

Concluding Remarks

- ◆ Ultimately the Mainland and Taiwan can become a free trade area with free movement of goods and capital—free movement of labor will take a much longer time.
- ◆ Taiwan will specialize in R&D and upstream activities; Mainland will specialize in quantity manufacturing (both light and heavy industry) and provide the domestic market.
- ◆ Mainland will supply the light manufactured consumer goods.
- ◆ In the long run Taiwan can be to the Mainland as the Silicon Valley is to the United States.
- ◆ Mainland-Taiwan economic cooperation can be win-win and Fujian can have an important role 創造雙贏