

**THE ECONOMICS OF  
TAIWAN'S THREE DIRECT LINKS  
WITH MAINLAND CHINA**

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*EAI Background Brief No. 415*

Date of Publication: 27 November 2008

## **Executive Summary**

1. On 4 November 2008, four agreements on bilateral air and maritime transportation, postal services and food safety were signed at the historic meeting in Taipei between representatives of mainland China and Taiwan.
2. The withdrawal of investment and the transfer of overseas headquarters by some multinationals away from Taiwan have been due to the absence of cross-Strait links.
3. With China's emergence as both a production network and a final export market for the East Asia region, Mainland China-Taiwan trade and investment have surged over the past several years.
4. The peaceful cross-Strait development will also have a positive impact on economic growth in Taiwan as it facilitates regional economic integration.
5. With cross-Strait economic and financial cooperation becoming increasingly critical and distinctive in the wake of the global financial turmoil, the two sides will in the future seek to normalize cross-Strait economic relations and establish a framework for institutionalized economic cooperation.
6. Direct charter flights will no longer have to pass through Hong Kong's air traffic control zone, and will be expanded from weekends to the whole week. Routes will be shortened.
7. Direct air transportation links will cut airline fuel costs by 40-50 percent and thus greatly boost Taiwan's competitiveness.
8. Transportation costs for many commodities will be greatly reduced, boosting Taiwan's farm produce sales to the mainland market.

9. Direct maritime shipping links will cut shipping costs by 15-30 percent, with journey time being shortened by up to 27 hours.
10. Direct postal links will save a lot of time and simplify procedures in postal operations, thereby reducing the costs significantly.
11. The transparency of food safety will push Chinese food producers to enhance safety standards, a win-win result for consumers on both sides.
12. Development strategies aimed at the international markets and gaining quick access to the Chinese market are one way of developing Taiwanese enterprises and the Taiwanese economy.

# THE ECONOMICS OF TAIWAN'S THREE DIRECT LINKS WITH MAINLAND CHINA

CHEN Chien-Hsun\*

## Absence of the Three Direct Links

- 1.1 Because of political hostility and confrontation, the three direct links via mail, transportation and trade between the two sides of the Taiwan Strait were banned for almost six decades.
- 1.2 The absence of the three links has been the biggest stumbling block to the deepening of economic cooperation across the Taiwan Strait. With such links in place, Taiwan businessmen would be in a better position to take advantage of the potentially large market, low labor costs and huge talent pool in the mainland to boost their business operations. Mainland enterprises would benefit from Taiwan firms' advanced experience in management and in navigating international markets. Taiwan's competitive edge would also be greatly weakened if the ban on the three direct links were not lifted. The withdrawal of investment and the transfer of overseas headquarters by some multinationals away from Taiwan have been due to the absence of cross-Strait links.
- 1.3 China has become a world engine of growth, with its economy growing at an average of 9.7% a year for the last 30 years, and with China emerging as both a production network and a final export market for the East Asia region.<sup>1</sup> Mainland China-Taiwan trade and investment have surged over the past

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<sup>1</sup> See Wu, H.L., C.H. Chen and L.T. Chen (2007), "Foreign Trade in China's Electronics Industry", *Eurasian Geography and Economics*, 48 (5): 626-642.

several years. Cross-Strait economic and trade activities are continuously increasing, as is Taiwan's dependence on China's imports and exports (see Table 1).<sup>2</sup>

1.4 Bilateral trade between Taiwan and the mainland stood at US\$77.01 billion for the period January–August 2008, accounting for 21.5% of Taiwan's total foreign trade, and representing a 19.6% increase over the same period in the previous year. Of this amount, Taiwan's exports to the mainland increased by 18.1% to US\$54.72 billion, accounting for 30% of its total exports, while Taiwan's imports from the mainland increased by 23.4% to US\$22.29 billion, accounting for 12.7% of its total imports; therefore, this bilateral trade yielded a trade surplus of US\$32.44 billion for Taiwan, or an increase of 14.6% over the same period in the previous year (see Table 1).

1.5 Meanwhile, the total number of applications for investment in the mainland amounted to 390 cases for the period January–September 2008, a decrease of 34% over the same period in the previous year. The amount of investment on the mainland was US\$688.274 million for the period January–September 2008, representing an increase of 8.18% over the same period in the previous year (see Table 2).

### **Chiang and Chen Signed Landmark Agreements**

2.1 Since the Hu Siew meeting at the Boao Forum on 12 April 2008, which was followed by Lien Chan, Wu Po-hsiung and Chiang Pin-kung visiting the mainland in rapid succession, the previously icy cross-Strait relations have improved at a rate that was inconceivable during the eight-year administration of the Democratic Progressive Party (DPP).

2.2 Chiang Pin-kung, Chairman of the Straits Exchange Foundation (SEF), and Chen Yunlin, Chairman of the Association for Relations Across the Taiwan Strait (ARATS), met for the first time in Beijing in June 2008 and the two

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<sup>2</sup> See Chen, C.H. (2008), "Ma Ying-jeou Facing a Formidable Economic Challenge", *EAI Background Brief No. 381*.

sides announced the commencement of cross-Strait weekend charter flights and the arrival of mainland tourists in Taiwan. The meeting was viewed as a major breakthrough in cross-Strait ties after President Ma Ying-jeou assumed office on 20 May 2008. They also agreed that the second Chiang-Chen meeting would be held in Taipei in November 2008. Issues to be discussed included expanding direct charter flights, establishing shipping services and postal links, as well as promoting food safety following China's melamine-tainted milk powder scandal.

2.3 On 4 November 2008, four agreements on bilateral air transportation, maritime transportation, postal services and food safety were signed at the Chiang-Chen historic meeting in Taipei. Full-fledged three direct links (transport, postal services and trade) across the Taiwan Strait were thus established.<sup>3</sup> The agreements will take effect in 40 days, except for the one on food safety, which is effective in a week.<sup>4</sup> It is worth noting that the peaceful cross-Strait development will also have a positive impact on economic growth in Taiwan as it facilitates regional economic integration.

2.4 Issues to be addressed by the two sides in the next round of meetings in 2009 include a memorandum of understanding (MOU) on cross-Strait financial supervision, cross-Strait cooperation on crime, disease control and prevention, financial matters and investment protection for China-based Taiwan businesses. With cross-Strait economic and financial cooperation becoming increasingly critical and distinctive in the wake of the global financial turmoil, the two sides will in the future seek to normalize cross-Strait economic relations and establish a framework for institutionalized economic cooperation.

### **Expanding Direct Air Transportation**

3.1 According to the agreement on air transportation, charter flights will no longer have to pass through Hong Kong's air traffic control zone, and will be

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<sup>3</sup> See "Resisting China's Charm Offensive", *The Economist*, 6 November 2008.

<sup>4</sup> The air transportation and direct maritime shipping agreements will be submitted to the Legislative Yuan for ratification.

expanded from weekends to the whole week.<sup>5</sup> Routes will be shortened, and private business jets will also be allowed to fly. The number of direct charter flights will be tripled to 108 per week. The frequency will be raised from four times a week to daily.

3.2 The destinations in Taiwan are Taoyuan, Kaohsiung (Siaogang), Taichung (Chingchungkang), Taipei (Sungshan), Penghu (Makung), Hualien, Kinmen and Taitung, while the number of destinations in China will rise from 5 to 21, including the 5 existing destinations of Beijing, Shanghai (Pudong), Guangzhou, Xiamen and Nanjing, plus the 16 new destinations of Chengdu, Chongqing, Hangzhou, Dalian, Guilin, Shenzhun, Wuhan, Fuzhou, Qingdao, Changsha, Haikou, Kunming, Xi'an, Shenyang, Tianjin and Zhengzhou.

3.3 As the definition of the new air routes across the Taiwan Strait was considered to be sensitive, negotiators reached a consensus to define them as “special cross-Strait air routes” without saying whether they are domestic or international routes. Direct air transportation links would cut airline fuel costs by 40-50 percent, thereby greatly boosting Taiwan’s competitiveness.<sup>6</sup> For the first time, there will also be direct cargo flights, but initially only between Taoyuan and Kaohsiung in Taiwan and Guangzhou (Baiyun) and Shanghai (Pudong) in China. There will be 60 direct cargo flights per month.<sup>7</sup> The direct cargo flights will also benefit cross-Strait transportation of electrical equipment and components and mechanical appliances and parts (see Tables 3 and 4).

3.4 The agreement on direct flights will immediately reduce the cost and time involved for people traveling across the Taiwan Strait. Ordinary people and companies will save at least NT\$3 billion annually.<sup>8</sup> The benefits will

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<sup>5</sup> With a new air link pact between Taiwan and China, Hong Kong might lose China-bound transit travels from Taiwan.

<sup>6</sup> See *Economic Daily News*, 5 November 2008.

<sup>7</sup> See “China and Taiwan Expand Accords”, *New York Times*, 4 November 2008.

<sup>8</sup> See *China Times*, 5 November 2008.

outweigh the costs. Transportation costs for many commodities will be greatly reduced and this will boost Taiwan's farm produce sales (e.g., fruit, flowers, vegetables, ornamental fish and rockfish) to the mainland market. Furthermore, the costs of shipping damage for farm produce will be reduced from 15 percent to 5 percent.

### **Launching Direct Maritime Shipping**

- 4.1 Direct tax-free (business and income tax) cargo shipments will be allowed between 11 Taiwan seaports and 63 ports in the mainland, with ships not being allowed to fly the national flags.<sup>9</sup> Taiwan will open the 6 ports of Keelung (including Taipei), Kaohsiung (including Anping), Taichung, Hualien, Mailiao and Budai, and the 5 "small three links" ports of Liaoluo and Shueitou in Kinmen, Fuao and Baisha in Matsu, and Magong in Penghu. Direct maritime shipping links will cut shipping costs by 15-30 percent, shortening journey time by up to 27 hours, and enable an annual saving of at least NT\$1.2 billion in documentation fees collected by a third place in transit.
- 4.2 Through direct flights and shipping services, Taiwan can truly reflect its industries' comparative advantages and realize the international division of labor; it might then be more prepared to become a regional headquarter for multinational business. The number of multinational companies with regional headquarters in Taiwan could increase from 615 to 800 next year thanks to direct travel and transportation.<sup>10</sup>

### **Providing Direct Postal Services**

- 5.1 In 1989, indirect postal parcel delivery was established via Hong Kong, and in April 1993, ARATS and SEF signed the "Agreement on the Tracing of and Compensation for Lost Registered Mail Between the Taiwan Area and the Mainland Area" to normalize registered mail service across the Taiwan Strait.

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<sup>9</sup> The mainland will open 48 seaports and 15 river ports.

<sup>10</sup> See *Commercial Times*, 5 November 2008



During the initial stage when the two sides of the Taiwan Strait started indirect postal exchanges, postage stamps used to be a sensitive issue because they symbolize sovereignty. Therefore, stamps would only be affixed in Hong Kong, or the country's name printed on the stamps would be crossed out to avoid sensitive issues. Without direct postal links, the 10 million pieces of express mail and letters sent annually between Taiwan and the mainland have to pass through Hong Kong or Japan. As a result, it takes five to seven days for an express letter to go from Taipei to Beijing. There is a monthly average of over 10,000 express mail items from Taiwan to the mainland, indicating the high demand for more direct cross-Strait postal services.

- 5.2 Without direct postal links, it takes three to five days to deliver express mail or parcels to primary cities on the mainland, and five to six days to reach second-tier cities, depending on flight connections and customs clearance. With direct postal links it will take only two days for mail sent by express delivery to arrive in primary cities on the mainland,<sup>11</sup> saving a lot of time and simplifying procedures in postal operations, as well as reducing operational costs significantly. Given the very keen competition between Taiwan and foreign companies in the postal business, Taiwan can further promote its competitive advantage.

### **Establishing a Food Safety Mechanism**

- 6.1 The food safety agreement between Taiwan and China will enhance bilateral cooperation and ensure the safety of food ingredients at the source of production.<sup>12</sup> The agreement has established a cross-Strait platform for dialogue on food safety for the first time, raising information transparency and permitting both sides to take necessary measures in a timely manner when food safety problems occur.

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<sup>11</sup> See *Taiwan News*, <<http://www.taiwannews.com.tw>>, accessed 6 November 2008.

<sup>12</sup> See *United Daily News*, 5 November 2008.

- 6.2 The agreement also helps protect victims' rights and enhances cross-Strait experts' exchanges on such issues. In recent years, many food items imported from China, such as shrimps, moon cakes, crabs and milk powder, were found to contain harmful substances, including bleaching agents, aflatoxin and melamine. The transparency of food safety will push Chinese food producers to enhance safety standards and the authorities to amend food safety regulations, a win-win result for consumers on both sides.

### **Cross-Strait Economic Integration Between Taiwan and China**

- 7.1 The three direct links were banned for almost 60 years and will now finally be realized through the Chiang-Chen meeting. The successful talks mark a historic moment signifying that cross-Strait relations have moved past hostility towards negotiation and cooperation.
- 7.2 The three direct links will not only create a new boom in cross-Strait economic exchanges but also enhance closer ties between Taiwan and the mainland. A high degree of mutual economic interdependence can be expected in the near future, intensifying the stability of relationship between Taiwan and the mainland.
- 7.3 Due to the global financial turmoil, Taiwan's economic growth next year might not reach 5.08 percent as expected. The three direct links should not be seen as a panacea for Taiwan's economic problems.
- 7.4 Establishing the three direct links with the mainland will facilitate the movement of goods, services, and human resources across the Taiwan Strait. This will not only increase Taiwan's appeal as a regional logistics center or Asia-Pacific financial center, but also substantially promote the efficiency of Taiwanese and foreign companies operating on both sides of the Taiwan Strait. Moreover, this will also help both sides find a new pattern of investment and trade.

- 7.5 The basic industry structure of Taiwanese enterprises is mainly OEM (original equipment manufacturing) based, while Chinese enterprises have already started getting involved in the OBM (own brand manufacturing) model. Therefore, Taiwanese enterprises should try to transcend their initial OEM model. A lack of professional staff skilled in international marketing is a factor that limits the internationalization of brands and channels of Taiwanese companies. The heavy investment needed to establish brands and channels is also another factor. However, the accumulation of experience and the training of skilled staff are an important way of making up for these weaknesses. A feasible way to improve Taiwan's lack of brands and channels would be to combine Taiwan's most competitive domains with international companies that have strong abilities in terms of branding and marketing.<sup>13</sup>
- 7.6 Taiwanese enterprises should therefore change their investment strategies from production-oriented investment to market-oriented investment. Development strategies aimed at international markets and gaining quick access to the Chinese market are one way of developing Taiwanese enterprises and the Taiwanese economy.
- 7.7 Avoiding the Chinese market is not beneficial for Taiwanese enterprises or Taiwan's economic development in general. In terms of R&D technology, Chinese enterprises have an advantage in terms of basic technology while Taiwanese enterprises have an advantage in terms of applications. These enterprises should combine their strengths to increase complementarity as well as to create new markets. For example, cooperation of this sort would work well in the communications industries of mainland China and Taiwan.
- 7.8 Meanwhile, Taiwanese enterprises have close international supply chain links with multinational manufacturers. This has allowed the Taiwan economy to grow at a rapid pace. However, in addition to keeping these links, Taiwan must combine these links with the advantages that Chinese enterprises enjoy to ensure the sustainability of strong growth.

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<sup>13</sup> See Chen, C.H. and H.T. Shih (2008), *Mergers and Acquisitions in China*, Cheltenham: Edward Elgar.

7.9 With more and more multinational enterprises setting up R&D and manufacturing operations in China, world processing manufacturers and component suppliers are also more likely to invest in and move to China to be closer to these large multinational enterprises, especially now that China is the third largest manufacturer and exporter of IT products in the world. There will also be an inevitable trend of more and more Taiwanese IT enterprises investing in China and setting up factories and R&D bases there.

**TABLE 1 CROSS-STRAIT TRADE STATISTICS**

Year	GDP (US\$ millions)	Exports from Taiwan to China			Imports from China to Taiwan		
		Amount (US\$ million)	Change (%)	Export Dependency (Amount/GDP) %	Amount (US\$ million)	Change (%)	Import Dependency (Amount/GDP) %
1991	184,267	6,928.3	66.1	3.76	1,126.0	47.1	0.61
1992	218,712	9,696.8	40.0	4.43	1,119.0	-0.6	0.51
1993	230,926	12,727.8	31.3	5.51	1,015.5	-9.2	0.44
1994	252,227	14,653.0	15.1	5.81	1,858.7	83.0	0.74
1995	273,792	17,898.2	22.1	6.54	3,091.3	66.3	1.13
1996	289,315	19,148.3	7.0	6.62	3,059.8	-1.0	1.06
1997	300,005	20,518.0	7.2	6.84	3,915.3	28.0	1.31
1998	276,105	18,380.1	-10.4	6.66	4,110.5	5.0	1.49
1999	298,757	21,221.3	15.5	7.10	4,526.3	10.1	1.52
2000	321,230	26,144.0	23.2	8.14	6,223.3	37.5	1.94
2001	291,694	24,061.3	-8.0	8.25	5,902.0	-5.2	2.02
2002	297,668	29,446.2	22.4	9.89	7,947.4	34.7	2.67
2003	305,624	35,357.7	20.0	11.57	10,962.0	37.9	3.59
2004	331,007	44,960.4	27.2	13.58	16,678.7	52.2	5.04
2005	355,958	51,773.2	15.2	14.54	19,928.3	19.5	5.60
2006	365,503	63,662.4	12.5	17.42	24,783.1	23.3	6.78
2007	383,303	74,279.1	16.7	19.38	28,019.2	13.1	7.31
2008 Jan – Aug		54,720.0			22,290.0		

Sources: Board of Foreign Trade, Ministry of Economic Affairs, Taiwan, <<http://www.trade.gov.tw>>, accessed 21 November 2008; Directorate-General of Budget, Accounting, and Statistics (DGBAS), Taiwan, <<http://www.dgbas.gov.tw>>, accessed 21 November 2008.

**TABLE 2 CROSS-STRAIT INVESTMENT STATISTICS**

Year	Outward Investment (Excluding China)		Approved Investment in China			
	Cases (1)	Amount (US\$ million) (2)	Cases (3)	Amount (US\$ million) (4)	% of Total Cases (3/(1+3))	% of Total Outward Investment (4/(2+4))
1991	364	1,656.0	237	174.2	39.43	9.52
1992	300	887.3	264	247.0	46.81	21.78
1993	326	1,660.9	9,329	3,168.4	96.62	65.61
1994	324	1,616.8	934	962.2	74.24	37.31
1995	339	1,356.9	490	1,092.7	59.11	44.61
1996	470	2,165.4	383	1,229.2	44.90	36.21
1997	759	2,893.8	8,725	4,334.3	92.00	59.96
1998	896	3,296.3	1,284	2,034.6	58.90	38.17
1999	774	3,269.0	488	1,252.7	38.67	27.70
2000	1,391	5,077.1	840	2,607.1	37.65	33.93
2001	1,387	4,391.7	1,186	2,784.2	46.09	38.80
2002	925	3,370.0	5,440	6,723.1	85.47	66.61
2003	714	3,968.6	10,105	7,698.8	93.40	65.99
2004	658	3,382.0	2,004	6,940.7	75.28	67.24
2005	521	2,447.4	1,297	6,007.0	71.34	71.05
2006	478	4,315.4	1,090	7,642.3	69.52	63.91
2007	464	6,470.0	996	9,970.5	68.22	60.65
2008 Jan – Sept	307	3,275.6	390	6,882.7	55.95	67.75

Source: Investment Commission, Ministry of Economic Affairs, Taiwan, <<http://www.moeaic.gov.tw>>, accessed 21 November 2008.

**TABLE 3 MAJOR IMPORT GOODS FROM CHINA TO TAIWAN  
(JANUARY–JULY 2008)**

<b>Rank</b>	<b>HS Code</b>	<b>Commodities Description</b>	<b>Amount (US\$ million)</b>	<b>Growth Rate (%)</b>	<b>% of Total Imports</b>
1	85	Electrical equipment and parts.	5,904.8	13.9	20.2
2	84	Machinery and mechanical appliances.	2,850.0	23.9	19.6
3	72	Iron and steel.	1,590.3	21.3	16.1
4	27	Mineral fuels, mineral oils and products of their distillation.	1,233.8	73.7	3.3
5	90	Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus.	1,107.8	34.5	16.2
6	38	Miscellaneous chemical products.	647.4	83.0	15.0
7	29	Organic chemicals.	603.7	31.0	9.4
8	39	Plastics and articles thereof.	401.6	16.2	10.5
9	28	Inorganic chemicals, organic or inorganic compounds of precious metals, of rare-earth metals.	354.4	68.1	20.8
10	25	Earths and stone, plastering materials, lime and cement.	348.0	39.5	49.0
Total			15,041.8	25.9	

Source: Mainland Affairs Council, Taiwan, <http://www.mac.gov.tw>, accessed 21 November 2008.

**TABLE 4 MAJOR EXPORT GOODS FROM TAIWAN TO CHINA  
(JANUARY–JULY 2008)**

<b>Rank</b>	<b>HS Code</b>	<b>Commodities Description</b>	<b>Amount (US\$ million)</b>	<b>Growth Rate (%)</b>	<b>% of Total Exports</b>
1	85	Electrical equipment and parts.	16,121.3	3.2	30.7
2	90	Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus.	8,955.4	57.3	62.4
3	39	Plastics and articles thereof.	4,251.8	14.6	38.6
4	29	Organic chemicals.	3,264.1	64.3	44.8
5	84	Machinery and mechanical appliances.	3,136.0	-3.9	19.2
6	27	Mineral fuels, mineral oils and products of their distillation.	1,631.7	457.0	14.1
7	74	Copper and articles thereof.	1,515.4	-0.7	57.6
8	72	Iron and steel.	1,457.6	-5.4	20.8
9	54	Man-made filaments.	669.1	-5.5	32.9
10	38	Miscellaneous chemical products.	443.7	16.0	30.6
Total			41,446.1	19.3	

Source: Mainland Affairs Council, Taiwan, <http://www.mac.gov.tw>, accessed 21 November 2008.