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# Asia-Pacific Perspectives

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# Taiwan in from the Cold, with China's Blessing

*Peter Drysdale*

Political tensions between China and its neighbors in the region may have been on the rise in the recent past but relations between the mainland and Taiwan have rarely been better. The conclusion of the Economic Cooperation Framework Agreement (ECFA) between Beijing and Taipei represents a significant step forward in deepening cross-straits economic relations and, more importantly, provides a surer economic and political base from which Taiwan can intensify its economic integration into the East Asian economy and its relations with partners in the region and around the world.

Trade between Taiwan and China has grown immensely with the opening for more direct trade and large scale Taiwanese investment on the mainland. In the 1990s Taiwan's trade with China was only 15 per cent of its estimated potential. By the beginning of this decade that had grown to 32 per cent for exports but was still only 17 per cent for Taiwan's imports from China. The accession of both economies to the WTO saw rapidly increased realization of trade and investment potential between Taiwan and China. But even recently, Taiwan's trade with China as only been running at half its potential is reckoned to be.

The fact is that, up to this point, economic relations between Taiwan and China have been on an uneven footing and the blame did not rest with Beijing. Even after the accession of both China and Taiwan to the WTO a decade ago, the peculiar feature of cross-Straits economic relations was that

Taiwan maintained deep discrimination against imports from the mainland, with embargoes on the import of thousands of commodities justified on security grounds but actually reflecting deep protectionism by local interests and unwillingness politically to grasp the full opportunities that opening up trade with China offered to Taiwan.

The ECFA goes a long way to correcting the lop-sidedness and opens opportunities for Taiwan's fuller integration not only into the Chinese but also the East Asian and global economy. Shiro Armstrong explains why this is in another article in this issue of *Asia-Pacific Perspectives*.

Taiwan's discriminatory trade and investment policies towards China meant that Taiwan had effectively cut itself off from participating fully in the East Asian production networks. Taiwan is now free to institutionalize economic relations with other important trading partners such as the US, Japan, EU, ASEAN and Australia.

Last week, Tsai Hong-tu, of Taiwan's APEC Business Advisory Council, announced that he, and Taiwan's APEC ambassador, former ROC Vice President Lien Chan, are set to meet Obama during a group discussion of trade and related issues in Japan next week and that they plan to seek Obama's support for Taiwan's participation in the Free Trade Area of Asia and the Pacific (FTAAP), which the US advocates as a long term objective.

Armstrong argues that this is not Taiwan's best strategy, now it has China's blessing to strengthen its trade relations with other countries, and that the economic rationale for Taiwan to join the FTA game is weak.

"Now that Taiwan can 'go global', a strategy of getting its own house in order will deliver larger gains, and faster, than when Taiwan had effectively cut itself off from China", he says. "A global strategy does not discriminate in trade dealings and instead lets market forces determine trade flows and



economic integration. Making the Taiwanese economy stronger, more flexible, efficient and resilient will help it reap the gains from globalization and integration into the Asian and global economy. ECFA is a framework for removing that discrimination against China; Taiwan should not now introduce discriminatory trade elsewhere."

Taiwan's position as an outlier in the region, encumbered by few preferential trade agreements, could indeed be a significant strategic advantage as it takes its relationship with the mainland and its economy to the next level. As Armstrong says, a strategy that focuses on domestic reform and global liberalization (including in the institutionalization of its relations with other major partners) is likely to yield higher economic gains as well as minimize geopolitical complications than one that dances attendance on the small pickings from bilateral or regional FTAs.

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# Taiwan's Strategy after the Framework Agreement with China

*Shiro Armstrong*

The Economic Cooperation Framework Agreement (ECFA) that Taiwan and China signed on June 29 this year is a milestone in relations across the Straits. It normalizes economic relations between Taiwan and the Mainland. Up to this point, Taiwan has had discriminatory trade and investment policies towards China under the guise of political-security concerns that severely limited economic engagement across the Straits. These measures meant that Taiwan had effectively cut itself off from participating fully in the East Asian production networks.

Taiwan is now free to institutionalize economic relations with other important trading partners such as the US, Japan, EU, ASEAN and Australia. Is it in Taiwan's best interest to now join the FTA game with partners around the region and around the world?

There is a strong desire in some quarters in Taiwan to sign preferential trade deals now that it can and there will be pressure from external powers too. Taiwan may seek to sign trade deals for geopolitical reasons, but not for economic reasons.

The economic rationale for Taiwan to join the FTA game is weak.

The best economic argument for FTAs are that Doha is stalled and liberalization via FTAs is the only alternative and may be better than nothing. There is now enough evidence that this isn't the case (Dee, 2009) Taiwan has very little leverage in negotiating trade access bilaterally with its major trading partners. So unilateral liberalization is a better option. Unilateral liberalization has served East Asia well in the past and the principle of open regionalism has brought into



being a region that is economically much more integrated than Europe or North America, yet depends on those markets for final goods exports. There is evidence of this in recent studies by Zhi Wang, myself and Peter Drysdale.

Taiwan is ideally placed to pursue a global strategy, and a strategy that focuses on domestic structural and regulatory reforms. The economic gains from structural reforms dominate gains from FTAs, even if FTAs are region wide. Estimates suggest that comprehensive unilateral regulatory reforms would deliver five times the gains of an ASEAN+3 agreement. The gains from bilateral FTAs are trivial.

Now that Taiwan can 'go global', a strategy of getting its own house in order will deliver larger gains, and faster, than when Taiwan had effectively cut itself off from China. A global strategy does not discriminate in trade dealings and instead lets market forces determine trade flows and economic integration. Making the Taiwanese economy stronger, more flexible, efficient and resilient will help it reap the gains from globalization and integration into the Asian and global economy. ECFA is a framework for removing that discrimination against China; Taiwan should not now introduce discriminatory trade elsewhere.

The China-ASEAN FTA which comes into force next year is viewed by some as a threat to Taiwan and others in Asia that aren't party to it. There is hope that it sets off competitive liberalisation through other FTAs. That would add more noodles to the mess of FTAs in the region. To date Taiwan has only signed 4 FTAs and they are with Central American countries that do not have significant trade shares in Asia. So Taiwan has a clean slate when it comes to FTAs.

The political capital and resources required in negotiating and signing FTAs are better spent elsewhere. There are political risks to Taiwan signing preferential deals with other countries that discriminate against the mainland. Article 16 of the ECFA is a termination clause where either China or Taiwan can notify the other of termination of the ECFA which takes effect 180 days later.

Taiwan can minimize political risk and maximize economic gains if it enters bilateral arrangements that avoid preferential treatment or allow ready sign-on by other countries. Taiwan has strongly pushed that point in one of its very few submissions to the WTO:

*we propose new provisions... requiring parties of RTAs to provide an accession clause for third-party members, which would expand the reach of RTAs and thereby promote broader, more inclusive and comprehensive trade liberalization (paragraph 7)*

*third parties will not be granted automatic accession to RTAs. However, the original parties to the RTAs will be required to afford third parties, in good faith, adequate opportunity to negotiate individual terms of accession to the RTAs (paragraph 9)*

Taiwan lifted itself into prosperity without FTAs despite, but also because of, its being politically between a rock and a hard place. Commitment to the multilateral trading system through unilateral tariff liberalizations, in which APEC played a significant role, was one way of doing that. Recent economic troubles, which gave the government a window of opportunity to sign ECFA, were not the result of Taiwan's inability to join FTAs. They resulted from the global economic slowdown and significantly Taiwan's being left out of the East Asian production networks.

The restrictions on trade and investment across the Strait have prevented deepening of Taiwan's specialization in the regional and international economy. This has slowed Taiwan's climb up the value-added chain. Taiwan has not been able to add value to some cheap intermediate imports from China and is limited in what it can export to China. Taiwanese firms have not been able to take full advantage of China's upstream or downstream processing capacity. As recently as 2006, Taiwan's imports from China were half of what might have been expected given the size of the Chinese and Taiwanese economies, their distance apart and their trade structure. Taiwan's imports from China were less



than 50 per cent of its potential. Korea's trade with China, for example, was much closer to its potential than was Taiwan's trade with China. This severely limits the engagement of foreign MNEs in Taiwan as they look to participation in production networks with China as part of the advantage of location in East Asia.

FDI into Taiwan has been low and there is much fanfare that Taiwan will now become a more attractive destination after ECFA. Some wrongly point to the lack of FTAs as the reason low FDI in Taiwan. The real reason is that by severely limiting trade flows with the mainland, Taiwan was not an attractive destination for foreign capital. Everything else equal, why build a factory in Taiwan when you could set up in Korea or Vietnam, for example, and enjoy relatively unfettered trade with China, one of the largest, most dynamic and most important economies in the region.

Pursuing deep domestic reforms is not an easy strategy to pursue when there is pressure to sign FTAs. It may seem a lonely strategy although that is nothing new for Taiwan. But given its unique circumstance, Taiwan is in a position to become an exemplar of a new drive towards multilateral liberalization and structural reform. Efficient specialization in the international economy involves heavy interdependence across the Straits: global engagement reduces the economic and political risks associated with that.

It may be an outlier in the region but the economic gains and minimization of geopolitical complications that come with a strategy that eschews preferential trade agreements is likely to provide maximum momentum and confidence in taking Taiwan's economy to the next level.

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# APEC Growth Strategy and the Standpoint of Taiwan

*Darson Chiu*

APEC is currently the most important intergovernmental entity in the region of Asia-Pacific. And the economic leaders' meeting is the most essential event on APEC agenda. As a full member, Taiwan should seriously contemplate about its role and position in such an essential event. We need to think about how to maximize our benefits and utility through this channel.

The global economy experienced a tremendous downturn in 2008 and 2009. The recovery started more significantly in 2010, whereas the APEC region outperformed other regions. It is very important for the region to continue the momentum and keep on the recovery process, since the whole world will be depending further on the economic potential and strength of our region from 2011 on. As a unique intergovernmental forum in the region, APEC has been widely expected to play a more influential role in directing a new economic order and promote regional cooperation. It is again for the USA, the world economic super power, to host the annual APEC events in 2011. APEC member economies are anticipating for a strong and effective leadership in charting APEC agendas and optimizing APEC's functions as the USA is taking the helm.

2010 is the year of phoenix rising for APEC, because all economies in the region started to enjoy stronger GDP growths again after the unprecedented crisis. During the crisis, only a few emerging economies were able to exempt from the negative impacts. With optimistic readings



issued by major forecasting agencies, the entire Asia-Pacific region may now consider itself situated in the post-crisis era.

In the post-crisis era, full and quality recovery from the crisis is a goal that all economies are looking for. Every economy in the APEC region is facing different challenges for the time being. The USA is fighting its high unemployment rate and increasing fiscal deficits, whereas quantitative easing measure seems to be the only option left. Japan is dealing with the potential threat of deflation and inevitable currency appreciation. Despite of the high growth rate, China is addressing its overheated economy with possible asset bubbles. What about Taiwan? It is forecasted to have a good GDP growth rate for this year, and the inflation is moderate. Taiwan seems doing good so far; however, there's always room for improvement. Firstly, we should note that the miserable base period of 2009 with poor economic scores did contribute to the relatively cheerful performance of 2010. Secondly, the recovery of job markets in Taiwan still has no match for the GDP revival.

Although different countries are facing diverse problems, APEC has come up with a collective plan. Known the old growth model was inadequate to support the regional needs, APEC has been trying to come up with a new model since last year. One of the most important issues to be stressed in the upcoming leaders' meeting agenda will be the so called "APEC Growth Strategy". The strategy is designed to include five dimensions or attributes: the balanced, inclusive, sustainable, innovative, and secure growth. Balanced growth is about adopting economic related policies to balance imbalances across economies. Inclusive growth is to look after all civilians especially the vulnerable groups so they can all enjoy benefits from economic growth. Sustainable growth is to mitigate pollutions and protect environment while pursuing growth. Innovative growth is to better utilize modern technologies

and scientific innovation to promote growth. Finally, secure growth is to guarantee safe surroundings for economic activities that nurture growth.

Frankly speaking, the APEC growth strategy is not a panacea that can cure all problems facing different economies. However, it does provide an idea regarding where we can go from here. The strategy was declared in Yokohama and put into APEC joint actions thereafter. It is known that the 2011 APEC meetings hosted by the US will continue to improve and activate the strategy. We may seize the momentum and devise a tactic of our own that maximizes Taiwan's national interests.

Starting from the year of 2010 on, Taiwan and other APEC countries are all facing different sets of supply and demand associated with new economic and social dimensions. Despite the GDP upturn, we must note that vulnerable groups in the region have become even more vulnerable as labor markets deteriorate. Regional decision makers should do something to restore confidence in those vulnerable groups where their confidence was once shattered by the crisis. And to ensure all people a fair chance to prosper, the prospect of growth should be all inclusive.

Like other APEC countries, the Taiwanese government also has to improve the labor markets by providing more job trainings and opportunities. To fulfill that goal, the government can leverage its existing strengths. Without a doubt, Taiwan's strengths lie in its small and medium sized enterprises (SMEs) and information technology (IT) capacity. SMEs in Taiwan are not only more significant for GDP growth but also more jobs oriented, whereas Taiwan has long been recognized as an advanced IT island.

The strategy aiming at making the region to grow more balanced, inclusive, sustainable, innovative, and secure is precisely the model that Taiwan can use to upgrade its SMEs competence. SMEs play a major role in



Taiwan's economic development and growth; however, SMEs also have many disadvantages due to their short in resources. For example, most SMEs have difficulty in getting credit and acquiring funds. In addition, SMEs are also defenseless when it comes to financial crisis and not to mention the potential currency war. Therefore, more government developing plans and spending can be initiated and allocated on empowering SMEs. The objectives of doing it can be making domestic SMEs easier of doing business, more IT capable, more environmental propensity, and resilient to external impacts.

The APEC strategy may not be one-size-fits-all, but we can support the model and make it better meeting our needs. APEC can be used as a platform to coordinate policies and avoid irrational competition such as competitive currency devaluation. In addition to the APEC joint effort, individually we need to fully leverage our resources and maximize our potential to advance SMES as an active engine to continue moving our economy forward, look after our citizens and preserve our precious environment.

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# Introducing the 2011 ABAC Innovative Growth Initiative

*Chen-Sheng Ho*

## **Reviewing the 2010 ABAC Innovative Growth (IG) Initiative**

APEC Economic Leaders stated in the 2009 APEC Leaders' Declaration that APEC should advance economic growth in a sustainable, balanced and inclusive manner. APEC Leaders also supported the enhancement of growth through innovation and a knowledge-based economy. The response from APEC in 2010 was the development of the APEC Growth Strategy that focused on five growth attributes: balance growth, inclusive growth, sustainable growth, innovative growth, and secure growth.

The APEC Business Advisory Council (ABAC) was extremely supportive of the APEC Growth Strategy and began to seek ways for its enhancement. In order to demonstrate support for the APEC Growth Strategy, ABAC Chinese Taipei in 2010 proposed the ABAC Innovative Growth (IG) Initiative. The purpose of the Initiative was to develop suggestions for advancing innovative growth in the APEC region. ABAC members gave solid support to the Initiative. Particularly, the ABAC Capacity Building Action Plan Working Group (CBAPWG) played a major role in providing guidance and encouragement.

As part of the 2010 IG Initiative, the ABAC Knowledge-Based Growth Symposium was held in Taipei during the 2010 2<sup>nd</sup> ABAC Meeting. In addition, suggestions derived from the IG Initiative were stated in the 2010



ABAC Report to APEC Economic Leaders. For example, it was suggested that venture capitalists should integrate market viability research and technology evaluation, so as to ensure more complete services for start-up companies. Additionally, the Report stated that international developers should be encouraged to build multi-option ready-to-move-in industrial parks or living campuses, in order to test emerging applications. Most importantly, the Report suggested the development of market knowledge centers that provide consultancy, organize overseas business missions and offer integrated market research data for small, medium and micro-enterprises (SMMEs).

A survey was also conducted to gather information on ABAC members' views regarding innovative growth. The important information derived from the survey was the belief that human resource development (HRD) should be considered the most significant factor for fostering IG. The survey also indicated that the private sector should be a decisive participant in the national innovation system to promote IG. Furthermore, it was suggested that the national innovation system should support SMEs to develop new products or technologies to derive new service innovation.

## **APEC Viewpoint**

In the APEC document, "The APEC Leaders' Growth Strategy," Leaders states that innovative growth is about creating an economic environment that supports innovation and emerging economic sectors. An important action is the development of a skilled, adaptable, and professional APEC work-force. Specifically, APEC will seek to advance technical and vocational education and training. The purpose is to cultivate skilled personnel. APEC will also promote new skills and strengthen human resource development.

Furthermore, the aforementioned document also relates that it is necessary to promote dialogues and information sharing on innovation policy. The rationale is that innovation policy needs multi-dimensional approaches, such as human resource and entrepreneurship development, R&D investment, tax incentives, financial measures, public-private partnership, and international cooperation. APEC should enhance innovation policies through the sharing of best practices.

According to "APEC's Growth Strategy for the Asia-Pacific Region," the global economy has passed through much turbulence in recent years. However, the Asia-Pacific region has begun to recover. One significant lesson learned from the economic crisis is that the quality of growth must be enhanced, so as to enable APEC economies to continue with their economic development. Furthermore, innovative growth is about the creation of an environment that supports the development and commercialization of ideas.

## **Introducing the 2011 ABAC IG Initiative**

### *The Research Focus*

During the 2010 4<sup>th</sup> ABAC Meeting in Yokohama, ABAC members enthusiastically called for the development of the 2<sup>nd</sup> phase of the ABAC IG Initiative in 2011. The main purpose was to deepen the research on innovative growth and to ensure that the research outcomes will benefit small, medium and micro-enterprises (SMMEs). From the discussions among ABAC members, they agreed that the commercialization of ideas was a significant issue facing SMMEs and entrepreneurs. Particularly, the strengthening of entrepreneurship becomes even more critical in the post-crisis economic recovery because the SMMEs created by entrepreneurs can



provide jobs.

In the 2010 IG Initiative, Human Resource Development (HRD), innovation system, and business environment had been identified as major elements of IG. According to the 2010 survey, ABAC members had considered the HRD factor to be the most important improvement needed for fostering IG. Essentially, the 2010 survey had identified four aspects of HRD for promoting IG: 1) Product technology R&D talent; 2) Customer-oriented, interdisciplinary innovation talent; 3) Knowledge management talent; 4) Government officials with cooperative spirit and ability.

The 2011 ABAC IG Initiative will seek to advance entrepreneurship and the commercialization of ideas. Specifically, the Initiative will focus on the commercialization of ideas in three areas: 1) Green Technology; 2) Service-Added Manufacturing (SAM); and 3) E-services. Most importantly, the Initiative will consider how HRD, innovation system, and business environment elements affect SMMEs' commercialization of ideas in the three aforementioned areas. Furthermore, the Initiative will state the best practices for SMEs. In addition, suggestions for enhancing public-private partnerships will be given.

## **Specific Details of the 2011 ABAC IG Initiative**

### *Purpose*

1. Analyze the latest development on APEC Growth Strategy in general and the innovative growth attribute in particular.
2. Assess the relationship between HRD, innovation system, and business environment; and SMMEs' commercialization of ideas.
3. Enhance the collaboration between ABAC and APEC working groups.

### *Motivation*

1. APEC continues to emphasize the APEC Growth Strategy in 2011, so that the input from ABAC is essential.
2. ABAC members have called for the necessity to deepen the understanding of innovative growth.
3. There is the need to gather and analyze the latest information and best practices, in order to advance SMME development in the APEC region.

### *Key Activities*

1. Undertake research on the role of HRD, innovation system and business environment in advancing SMMEs' commercialization of ideas.
2. Conduct survey of APEC SMEWG and ABAC members on the above stated research agenda.
3. Hold one workshop on entrepreneurship and commercialization of ideas.
  - The workshop will be held during the week of APEC SME Working Group (SMEWG) Meeting, SME Ministerial Meeting (SMEMM) and Ministers Responsible for Trade (MRT) Meeting in Big Sky, Montana, USA, in May 2010.
  - The workshop themes: 1) Entrepreneurship and Employment; 2) Entrepreneurship and Green Growth; 3) Entrepreneurship and Commercialization of Ideas.
  - The Kauffman Foundation and the International Council for Small Business (ICSB) are providing support through the provision of speakers. Speakers from ABAC and SMEWG will also be invited.
  - The SMEWG, Taiwan Institute of Economic Research (TIER), and the APEC SME Crisis Management Center (SCMC) will cooperate to realize the workshop. The objective is to enable ABAC members, SMEWG members, APEC delegates, entrepreneurs, scholars and stakeholders to



share ideas.

### *Methodology*

1. Research will be conducted using qualitative analysis. The research team will collect and analyze information from APEC and ABAC documents, the Internet, and academic literature.
2. The research team will conduct a survey focusing on APEC SMEWG and ABAC members.
3. A workshop will be held to gather information and suggestions for advancing entrepreneurship and SMMEs' commercialization of ideas.

### *Deliverables*

1. An overall report of the 2011 ABAC IG Initiative.
2. A report on the results of survey.
3. The workshop in Big Sky, Montana.

### *Project Team*

1. The Taiwan Institute of Economic Research (TIER) will execute the Initiative.
2. The team members will primarily compose of researchers from TIER.

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