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**Political Conflict and Economic Cooperation Between Beijing and Taipei**

by

**Kung-wing Au**

**A dissertation submitted to the Graduate Faculty in Political Science  
in partial fulfillment of the requirements for the degree of  
Doctor of Philosophy, The City University of New York**

2003

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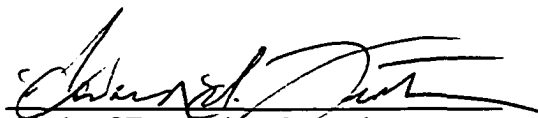
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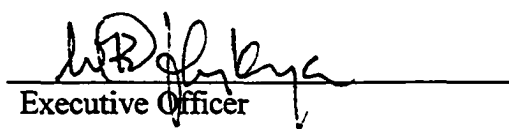
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## Abstract

### Political Conflict and Economic Cooperation Between Beijing and Taipei

by

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Advisor: Professor Howard H. Lentner

The Beijing-Taipei relationship is characterized by political conflict on the one hand, and economic cooperation on the other. This dissertation examines the interplay between these two phenomena, to determine which of them has become the dominating factor in Beijing-Taipei ties. The research finds that (1) the political conflict between Beijing and Taipei has seriously affected, and continues to affect, their economic cooperation; and that (2) the economic exchanges between the two sides of the Taiwan Strait have not muted their political conflict.

The first finding contradicts the common impression that the Chinese mainland and Taiwan have a high degree of “economic interdependence.” A more careful examination reveals that, owing to the political conflict, only a low level of economic interdependence exists between the two sides. This finding is further confirmed by a broader view that includes more players in the region for comparison. Despite Taiwan’s investment in the Chinese mainland, Taiwan’s trading economy is oriented towards Japan and the United States as a bloc rather than towards the Chinese mainland and Hong Kong. Using the case of Beijing-Taipei relations, the dissertation demonstrates the great effects of politics on economics.

The second finding lends support to one side of the liberal-realist debate on the pacifying effects of trade and investment. Cross-strait trade began in 1987. By comparing 1987 with 2002, the research finds few signs of political reconciliation; that is, 15 years of economic cooperation has not brought the two sides closer politically, though they now have closer economic ties.

Since conflict and cooperation are seemingly incompatible, the coexistence of political conflict and economic cooperation between Beijing and Taipei is a puzzle to resolve. Through an analysis of different sources of materials, the research finds that in cross-strait economic exchanges, a lot of political motives exist, and these motives serve to support the economic cooperation.

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## Chapter 1

### Conflict and Cooperation

#### Introduction

Since Taipei lifted its restriction on travel to the Chinese mainland in 1987, economic, social, and cultural exchanges between the two sides of the Taiwan Strait have developed rapidly. By the end of 2000, about 30 percent of the population in Taiwan had visited the mainland, cross-strait trade had amounted to US\$30 billion, and more than 50,000 Taiwanese enterprises had set up factories on the mainland, according to Zhou Mingwei, deputy director of the State Council's Taiwan Affairs Office on the mainland.<sup>1</sup> It was estimated that Taiwan-funded factories provided 5 million jobs in China, 70 percent of which concentrated in Guangdong and Fujian.<sup>2</sup> According to an internal document from Taipei's Mainland Affairs Council (MAC), at least 200,000 Taiwanese expatriates are living on the mainland.<sup>3</sup> Although the share of China's exports that was linked to Taiwan-funded factories was hard to estimate, it could occupy a significant portion as Taiwanese manufacturers produced everything from shoes to computers in China and sold their products to the United States and other major markets in the world.

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<sup>1</sup> Gang Ji, "Exchanges between Cities and Parties Grow," *China Daily (Hong Kong Edition)*, March 1, 2001. Nongovernmental sources generally reported a smaller number of Taiwan-funded enterprises on the mainland. See, for example, David Murphy and Maureen Pao, "A Place to Call Home," *Far Eastern Economic Review*, July 5, 2001, pp. 56-59. These authors put the number at 40,000.

<sup>2</sup> Hsing You-tien, *Making Capitalism in China: The Taiwanese Connection* (New York: Oxford University Press, 1998), 3.

<sup>3</sup> Yun-han Chu and Jih-wen Lin, "Political Development in 20<sup>th</sup> Century Taiwan: State-Building, Regime Transformation and the Construction of National Identity," *China Quarterly*, no. 165 (March 2001), 129.

Thus, other than creating jobs, Taiwanese enterprises generated revenues for China locally and nationally. When Taiwanese industries escaped from the island's stringent environmental protection laws, expensive land and labor costs, and the impact of appreciation of Taiwan's currency on exports, they found in China many of the conditions that would allow them to sustain their business competitiveness. On the other hand, China relied on Taiwanese investment as an important means to generate jobs, bring in revenue, promote export growth, and transfer technology and managerial expertise. Despite occasional exchanges of hostile rhetoric, lingering ideological rivalry, and the tensions caused by potential military confrontation, the two sides of the Taiwan Strait kept trying out a *modus vivendi* for economic cooperation in the 1990s.

The growth of cross-strait exchanges seemed to continue unabated as a new page of history was turned, ushering in a new century that witnessed for the first time the coming to power of a pro-independence political party on the island of Taiwan. Journalists, scholars, scientists, athletes, performers, politicians, and tourists from Taiwan continued to visit the mainland in large numbers. On both sides of the strait, official and nongovernmental agencies organized and sponsored various cultural exchanges, including the exhibition in Taipei of the terra cotta warriors from China's ancient city of Xian, and the visits to Taiwan of Chinese opera troupes. On the societal level, the people-to-people contacts between the two sides became increasingly frequent. According to the data from the MAC, in 2001 residents on the island of Taiwan made 102 million phone calls to the mainland, and mainland residents made 133 million phone calls in return.<sup>4</sup> During the same year, indirect mail delivery across the Taiwan Strait amounted to 5 million letters from Taiwan to China, and 8 million letters from China to

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<sup>4</sup> MAC, *Cross-Strait Economic Statistics Monthly*, no. 121 (September 2002).

Taiwan.<sup>5</sup> MAC data also show that in the past few years, about one-third of Taiwan's approved outward investment flowed to China, about 17 percent of Taiwan's exports were shipped across the strait, and in terms of total trade China had become Taiwan's fourth largest trade partner, while Taiwan had become China's fifth largest trade partner. Furthermore, officials from both sides of the Taiwan Strait did meet on the sidelines of important international conferences such as the Asia-Pacific Economic Cooperation (APEC) forum. This phenomenon has prompted some writers to describe cross-strait relations as economic interdependence.<sup>6</sup>

There is undoubtedly a great deal of activities and transactions going on across the Taiwan Strait. Although the Taiwanese government still maintains a relatively tight policy toward migration, investment, and to some extent visits from the mainland, Taiwanese business people have helped to transform several popular destinations in China into prosperous towns and cities that they call their second home. Among these are Dongguan in the Pearl River Delta region, Kunshan near Shanghai, and Xiamen in Fujian province. Many Taiwanese men did marry mainland women, who would bear their children. To some observers, the people-to-people contacts across the Taiwan Strait have been diluting the distinctive Taiwanese identity, a process that would eventually facilitate China's national reunification.<sup>7</sup> The revival of the Mazu (Goddess of the Sea) cult on both sides of the Taiwan Strait has led to what Murray Rubinstein called the

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<sup>5</sup> Ibid.

<sup>6</sup> See, for example, Steve Chan and Cal Clark, "The Mainland China-Taiwan Relationship: From Confrontation to Interdependence?" in *Inherited Rivalry: Conflict Across the Taiwan Strait*, ed. Tun-jen Cheng, et al (Boulder: Lynne Rienner, 1995), 47-62; and Suisheng Zhao, "Economic Interdependence and Political Divergence," in *Across the Taiwan Strait*, ed. Suisheng Zhao (New York: Routledge, 1999), 21-40.

<sup>7</sup> On the other hand, the Chinese government allowed Taiwanese business people to build their own schools to educate their own children, with materials shipped largely uncensored from Taiwan, and this is a contradictory tendency that would reinforce the Taiwanese identity.

reconnection of temple ties in Fujian and Taiwan, and to the rediscovery of ancestral roots by the Taiwanese who embarked in large numbers for pilgrimage to Fujian.<sup>8</sup> Rubinstein suggested that such pilgrimage is “becoming a means of creating an atmosphere in which future interpersonal, if not interstate, relationships can become even closer,” and he saw that “by engaging in the process of pilgrimage and returning to their *zumiao* [ancestral temple] and their roots as Minnan Ren [southern Fujianese], the Taiwanese reinforce their sense of Chinese regional identity, and, at the same time, weaken their own particularistic sense of Taiwanese identity.”<sup>9</sup> Yet as Rubinstein discussed this observation with some prominent members of the Democratic Progressive Party (DPP), they recoiled at the idea and rejected the notion of a religiously and culturally based identity for southern Fujianese, and one of them said that the cultural and historical ties to Fujian have little power among the average Taiwanese.<sup>10</sup>

Other analysts, such as Yun-han Chu and Jih-wen Lin, acknowledged “the deepening economic interdependence” between Taiwan and China and held that “the settlement of an increasingly larger number of Taiwanese businessmen and migrants in the mainland, and the emergence of a Mandarin-based media industry across the Strait will certainly complicate the consolidation of Taiwanese identity.”<sup>11</sup> But they also warned that “an elite-orchestrated Taiwanese nation-building project will inevitably run

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<sup>8</sup> Murray Rubinstein, *The Revival of the Mazu Cult and of Taiwanese Pilgrimage to Fujian* (Cambridge, MA: Harvard University – the Fairbank Center for East Asian Research, 1994).

<sup>9</sup> *Ibid.*, 41.

<sup>10</sup> *Ibid.*, 40.

<sup>11</sup> Chu and Lin, 129.



into a head-on collision with a state-orchestrated Chinese nationalism on the mainland.”<sup>12</sup>

On the economic front, which is the focus of this research, the emerging exchanges across the Taiwan Strait, as well as the growing web of business and personal ties that come from such exchanges, have prompted some observers to write on the rise of a “China Circle.”<sup>13</sup> Depending on the need of analysis, this circle may constrict and expand. Focusing on the process of economic integration among different Chinese societies, the notion at a minimum includes the southern provinces of China, Hong Kong, and Taiwan.<sup>14</sup> At a maximum it involves the Chinese state of Singapore, Chinese communities in Southeast Asia, and overseas Chinese elsewhere.<sup>15</sup> Harry Harding, one of the leading scholars in Chinese studies, preferred to use the term “Greater China,” and he dissected such an entity into economic, cultural, and political aspects for analysis, noting that these aspects do not necessarily overlap.<sup>16</sup>

Rather than defining and analyzing the ethnic, economic, or political scope of a Greater Chinese Community, others have chosen to examine the implications of economic integration on political union, focusing on the relations between Beijing and Taipei. Jun Zhan, for example, used a Graduated Reciprocation in Tension-Reduction

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<sup>12</sup> Ibid.

<sup>13</sup> See, for example, Barry Naughton, ed., *The China Circle: Economics and Electronics in the PRC, Taiwan, and Hong Kong* (Washington, DC: Brookings Institution, 1997). It should be noted that a proliferation of terms has now been used to describe the phenomenon.

<sup>14</sup> For instance, Hong Kong economist Yun-wing Sung tends to see a smaller circle centering on Hong Kong and including Taiwan and south China. See his article, “Hong Kong and the Economic Integration of the China Circle,” in *The China Circle*, ed. Barry Naughton (Washington, DC: Brookings Institution, 1997), 41-97.

<sup>15</sup> See, for example, Murray L. Weidenbaum, *The Bamboo Network* (New York: Martin Kessler Books, 1996).

<sup>16</sup> Harry Harding, “The Concept of ‘Greater China’: Themes, Variations, and Reservations,” *China Quarterly*, no. 136 (December 1993): 660-687.

(GRIT) model to describe and predict an easing up of cross-strait relations as a result of cross-strait trade that began in the late 1980s.<sup>17</sup> Zhan distinguished “low politics” from “high politics” and wrote that reciprocal acts in the “low politics” sphere would improve ties and lead to similarly reciprocal acts in the “high politics” sphere. According to Zhan, trade and investment belong to the less contentious realm of “low politics,” and security and sovereignty belong to the more intractable realm of “high politics.” Zhan suggested that “when low politics activities reach a certain level, governments have to get involved one way or another to mediate civil affairs, arbitrate business disputes, coordinate economic cooperation, and the like. So low politics activities can accomplish what the high politics activities sometimes fail to do – bringing the two opponents to the negotiation table.”<sup>18</sup> Looking at the events in the late 1980s and the early 1990s – a time when cross-strait trade began to take off – Zhan predicted that “trade can bypass politics and promote cooperation” and that “as the bilateral trade grew up, the tensions between Beijing and Taiwan decreased.”<sup>19</sup> Impressed by the exchanges across the Taiwan Strait in the early 1990s, Ralph Clough also wrote, “All of this activity transformed the atmosphere between the two adversaries. Tension declined and the risk of military conflict receded.”<sup>20</sup> Steve Chan and Cal Clark also held that resulting from the increasing economic interdependence, “rising interaction and communication between

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<sup>17</sup> Jun Zhan, *Ending the Chinese Civil War: Power, Commerce, and Conciliation between Beijing and Taipei* (New York: St. Martin's, 1993).

<sup>18</sup> *Ibid.*, 6.

<sup>19</sup> *Ibid.*, 110.

<sup>20</sup> Ralph Clough, *Reaching Across the Taiwan Strait: People-to-People Diplomacy* (Boulder, CO: Westview Press, 1993), 1.

the two sides have laid a foundation of mutual confidence and lengthened the shadow of the future” that would serve as an incentive for cooperation.<sup>21</sup>

Of course, these scholars wrote their works before the 1995-96 missile crisis occurred, and before Taiwanese President Lee Teng-hui caused great tensions in 1998 by proposing a “two states theory.” They also failed to foresee the tensions caused by Taiwan’s presidential election in 2000, as well as the political impasse that ensued. At a minimum, tension reduction in the Taiwan Strait has not been a linear process. The events in the past decade indicate that tensions could subside and reemerge. The intermittent relaxation and heightened tensions in the Taiwan Strait suggest that it could be an on-and-off process, despite the economic cooperation between the two sides. What is indicative of the ineffective pacifying function of economic exchanges is perhaps a report by Donald Zagoria, who wrote in 2000 that he saw that “currently the main problem is the existence of a political impasse heightened by no sign of compromise”; that “currently a vicious circle is developing” in which hard-liners in the PRC contend that military threat is the only effective counter to Taiwan’s drift toward independence, while hard-liners in Taiwan and the United States see military strength as the only response to Beijing’s threat”; and that “China and Taiwan are now on a collision course.”<sup>22</sup>

Unlike Jun Zhan, other scholars see both the integrative and disintegrative forces at work. Taiwanese scholars are generally less sanguine. Tse-kang Leng, for example, vacillated on the issue. In his seminal work on the development of Taiwan-China

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<sup>21</sup> Chan and Clark, 59.

<sup>22</sup> Donald S. Zagoria, *Cross-Strait Relations: Breaking the Impasse – An Interim Report (with Policy Recommendations) on U.S.-China Policy and Cross-Strait Relations* (New York: National Committee on American Foreign Policy, Inc.), pp. 12, 14, 26.

business ties, Leng wrote, "Taiwan, Hong Kong, and the coastal provinces of China have become closely connected and economically interdependent. From an optimistic perspective, economic interdependence could ease political tensions and promote trade liberalization in this region. The creation of a 'Greater China Economic Circle' could also lay the foundation for future political cooperation and integration."<sup>23</sup> But Leng also held that "given the fact that economic interaction across the Taiwan Strait has created a situation of economic dependence for Taiwan, rather than interdependence, political integration through economic cooperation, such as the creation of a 'Greater China Economic Circle,' seems to be a remote goal."<sup>24</sup> Similarly, Harding noted that after a period of euphoria, analysts both in China and abroad have expressed reservations about the desirability and feasibility of forming a highly institutionalized transnational Chinese economy; and that instead they now prefer informal and flexible economic arrangements that would allow all sides to reap benefits.<sup>25</sup> This being the case, a formal, highly institutionalized political arrangement that could be termed China's unification seems to be more remote. The reason for this phenomenon can largely be found in Taiwan's reluctance to unify with the People's Republic of China (PRC). As a leading French scholar in Chinese studies observed, despite all the goodwill gestures from Taipei, Taiwan is only interested in improving ties with the PRC but not in unifying with it.<sup>26</sup> If Beijing loses patience as a result of rising nationalistic sentiment or increasing confidence

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<sup>23</sup> Tse-kang Leng, *The Taiwan-China Connection: Democracy and Development Across the Taiwan Straits* (Boulder CO: Westview Press, 1996), 116-17.

<sup>24</sup> *Ibid.*, 127.

<sup>25</sup> Harding, 670.

<sup>26</sup> Jean-Pierre Cabestan, "Taiwan's Mainland Policy: Normalization, Yes; Reunification, Later," *China Quarterly*, no. 148 (December 1996): 1260-83.

in its capability; or if Taiwan, driven by domestic politics, drifts further toward independence, a demand for resolving the conflict may be felt, and tensions resurface.

In his book, Zhan hinted that political integration can be achieved through commerce. The title of Zhan's book is *Ending the Chinese Civil War: Power, Commerce, and Conciliation between Beijing and Taipei*. Ironically, Beijing and Taipei are still *technically* at war because they have yet to negotiate a formal end to the state of hostility, despite the fact that Chinese President Jiang Zemin called for it in his 1995 eight-point proposal and Taiwanese President Lee Teng-hui concurred.

Other works have been written to analyze, or speculate on, the pacifying functions of cross-strait economic exchanges. J.W. Wheeler suggested that since the economic cooperation between the two sides brings about hard-won benefits that are so vital to both economies, both sides would consider alternatives and costs before seriously disrupting such mutually beneficial ties.<sup>27</sup> Chang Chun-yen, president of National Chiao Tung University and an adviser to Taiwan's President Chen Shui-bian, told a 2000 seminar in Taipei that, owing to their closer economic ties, a military clash between China and Taiwan is unlikely because not only Taiwan but China would suffer economically.<sup>28</sup>

Researchers have also offered a microscopic view of the "symbiotic" relationship between Taiwanese investors and local Chinese bureaucrats. They noted that in Taiwan, constituencies have emerged arguing for cross-strait stability, among them are the business conglomerates that have investments in China. Conversely, local Chinese

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<sup>27</sup> J.W. Wheeler, "Taiwan and the Mainland: Can Economic Interaction Mute the Conflict?" in J.W. Wheeler, ed., *Chinese Divide: Evolving Relations Between Taiwan and Mainland China* (Indianapolis: Hudson Institute, 1996), 81-95. See also Harry Harding's "Discussion: Can Economics Mute the Conflict?" in the same volume, pp. 97-99.

<sup>28</sup> "War Unlikely Given Investment: Aide," *South China Morning Post*, July 10, 2000 at [www.scmp.com](http://www.scmp.com).

officials depending on Taiwanese investors for revenue and jobs generation welcome them to the extent of bending rules laid down by Beijing. It was reported that in some medium-sized cities, Taiwanese merchants contributed between 30 and 50 percent of the local tax revenue.<sup>29</sup> Local Chinese officials do not want to see a war in the Taiwan Strait, and they could act as a restraining force against the warlike rhetoric from Beijing. An anonymous Taiwanese businessman based in the south told a reporter that “the locals around here don’t share the views of Beijing people,” and “in Shanghai and Guangdong they don’t want war. They tell us don’t worry it won’t happen.”<sup>30</sup> Leong Liew suggested that as business ties develop across the Taiwan Strait, a lobby group that is dependent on China-Taiwan economic exchanges will be formed on the mainland to articulate Taiwan’s major concerns.<sup>31</sup> However, given Beijing’s reluctance to give consent to the creation of a nation-wide association of Taiwanese business people on the mainland (local associations are allowed), it is doubtful that Taiwanese business people will have much collective bargaining power.<sup>32</sup>

The fact that local authorities have limited restraint on the Beijing leadership should it decide to initiate a conflict can be seen from the missile buildup in Fujian. Jude Howell pointed out that during an armed confrontation in the Taiwan Strait, Fujian would

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<sup>29</sup> Percentages suggested by Alexander Pann, chairman, Taiwan Business Association in Hong Kong. See David Murphy, “Holding the Purse Strings,” *Far Eastern Economic Review*, July 5, 2001, P. 61.

<sup>30</sup> Ibid.

<sup>31</sup> Leong H. Liew, “A Political Economy Analysis of Taiwan-Mainland Economic Relations,” in *Uncertain Future: Taiwan-Hong Kong-China Relations after Hong Kong’s Return to Chinese Sovereignty*, ed. C.L. Chiou and Leong H. Liew (Brookfield, Vermont: Ashgate, 2000), 151.

<sup>32</sup> Tse-kang Leng, “Dynamics of Taiwan-Mainland China Relations: the Role of Private Firms,” *Asian Survey* (May 1998), 506.

be threatened by an American air strike.<sup>33</sup> This could happen as aircraft take out missile sites, airports, military facilities, and other infrastructure in Fujian. Officials in Fujian know that their province would bear the blunt should an armed conflict erupt, but they also know that it is beyond their authority to reject the deployment of missiles that are aimed at Taiwan.

Some scholars have chosen to analyze the evolving political relationship between Beijing and Taipei independently of economic exchanges. Qimao Chen, president emeritus of Shanghai Institute for International Studies, thinks that the main thrust comes from political maneuver rather than economic consideration; and this can be seen from the three scenarios he sees in the future:

1. Taipei and Beijing work together to normalize and improve bilateral relations.  
“This would be the ideal development.”
2. Taipei continues its diplomatic activities even more aggressively to create “two Chinas.” This makes the mainland react so strongly that tensions resurface and escalate into a new crisis, which in turn, might escalate into military conflict. “The possibility of this scenario should not be underestimated.”
3. Taipei tries to reduce cross-Strait tensions and agrees to hold peace negotiations, on the one hand, but, on the other hand, continues to work to increase its international recognition and international status and to weave an “international security network” to constrain China. Although Beijing will not resort to force, it will take a variety of measures to deter Taiwan

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<sup>33</sup> Jude Howell, “The Political Economy of Xiamen Special Economic Zone,” in *Fujian: A Coastal Province in Transition and Transformation*, ed. Y.M. Yeung and David K.Y. Chu (Hong Kong: Chinese University Press, 2000), 139.

independence. Under these circumstances, there will be neither war nor peace, but continuous tensions along the strait. “Such a scenario...is very possible.”<sup>34</sup>

Judged from the difficulty in the political relationship between Beijing and Taipei, it seems that cross-strait economic cooperation is more likely to become the dependent variable rather than the independent variable in the development of cross-strait relations. Timothy Wong, a researcher at the Chinese University of Hong Kong, explained the interaction of politics and economics in the following way:

The development of Fujian-Taiwan, and the broader cross-Strait, economic and trade relations can at best ease the cross-Strait political tension to some extent, *but the effect is, nevertheless, limited. As the cross-Strait conflict is essentially political, it can only be solved by a political solution that might come with the wisdom of the leaders and people on both sides.* Without doubt, the development of Fujian-Taiwan economic and trade relations today is constrained by the political logjam in the cross-Strait relationship. If there is no political breakthrough in the near future, further economic cooperation between Fujian and Taiwan will be seriously hampered. It may even face the risk of deterioration should political confrontations reemerge across the Taiwan Strait (emphasis mine).<sup>35</sup>

The political solution mentioned by Wong remains an issue to be discussed. But it seems that it will have to be a win-win arrangement for both sides. Paul Bolt held that economic benefits cannot provide a sufficient condition for resolving the political conflict, and he suggested that if the Taiwan issue is to be settled satisfactorily, it will have to be

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<sup>34</sup> Qimao Chen, “The Taiwan Strait Crisis: Causes, Scenarios, and Solutions,” in *Across the Taiwan Strait*, ed. Suisheng Zhao (New York: Routledge, 1999), 148-50.

<sup>35</sup> Timothy K.Y. Wong, “Bridging the Two Sides of the Taiwan Strait,” in *Fujian: A Coastal Province in Transition and Transformation*, ed. Y.M. Yeung and David K.Y. Chu (Hong Kong: Chinese University Press, 2000), 164.



settled with dignity for both sides, “involving not only economics but also issues of identity, power, pride, security, political values, and international relations.”<sup>36</sup>

At present, the conflict between Beijing and Taipei is largely zero-sum in nature. Joseph Nye defines a zero-sum game in the following way: “In a zero-sum situation, your loss is my gain and vice versa. In a positive sum situation, we both gain; in a negative sum situation, we both lose. Dividing a pie is zero-sum, baking a larger pie is positive sum, and dropping it on the floor is negative sum.”<sup>37</sup> At this moment, if the Republic of China (ROC) on Taiwan is unified with the PRC solely on Beijing’s terms, it will become a special administrative region of the PRC and lose its *de facto* statehood; if the PRC fails to bring Taiwan back to its fold, it cannot achieve national reunification. At present, Beijing tries to isolate Taipei diplomatically to dash its hope of winning international recognition as an independent state, and Taipei tries to break out in the hope of finding the legal protection accorded to a sovereign state. As John Garver observed, “To the extent that Beijing succeeded in this, Taiwan stood isolated before PRC attempts at economic and military coercion. To the extent that Taiwan secured international recognition of its status as a sovereign state, it enjoyed the powerful protection of the legal norms of international society.”<sup>38</sup> The Beijing-Taipei political conflict was zero-sum in nature because in the 1950s and 1960s, both sides of the Taiwan Strait tried to replace each other as the legitimate government of China, by military means if necessary, and armed conflicts did erupt. Currently, the ways in which the conflict should be

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<sup>36</sup> Paul J. Bolt, “Economic Ties Across the Taiwan Strait: Buying Time for Compromise,” *Issues & Studies*, vol. 37, no. 2 (March/April 2001), 105.

<sup>37</sup> Joseph S. Nye, *Understanding International Conflicts: An Introduction to Theory and History* (New York: Longman, 1997), 163.

<sup>38</sup> John W. Garver, *Face Off: China, the United States, and Taiwan's Democratization* (Seattle: University of Washington Press, 1997), 16.

resolved as suggested by both sides still show the outcome of a zero-sum game. Beijing's "one country, two systems" model would downgrade Taiwan to a local government of the PRC. Taipei's initiatives include the Kuomintang's (KMT) confederation model and the DPP's pro-independence stance, all point to "two Chinas" or "one China, one Taiwan," which contradicts Beijing's one-China principle. However, the zero-sum nature of the political conflict between Beijing and Taipei is not absolutely immutable. As Arthur Waldron observed, mainland Chinese and Taiwanese are not Arabs and Israelis and they understand that; they also understand that their disagreements are political and they share a great deal culturally as well as in objective interests, "therefore the raw material exists for a breakthrough."<sup>39</sup> With lots of imagination and goodwill, both sides can transform the zero-sum game into a positive-sum one. But if they decided to fight, to the extent of devastating their economies and killing their own people, they can turn their political conflict into a negative-sum game.

The above discussion raises two questions. First, given the fact that the political conflict itself remains unresolved and continues to affect cross-strait economic cooperation, how much truth is there in suggesting that an economic interdependence exists between the two sides of the Taiwan Strait? Some analysts have reservations about such a description. Cabestan, for example, pointed out (in 1996) that Taiwan's economic dependence on the mainland remained "rather limited" because the level of dependence was only 10 percent of Taiwan's foreign trade and 16.5 percent of Taiwan's exports, a level that was "much lower than the one which links for instance France and Germany

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<sup>39</sup> Arthur Waldron, "Back to the Basics: the U.S. Perspective on Taiwan-PRC Relations," in *Crisis in the Taiwan Strait*, ed. James Lilley (former U.S. ambassador to China) and Chuck Downs (Washington, DC: National Defense University, 1997), 336.

and it will take time before such a level is reached (25 percent).”<sup>40</sup> Other than trade dependence rate, perhaps a few more indicators, both nominal and comparative, should be added to capture the whole picture of cross-strait economic interaction. The second question is: In the light of the reasonable expectation that economic exchanges have a pacifying effect, to what extent have cross-strait economic exchanges muted the political conflict between Beijing and Taipei? As shown above, some analysts see a more gluing effect of trade and investment while others remain skeptical. The divergence of their views is captured by a theoretical debate between the liberals and realists in the study of international politics, to be shown below.

### **I. International Relations (IR) Theories**

Generally speaking, the liberals who see the pacifying effect of trade argue that trade creates mutual dependence which makes conflict more costly, thereby increasing the incentives toward cooperation, and hence toward peace. According to the liberals, trade brings about economic welfare, which can be lost if a conflict erupts, and since states want the economic welfare they refrain from conflict. A second theme articulated by the liberals is that they “consider trade a force for peace because they believe that economic interdependence creates positive bonds among peoples and promotes a harmony of interest among societies.”<sup>41</sup> By “positive bonds” it means friendships among the communities that come into contact through trade.

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<sup>40</sup> Cabestan, 1281.

<sup>41</sup> Robert Gilpin, *The Political Economy of International Relations* (Princeton, NJ: Princeton University Press, 1987), 172.

Critics who hold a different view argue that the level of trade between two states is simply a reflection of, or a response to, their political relations. They reason that states in conflict hardly trade, and that mutual hostility between two states motivates them to refrain from depending on each other for supplies and incomes that may be disrupted in a conflict. These critics would also point out that traders in ancient and present time traded with the communities where they had friends and did not venture into the communities where their heads would likely be chopped off. In addition, they hold that more contacts mean more opportunities for conflict.<sup>42</sup>

These two different perspectives fall into two theoretical categories in the study of international politics, namely, liberalism and realism.<sup>43</sup> In other words, while the liberals see the pacifying effect of trade, which may mute political conflict, the realists think it is futile to bet on this kind of effect because trade takes place in a political context, is conditioned by politics, and is often affected by political disputes rather than muting such disputes. To the realists, even free trade, much vaunted by the liberals, is a political arrangement.

Among the liberals, Richard Rosecrance has written extensively on this subject.<sup>44</sup> Rosecrance explained the rise of the trading state to replace the belligerent state from a perspective of cost-benefit analysis. According to Rosecrance, contemporary states do not have to fight wars for power and wealth, because they can acquire these things

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<sup>42</sup> Kenneth Waltz argued for this theme. See Kenneth Waltz, "Conflict in World Politics," in *Conflict in World Politics*, ed. Steven Spiegel and Kenneth Waltz (Cambridge: Winthrop Publishers, 1971), 454-474.

<sup>43</sup> For a succinct comparison between realism and liberalism, see Howard H. Lentner, *International Politics: Theory and Practice* (St. Paul, MN: West Publishing Company, 1997), 39.

<sup>44</sup> See his books, *The Rise of the Trading State: Commerce and Conquest in the Modern World* (New York: Basic Books, 1986); and *The Rise of the Virtual State: Wealth and Power in the Coming Century* (New York: Basic Books, 1999).

through trade. Rosecrance took issue with the realist theories that emphasize international anarchy, a hierarchy of issues dominated by questions of military security, and force as a usable means. "According to realist theories, conflict remains as the typical outcome in international politics and that conflict will periodically lead to war."<sup>45</sup> But Rosecrance held that wars are increasingly a phenomenon of the past, because "in the nuclear age, wars of territorial expansion are not only dangerous, they are costly and threatening to both sides."<sup>46</sup> A better path to power and wealth is through trade.

Political philosophers have long discussed the pacifying effect of trade. For example, Baron de Montesquieu, a leading philosopher of the Enlightenment period, declared the unifying effect of trade in the following way:

The natural effect of commerce is to bring about peace. Two nations which trade together render themselves reciprocally dependent if the one has an interest in buying, the other has an interest in selling, and all unions are based on mutual needs.<sup>47</sup>

Immanuel Kant, another political philosopher, saw the pacifying effect of trade in this way:

The spirit of commerce, which is incompatible with war, sooner or later gains the upper hand in every state. As the power of money is perhaps the most dependable of all the powers (means) included under the state power, states see themselves forced, without any moral urge, to promote honorable peace and by mediation to prevent war whenever it threatens to break out.<sup>48</sup>

More recently, David Mitrany, representing the functionalist school in the study of politics, said:

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<sup>45</sup> Rosecrance 1986, 47.

<sup>46</sup> Rosecrance 1986, 13.

<sup>47</sup> Quoted in Ruth Arad, Seev Hirsch and Alfred Tovias, *The Economics of Peacemaking: Focus on the Egyptian-Israeli Situation* (New York: St. Martin's Press, 1983), 11.

<sup>48</sup> Immanuel Kant, *Perpetual Peace* (Indianapolis: Bobbs-Merrill, 1957), 32.

Society will develop by our living in it, not by policing it. Nor would any political agreement survive long under economic competition, but economic unification would build up the foundation for political agreement, even if it did not make it superfluous.<sup>49</sup>

Mitrany's argument clearly points to the economic origin of political agreement. It emphasizes economics as the driving force in world affairs.

This kind of view is provocative to the realists. Kenneth Waltz, for example, is diametrically opposed to such reasoning. Waltz criticized the economists who "single out one aspect of man" to explain the whole of human life, observing that the famous "economic man," as a single-minded profit maximizer, does not exist.<sup>50</sup> But what is more important, and this is directly related to the research of this dissertation, is Waltz's proposition that "goods and capital flow freely where peace among countries appears to be reliably established," and "states, if they can afford to, shy away from becoming dependent on goods and resources that may be denied them in crises and wars."<sup>51</sup> States do so because security, autonomy, and survival are their foremost concerns. Waltz held that trade creates "uneven effects of interdependence," with weaker states dependent on stronger ones. "Relatively independent states are in a stronger position than relatively dependent ones. If I depend more on you than you depend on me, you have more ways of influencing me and affecting my fate than I have of affecting yours."<sup>52</sup> In light of this, "states take measures, such as Japan's managed trade, to avoid excessive dependence on

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<sup>49</sup> David Mitrany, *A Working Peace System* (Chicago: Quadrangle Books, 1966), 97.

<sup>50</sup> Kenneth N. Waltz, *Theory of International Politics* (New York: Random House, 1979), 89.

<sup>51</sup> Kenneth N. Waltz, "Structural Realism after the Cold War," *International Security*, vol. 25, no. 1 (Summer 2000): 15.

<sup>52</sup> *Ibid.*, 15-16.

others,” and they do so because “the impulse to protect one’s identity—cultural and political as well as economic—from encroachment by others is strong.”<sup>53</sup>

Another realist formulation predicting difficulty in international cooperation is the concept of relative gains. This concept is thoroughly explained by Joseph Grieco.<sup>54</sup> According to Grieco, “international anarchy fosters competition and conflict among states and inhibits their willingness to cooperate even when they share common interests.”<sup>55</sup> Grieco wrote that in international anarchy, states know that “*there is no overarching authority to prevent others from using violence, or the threat of violence, to destroy or enslave them.*” (Grieco’s emphasis)<sup>56</sup> Since “states worry that today’s friend may be tomorrow’s enemy in war, and fear that achievements of joint gains that advantage a friend in the present might produce a more dangerous *potential* foe in the future,” states must pay serious attention to the gains of partners.<sup>57</sup> Based on this observation, Grieco challenged neoliberalism’s claim that states seek to maximize their individual *absolute* gains and are indifferent to the gains achieved by others. Grieco concluded:

The major goal of states in any relationship is not to attain the highest possible individual gain or payoff. Instead, *the fundamental goal of states in any relationship is to prevent others from achieving advances in their relative capabilities* (Grieco’s emphasis).<sup>58</sup>

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<sup>53</sup> Ibid., 15.

<sup>54</sup> Joseph, M. Grieco, “Anarchy and the Limits of Cooperation: A Realist Critique of the Newest Liberal Institutionalism,” *International Organization*, vol. 42, no. 3 (Summer 1988): 485-507.

<sup>55</sup> Ibid., 485.

<sup>56</sup> Ibid., 497-498.

<sup>57</sup> Ibid., 487.

<sup>58</sup> Ibid., 498.

Motivated in this way, “a state will decline to join, will leave, or will sharply limit its commitment to a cooperative arrangement if it believes that partners are achieving, or are likely to achieve, relatively greater gains. It will eschew cooperation even though participation in the arrangement was providing it, or would have provided it, with large absolute gains.”<sup>59</sup> As will be shown in Chapter 6, at least one analyst has applied the relative gains approach to the study of Beijing-Taipei relationship.

The realist-liberal debate bears resemblance to the divergent views on the effect of cross-Strait economic exchanges. Because the Taiwan Strait is one of the most dangerous flashpoints in world politics, the realists have every reason to expect the Beijing-Taipei political conflict to seriously affect cross-strait economic cooperation. The liberals, on the other hand, would expect the growing economic ties to reduce the conflict.

## **II. Recent Empirical Research**

Research on the relationship between trade and conflict is dominated by two approaches. One is to show that trade reduces conflict; the other is to show that conflict inhibits trade. The main theme of analysis is to show which affects which. It is understandable that researchers treat trade, or conflict, either as the independent or the dependent variable, because when conflict is being reduced by trade, it cannot block trade, and when trade is being inhibited by conflict, it cannot reduce conflict.

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<sup>59</sup> Ibid., 499.



Among those who have tried to demonstrate that trade reduces conflict is Solomon Polachek, who argued that the mutual dependence established between two trading partners is sufficient to raise the cost of conflict, thereby diminishing the level of their dispute.<sup>60</sup> Polachek hypothesized a negative correlation between trade and conflict, and tested his hypothesis by using the Conflict and Peace Data Bank (COPDAB), which is an extensive, longitudinal collection of more than 350,000 daily and yearly events reported by dyads from 47 newspaper sources.<sup>61</sup> In the data bank, inter-state events are coded on a 15-point scale ranging from political unification to armed conflict. After observing the relations between trade and conflict in a group of 30 countries for a period of 10 years (i.e., making 126,150 observations), Polachek reported that countries with the greatest levels of trade engage in the least amounts of hostility, and that a doubling of trade on average leads to a 20 percent diminution of belligerence.

Also using statistical methods but arriving at a different conclusion is Brian Pollins, who concluded that “trade does indeed follow the flag.”<sup>62</sup> Pollins observed that “the economic ties between any two nations are frequently affected by a warming or cooling of bilateral diplomatic relations, but there is little to be found in modern economics or political science that helps us understand the connections between international politics and commerce.”<sup>63</sup> He set out to find these connections by

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<sup>60</sup> Solomon William Polachek, “Conflict and Trade,” *Journal of Conflict Resolution*, vol. 24, no. 1 (March 1980): 55-78.

<sup>61</sup> See Edward E. Azar, “The Conflict and Peace Data Bank (COPDAB) Project,” *Journal of Conflict Resolution*, vol. 24, no. 1 (March 1980), 143-152.

<sup>62</sup> Brian M. Pollins, “Does Trade Follow the Flag?” *American Political Science Review*, vol. 83, no. 2 (June 1989): 465-480. Quote from pp. 477-478.

<sup>63</sup> *Ibid.*, 465.

measuring the imports of each of the six chosen countries with 24 other countries, from 1955 to 1978, against the background of their political relations. Pollins focused on imports because he thought that an importer takes account not only of the price and quality of the goods but of the place of origin of these goods and the political relationship between the importing and the exporting nation. "They do so essentially for traditional security reasons; that is, importers are motivated to manage risks of disruption in supply or the possibility of hurting friends or aiding foes."<sup>64</sup> According to Pollins, "an importer's utility will be affected by the wish to express goodwill or solidarity with those whom they identify as friends while shunning or punishing those they perceive as foes," and an importer avoids "establishing ties with a seller in an adversary nation, knowing that those ties may be ruptured by one government or the other as part of some foreign policy maneuver."<sup>65</sup> He reported that his research "confirmed that the relative cooperativeness or hostility of bilateral political ties does indeed affect trade flows between all types of nations, and that the estimates are robust and warrant inclusion on both statistical and theoretical grounds."<sup>66</sup>

Thus, while Polachek said that trade reduces conflict, Pollins said that conflict inhibits trade. Both men relied on statistical sophistication to make their cases. More recent researches on the causal relationship between conflict and trade are done by John

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<sup>64</sup> Ibid., 465-466.

<sup>65</sup> Ibid., 470.

<sup>66</sup> Ibid., 477.

Oneal and Bruce Russett, Katherine Barbieri and Gerald Schneider, and James Morrow and his team.<sup>67</sup> All of them relied on statistical methods to make their arguments.

In short, Oneal and Russett “found that interdependence significantly reduced the likelihood of conflict, 1950-92, among contiguous and major-power pairs,” and “it seems clear that economically important trade does have important pacific benefits.”<sup>68</sup>

However, Barbieri and Schneider reported that, despite the liberal claim that economic interdependence exerts an unconditionally pacifying influence on inter-state relations, “trade will have negligible and...even amplifying effect on conflict.”<sup>69</sup> Meanwhile, Morrow and his colleagues argued that politics shapes international trade because governments set the rules under which firms import and export. They suggested that “conflict and anticipation of conflict reduce trade flows between states, because economic actors respond to the risk conflict adds to a trading enterprise.”<sup>70</sup> They also held that “a state will be reluctant to trade with another state that may use its added wealth to increase its military capability against it.”<sup>71</sup> They then set out to test one of their three hypotheses, namely, *states in conflict with each other will have lower levels of trade than states not in conflict*, and reported confirmation of it.

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<sup>67</sup> John Oneal and Bruce Russett, “Assessing the Liberal Peace with Alternative Specifications: Trade Still Reduces Conflict,” *Journal of Peace Research*, vol. 36, no. 4, (1999): 423-442. Katherine Barbieri and Gerald Schneider, “Globalization and Peace: Assessing New Directions in the Study of Trade and Conflict,” *Journal of Peace Research*, vol. 36, no. 4 (1999): 387-404. James Morrow, Randolph Siverson, and Tressa Tabares, “The Political Determinants of International Trade: The Major Powers, 1907-90,” *American Political Science Review*, vol. 92, no. 3 (September 1998): 649-661. James Morrow, “How Could Trade Reduce Conflict?” *Journal of Peace Research*, vol. 36, no. 4 (1999): 481-489.

<sup>68</sup> Oneal and Russett, 439-440.

<sup>69</sup> Barbieri and Schneider, 387.

<sup>70</sup> James Morrow, et al., 649.

<sup>71</sup> *Ibid.*, 649.

In subsequent writing, Morrow held that the effect of trade interdependence on conflict is *indeterminate*, because “trade makes war less attractive to both parties, but the target’s lower willingness to fight makes coercion of the target easier and more attractive to the initiator.”<sup>72</sup> Morrow’s logic became a never-ending chain reaction when he said that with interdependence in place, “a state contemplating conflict considers its effect on both sides’ actions before beginning a dispute. The initiator is less willing to fight, reducing the chance that it initiates a dispute. At the same time, the target is also less willing to fight, increasing the chance that it makes concessions to the initiator to avoid war, and thus increasing the chance that the initiator begins a dispute.”<sup>73</sup> Thus, we do not know whether the initiator will initiate a dispute, and the effect of trade on conflict is indeterminate. Morrow also attacked the studies by Oneal and Russett that show a correlation between trade and conflict: states with higher trade flows have fewer militarized disputes. “The obvious question is whether this correlation is spurious,” and his research “only reinforces the suspicion that it is.”<sup>74</sup> In short, to Morrow, a good political relationship would determine both trade flows and the frequency of militarized disputes.

### III. Research Objectives, Research Design, and Hypotheses

The interrelationship between economic cooperation and political conflict is the subject of this dissertation. Specifically, the research uses the study of an empirical case

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<sup>72</sup> Morrow 1999, 487.

<sup>73</sup> *Ibid.*, 481.

<sup>74</sup> *Ibid.*, 487.

to ask, and answer: (1) how much truth is there in the realist proposition that political conflict inhibits economic exchanges? (2) how much truth is there in the liberal suggestion that economic exchanges mute political conflict? The realist-liberal debate provides conceptual lenses to look at the empirical case, and the empirical case in turn can shed light on the theoretical debate. The case of cross-strait relations is a good case because Beijing and Taipei are clearly identified political adversaries, but they have also developed economic cooperation. Past research efforts have concentrated on trade. This research will include both trade and investment.

This research has two major objectives. First, it seeks to identify the level of Beijing-Taipei economic interaction from 1987 to 2000, and then compare that level with a set of criteria and with the levels of economic cooperation they have with other partners. The purpose is to find out the extent of economic cooperation between the two sides, so as to determine the effects of politics on economics. Second, the research examines the reciprocal effects of economics on politics by reviewing the current Beijing-Taipei political relationship and comparing it with the one they had in 1987, to see if there is any improvement in political ties as a result of their economic cooperation. In other words, the effect of “low politics” on bringing about a closer political relationship between the two sides is examined. The year 1987 is chosen as the starting point because Taipei began to lift the ban on travel to China in that year—a move that would greatly facilitate cross-Strait business development in subsequent years.<sup>75</sup>

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<sup>75</sup> In terms of methodology, this is reminiscent of Steve Chan’s work, “Peace by Pieces? Mainland-Taiwan Transaction Flows” in which Chan compared China’s foreign trade volumes before and after the 1989 Tiananmen incident, to see if the incident, which he called the “test event,” had any effect on trade. See Steve Chan, Cal Clark, and Danny Lam, eds., *Beyond the Developmental State: East Asia’s Political Economies Reconsidered* (New York: St. Martins, 1998), 60-70.

To meet the first research objective, the research treats the political conflict between Beijing and Taipei as the independent variable, and their economic cooperation as the dependent variable, so as to test the first hypothesis in the case study. The hypothesis is: *A zero-sum political conflict exists between Beijing and Taipei, and it has seriously affected the positive-sum economic cooperation between the two sides.*

To meet the second research objective, the research treats the Beijing-Taipei economic cooperation in the past 15 years as the independent variable, and the current political relationship between the two sides as the dependent variable, so as to detect any pacifying effect of economics, and to test the second hypothesis in the case study. The hypothesis is: *Economic cooperation between Beijing and Taipei, as a cause, has little effect on reducing their political conflict.*<sup>76</sup>

If these hypotheses are proved correct, then it can be argued that politics, *defined as the process by which both sides of the Taiwan Strait try to outmaneuver the other in their conflict*, has been the dominating factor in cross-Strait ties. By “outmaneuver” I mean that one side of the Taiwan Strait gains an upper hand in a specific dispute by obstructing the other side or preventing it from realizing its goal. If these hypotheses are rejected, then it can be argued that the economic exchanges did play a pacifying role in fostering closer political ties and thus reducing the political conflict.

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<sup>76</sup> This hypothesis is similar to Timothy Wong’s suggestion that cross-strait economic exchanges have “limited” effect on reducing political tensions. “Political conflict” is described in chapter 2. Indicators of a reduction of the political conflict are given in chapter 5.

#### **IV. Organization of the Dissertation**

In the remaining part of the dissertation, Chapter 2 describes the evolution of the conflict, with attention to its zero-sum nature. Chapter 3 sketches out the development of economic ties across the Taiwan Strait, in order to ascertain the basic level of economic exchanges between the two sides. Chapter 4 takes a closer look at the level of economic exchanges between the two sides with a view to demonstrating the effect of the political conflict on economic cooperation. Hypothesis 1 will be tested here. Chapter 5 reviews the current political relations between Beijing and Taipei so as to determine whether there is any improvement compared with 15 years earlier. Seven empirical questions are posed and the answers to which serve as the indicators of relations. For example, if there is an impasse in political negotiation now as it was 15 years ago, no improvement of ties can be deduced from this indicator. By comparing 2002 with 1987, the research allows some time to pass, so that the assumed pacifying function of economics can take effect. Thus, hypothesis 2 will be tested here. Chapter 6 goes beyond the mutual effects between politics and economics to examine the motives and concerns, on both sides of the Taiwan Strait, for conducting economic exchanges. An in-depth analysis of these motives and concerns explains why they did what they did. A critique of two theoretical frameworks used to explain the dynamics of cross-Strait economic cooperation is also given in Chapter 6, to aid understanding of the motives and concerns on both sides. Chapter 7 is the conclusion that sums up the findings, discusses implications, and attempts a little generalization.

## Chapter 2

### Evolution of the Conflict

The conflict between Beijing and Taipei was, and arguably still is, zero-sum in nature because one side's gain would amount to another side's loss. The People's Republic of China (PRC) government, which was founded in 1949, and the Republic of China (ROC) government, which moved to Taiwan in the same year, have tried to replace each other as the legitimate government of China, by force if necessary. Actual fighting broke out in the 1950s and persisted into the 1960s. Taipei's determination to stand up to Beijing in the confrontation led it to start a nuclear weapons project probably "as early as the 1960s and extended to the late 1980s."<sup>1</sup> Former Premier Hao Po-tsun acknowledged in his book that the founding of Chung Shan Institute of Science and Technology in Taipei was initially for the purpose of developing nuclear weapons.<sup>2</sup> At present, Beijing's position is that it will not renounce the use of force to bring Taiwan back to China, which means the PRC. Taipei renounced the use of force against the PRC in the early 1990s, recognized the PRC as a political entity, and requested the PRC to

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<sup>1</sup> David Lampton, *Same Bed, Different Dreams: Managing U.S.-China Relations, 1989-2000* (Berkeley: University of California Press, 2001), 210.

<sup>2</sup> Hao Po-tsun, *Pu Chu* (Without Fear) (Taipei: May Fourth Books, 1995), 444. Hao revealed in 2000 that although Taiwan never detonated an atomic device, it has the knowledge to do so. According to Hao, researchers at Taiwan's Chung Shan Institute of Science and Technology (CSIST) managed to simulate tests on a computer through data they had acquired on nuclear explosions. The U.S. government learned about Taiwan's secret nuclear programs when a top CSIST researcher defected to the United States, and sent nuclear experts to Taiwan to deactivate nuclear reactors at CSIST in 1988. See Brian Hsu, "Ex-Military Chief Confirms Nuclear Weapons Program," *Taipei Times*, January 8, 2000, at [www.taipeitimes.com](http://www.taipeitimes.com).



reciprocate. But Taipei also said that the ROC is a sovereign state, that the ROC government is a central government, and that Taiwan does not want to become a part of the PRC.<sup>3</sup> At present, if Beijing succeeds in bringing Taiwan back to its fold on its own terms, the ROC on Taiwan, which is adamant in protecting its *de facto* statehood, will cease to exist; and if Taipei succeeds in becoming an internationally recognized sovereign state, the PRC will fail in its reunification effort. This chapter sketches out the evolutionary process of the conflict and provides a background for later analysis and comparison. Because the conflict is a well-documented one, this chapter focuses only on the major events and policy positions on both sides that can highlight the zero-sum nature, or intractability, of the conflict.

## I. Confrontation before 1979

Being defeated by the Communists on the mainland, the Nationalist government under the leadership of Chiang Kai-shek relocated to Taiwan in 1949. About half a million Nationalist soldiers crossed the sea to the island. In the 1950s, military confrontations between the two sides were intense. Although the Communists did not have adequate air cover and amphibious landing capabilities, they actually planned to invade Taiwan with 500,000 troops. This plan was aborted after the outbreak of the Korean War on June 25, 1950, because President Truman on June 27 announced that he had ordered U.S. air and naval forces to go to the aid of South Korea, and had ordered the

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<sup>3</sup> In the words of Shelley Rigger, "Most Taiwanese are united in their unwillingness to become part of the People's Republic." See Shelley Rigger, "Taiwan: Finding Opportunity in Crisis," *Current History* (September 1999): 286-290.

U.S. Seventh Fleet to prevent any attack on Taiwan. Truman linked the attack on South Korea by North Korea with the imminent attack on Taiwan by China in the following way: “The attack upon Korea makes it plain beyond all doubt that communism has passed beyond the use of subversion to conquer independent nations and will now use armed invasion and war...in these circumstances the occupation of Formosa [Taiwan] by Communist forces would be a direct threat to the security of the Pacific area and to United States forces performing their lawful and necessary functions in that area.”<sup>4</sup> Truman said: “Accordingly, I have ordered the 7<sup>th</sup> Fleet to prevent any attack on Formosa. As a corollary of this action I am calling upon the Chinese government on Formosa to cease all air and sea operations against the mainland. The 7<sup>th</sup> Fleet will see that this is done. The determination of the future status of Formosa must await the restoration of peace in the Pacific.”<sup>5</sup> Although PRC Premier Chou En-lai said that Truman’s decision to protect Taiwan with the Seventh Fleet was an “armed aggression against the territory of China,”<sup>6</sup> Communist forces did not attempt to cross the Taiwan Strait without comparable naval strength.

During the 1950s and the 1960s, the conflict between Beijing and Taipei was perceived to be an unfinished civil war, by the world and by both belligerents as well. These two decades witnessed some hostile military actions, initiated by Beijing and Taipei. On the mainland side, the slogan “liberation of Taiwan” meant elimination of the ROC government on the island. On Taiwan, retaking the mainland meant elimination of

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<sup>4</sup> “Statement by the President on the Situation in Korea, June 27, 1950,” *Public Papers of the President of the United States of America, 1950* (Washington, DC: United States Printing Office, 1965), 492.

<sup>5</sup> Ibid.

<sup>6</sup> *China: U.S. Policy Since 1945* (Washington, DC: Congressional Quarterly, Inc., 1980), 91.

the Communist regime on the mainland. The island was in a “period of mobilization for quelling Communist rebellion,” which was not ended until 1991, the year in which a change of stance in the conflict became apparent on the part of Taipei, when Taiwanese President Lee Teng-hui gave up its right to represent China and said China had no right to represent Taiwan. But before this happened, the governments on both sides of the Taiwan Strait firmly adhered to the principle of one China, and claimed to be the central government of China; since China could only have one central government, either one of them had to replace the other. In the international arena, the ROC government continued to hold the China seat in the United Nations (UN) until 1971, claiming to represent the whole of China. Although that seat was transferred from the ROC to the PRC in 1971, the ROC was still recognized by 54 countries, including the United States of America.

The 1950s saw two serious military confrontations in the Taiwan Strait. When the Nationalist, or Kuomintang (KMT) government had moved to Taiwan, its forces did not completely evacuate the offshore islands along the mainland coast. The Nationalists held three groups of islands: the Tachens near Shanghai in the north, the Matzu group of islands about 10 miles from Fuzhou, and Kinmen (Quemoy) off Xiamen further south. After the outbreak of the Korean War in June 1950, the United States was quickly involved in fighting on the Korean peninsula, and China entered the war in October the same year when U.S. and South Korean forces moved toward the Yalu River on the Chinese border. Thereafter, PRC forces were busily engaged in combat with U.S. forces on the Korean peninsula and had no time to deal with the Nationalist forces on the three groups of islands. In addition, Chinese forces entered Tibet in August 1950 and fought until resistance subsided in March 1951. But the ending of the Korean War in July 1953

by the signing of an armistice freed a large number of Chinese troops in the northeast that could be used in the first Taiwan Strait crisis.

The crisis began building in July 1954 when PRC media intensified the propaganda on “liberation of Taiwan.”<sup>7</sup> Heavy bombardment of Kinmen occurred on September 3, 1954. Another large-scale artillery bombardment took place on September 22. The United States responded forcefully and sent a large naval task force to the area. John Garver reported that when the crisis escalated in February and March 1955, “U.S. forces made preparations to use tactical atomic weapons to defend the offshores.” Top U.S. officials not only warned Beijing that atomic weapons would be used, but also tried to persuade Moscow to dissociate itself from Beijing’s actions. Secretary of State John Dulles “mixed threats of nuclear war against China with warnings to Moscow about the costs of supporting Beijing’s ambitions and hints of a reactivation of the ‘historic friendship’ between Russia and America.”<sup>8</sup>

According to Taiwan-based scholar Chang Tsan-ho, the real target of the bombardments turned out to be the Tachen Islands in the north, which were more than 200 miles from Taiwan and close to China’s Zhejiang Province. The Tachens were an irritant to Communist control of the waters near Shanghai, and could be used to harass commercial shipping lanes. The shelling of Kinmen was a tactic to tie down the Nationalist forces in the south so that Communist troops could take the Tachens in the north.<sup>9</sup>

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<sup>7</sup> For a good description of this episode, see John W. Garver, *Foreign Relations of the People's Republic of China* (Englewood Cliffs, NJ: Prentice Hall, 1993), 50-55.

<sup>8</sup> *Ibid.*, 54.

<sup>9</sup> Chang Tsan-ho, *Liang'an Guanxi Bianqian Shi* (A History of Transformation of Cross-Strait Relations) (Taipei: Chou Chih, 1996), 121.

The Tachens, as well as Kinmen and Matsu, had made the United States hesitate to enter into a mutual defense treaty with Taiwan, because their inclusion in the treaty had generated some misgivings. The United States had wanted to bring Taiwan into a chain running from Japan to the Philippines in order to contain communism, and a mutual defense treaty with Taiwan would serve that purpose. However, the United States thought that some of the Nationalist-held islands were barely rocks sticking out from the water and were indefensible. Including them for defense would easily lead the United States into an armed conflict with the PRC because a commitment to defend them would encourage Chiang Kai-shek to launch attacks from these islands against the mainland; but a clear refusal to defend them would provide the communists a chance to take them and use them as a stepping-stone to invade Taiwan.

To the Nationalists, holding Kinmen and Matsu had both practical and symbolic significance. The Nationalist forces on these islands were an additional shield protecting Taiwan; they could blockade the port cities of Xiamen and Fuzhou which could be used as bases for any amphibious assault against Taiwan. Furthermore, in the unfinished civil war in which the KMT government vowed to return to the mainland, these islands could serve as a springboard for retaking the mainland. But more importantly, holding them was an indication of preparation for actions that could tell the world that the ROC government would not settle with a divided China or content itself with its rule over Taiwan. Thus, holding them is a symbol to *“show the Chinese at home and abroad that the ROC government has not forgotten its mission of returning to the mainland (emphasis mine).”*<sup>10</sup> As it is still understood today, these islands are “links” between Taiwan and

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<sup>10</sup> Ibid., 122.

China, because, unlike Taiwan, they have always belonged to the mainland's Fujian Province. An evacuation of these islands would mean severing the ties between the Chinese mainland and Taiwan.

On January 18, 1955, communist forces fiercely attacked Yi Jiang Shan, an islet in the Tachen group.<sup>11</sup> After two days of fighting, all the 720 Nationalist troops on the islet were killed, and the islet fell to communist hands. On January 19, U.S. President Eisenhower decided that Nationalist forces must evacuate the Tachens. But Eisenhower and Secretary of State John Dulles agreed that if Taipei were asked to evacuate all the offshore islands, the evacuation would deal a serious blow to the ROC. They accepted Chiang Kai-shek's argument regarding the danger of the collapse of Nationalist morale. They also agreed that the United States should help defend Kinmen and Matsu so long as Taiwan and the Pescadores are under communist threat. To implement this policy, Eisenhower submitted to the U.S. Congress a Formosa Resolution, which was passed on January 25 by the House and on January 28 by the Senate. The Resolution authorized the U.S. president to use U.S. forces to defend Taiwan and the Pescadores, and to defend other areas deemed necessary for the defense of Taiwan and the Pescadores. This meant the possibility of defending Kinmen and Matsu. On 31 January, Washington informed Taipei that if a communist attack on Kinmen and Matsu were considered as a preparation for attacking Taiwan and the Pescadores, the United States would help defend Kinmen and Matsu. With such assurance, Taipei began to reluctantly evacuate the Tachens on February 8. The evacuation was completed on February 12, 1955.

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<sup>11</sup> Information for this paragraph relied on Chang, 124-125.

In April 1955, Zhou Enlai took the initiative in reducing tensions in the Taiwan Strait by announcing at the Bandung Conference that his government did not want war with the United States. Washington responded promptly and indicated that it was willing to open talks with Beijing. Chinese bombardment of the offshore islands soon tapered off. An important “side effect” of the crisis, however, was Beijing’s decision to develop nuclear weapons to meet U.S. nuclear “blackmail.”<sup>12</sup>

One incident shortly before the evacuation of the Tachens shows the emotion attached to the one-China principle on the part of Taiwan in the 1950s. ROC foreign minister George Yeh met with Assistant Secretary of State for Far Eastern Affairs Walter Robertson in Washington on January 22, 1955. Mr. Yeh was dour as he left the State Department. Asked what he thought about the course of the United States policy on China, he replied: “I am not prepared to take a position yet.” The *New York Times* continued to report about him in the following way:

He seemed angry, when his opinion was asked on efforts in the United Nations, which President Eisenhower has encouraged, to arrange a Formosa Strait cease-fire. “We feel that anything which would suggest two Chinas would be objectionable,” Mr. Yeh said. “Period. Period. Good-by.”<sup>13</sup>

Yeh’s insistence on “one China” contrasts sharply with Taipei’s ambiguous position at the present time, and shows the gap in stance between two points of time that is caused by the evolution of the conflict.

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<sup>12</sup> Information for this paragraph relied on Garver, 54-55.

<sup>13</sup> Elie Abel, “President to Set U.S. Defense Area in Formosa Policy,” *New York Times*, January 23, 1955, p. 3

The second Taiwan Strait Crisis occurred in 1958. Similar to the first Taiwan Strait crisis of 1954-55, both Kinmen and Matsu were fiercely shelled.<sup>14</sup> During the first two hours of artillery bombardment of Kinmen on August 23, 1958—the day when the crisis erupted—some 57,000 shells landed on the island, turning it into a hell.<sup>15</sup> On the other side, about one-third of Taiwan's armed forces were deployed on Kinmen and Matsu. These were crack troops, well-trained and well-equipped. Numbering more than 100,000, they were resolute in defending the islands and prepared to strike back. During the second crisis, U.S. warships were involved in convoying Taiwanese supplies to the islands, ignoring the 12-nautical-mile exclusion zones declared by China but staying clear of the recognized 3-nautical-mile territorial waters from the coast. The United States threatened to use atomic weapons again. When a question about the use of atomic weapons in the defense of Kinmen and Matsu was asked at a press conference in 1958, Eisenhower replied that he could not say definitely what he would do but that in general, “every war is going to astonish you in the way it occurred, and in the way it is carried out.”<sup>16</sup>

Garver wrote that the 1958 Taiwan Strait crisis contributed to what he called the “Sino-Soviet schism.” Soviet leader Nikita Khrushchev did warn the United States against attacking the Chinese mainland or using atomic weapons, but Mao and many in China felt that the Soviet support was not genuine because it came at a time when the crisis was being defused. Moscow was reluctant to be drawn into the conflict, and Khrushchev and

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<sup>14</sup> For a good account of the second (1958) Taiwan Strait crisis, see Thomas E. Stolper, *China, Taiwan, and the Offshore Islands* (Armonk, NY: M.E. Sharp, 1985).

<sup>15</sup> Chang, 135.

<sup>16</sup> Stolper, 90.



his colleagues also thought that Mao was reckless and had underestimated the danger of war and the destructive power of atomic weapons.<sup>17</sup> In subsequent writing, Garver held that a long-term U.S. policy toward China during the Cold War was to “socialize” China so that it would conform to the norms of the capitalist world, and to apply pressure on the Sino-Soviet alliance so as to break it.<sup>18</sup> Regarding the latter objective, the strong response from the United States did seem to spark a quarrel between Beijing and Moscow, though the two communist giants managed to cover their difference at that time.

Throughout the 1950s the KMT launched harassing attacks against the mainland coast from the offshore islands it held. Cross-strait military confrontation persisted in the 1960s. A real possibility of war existed when Chiang Kai-shek seriously pondered retaking the mainland by force in 1962.<sup>19</sup> In that year, famine broke out in China when the effects were felt from the failed campaigns such as the Great Leap Forward and the People’s Commune—an experimental social unit in which people were organized into production brigades and their properties were publicly held. Large numbers of refugees fled to Hong Kong. Chiang thought that this was a golden opportunity for action. Hao Po-tsun, who emerged as Taiwan’s hero in the artillery battle on August 23, 1958, recalled: “In 1962, we were indeed prepared to retake the mainland, but eventually we were restrained by the United States; according to the plan at that time, I would have been the first army-level commander to land on the mainland...thereafter, when I served

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<sup>17</sup> Garver, *Foreign Relations*, 55-65.

<sup>18</sup> John W. Garver, *The Sino-American Alliance: Nationalist China and American Cold War Strategy in Asia* (Armonk, NY: M.E. Sharpe, 1997).

<sup>19</sup> Chang, 155-159.

as the chief of general staff, the whole plan was locked in a safe, and could not be implemented for the time being.”<sup>20</sup> Nationalist commandos continued to harass the mainland coast in 1962 and 1963. In 1965, three serious naval battles broke out near the Fujian coast, and Taiwanese warships were sunk or damaged.<sup>21</sup>

Although the fighting was fierce in the two crises, the mainland Chinese attempted no real amphibious assaults to take Kinmen and Matsu. It was widely reported that Mao Zedong finally realized that it was better to let Chiang Kai-shek keep those islands, which could then serve as links between the Chinese mainland and Taiwan. On October 25, 1958, Beijing announced there would be no bombardment of Kinmen airfield, wharf or beach landing areas on even-numbered dates of the month.<sup>22</sup> Artillery activities would continue on odd-numbered dates, however. The purpose of this every-other-day truce was apparently to avoid strangling Kinmen and Matsu, which would then be allowed to obtain supplies and be held in Nationalist hands. At the same time, the intermittent shelling was to show that Beijing would not lapse in its effort to “liberate” Taiwan. Hence, shells usually landed on barren hills. Nationalist forces fired back, also aiming at no-man’s land. This pattern continued until January 1, 1979, when the PRC and the United States established diplomatic relations.<sup>23</sup>

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<sup>20</sup> Hao, 460-461.

<sup>21</sup> Chang, 159-160.

<sup>22</sup> *China: U.S. Policy Since 1945*, p. 119.

<sup>23</sup> Despite the 1972 visit by President Nixon, China continued to shell Kinmen and Matsu until 1979.

## II. Cross-Strait Relations after 1979

After China and the United States established diplomatic relations, tensions receded in the Taiwan Strait. The United States abrogated the 1954 Mutual Defense Treaty with Taiwan and promised to withdraw its remaining military personnel from Taiwan within four months from January 1, 1979. China changed its slogan from “liberation of Taiwan” to “peaceful reunification.”

In the Shanghai Communiqué of 1972, jointly issued by China and the United States at the end of Nixon’s visit, “the Chinese side reaffirmed its position: The Taiwan question is the crucial question obstructing the normalization of relations between China and the United States; the Government of the People’s Republic of China is the sole legal government of China; Taiwan is a province of China which has long been returned to the motherland; the liberation of Taiwan is China’s internal affair in which no other country has the right to interfere; and all U.S. forces and military installations must be withdrawn from Taiwan.”<sup>24</sup> The U.S. side declared in the communiqué: “The United States acknowledges that all Chinese on either side of the Taiwan Strait maintain there is but one China and that Taiwan is a part of China. The United States Government does not challenge that position. It reaffirms its interest in a peaceful settlement of the Taiwan question by the Chinese themselves. With this prospect in mind, it affirms the ultimate objective of the withdrawal of all U.S. forces and military installations from Taiwan. In

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<sup>24</sup> *China: U.S. Policy Since 1945*, p. 324.

the meantime it will progressively reduce its forces and military installations on Taiwan as the tension in the area diminishes.”<sup>25</sup>

With regard to the Chinese demands in the 1972 Shanghai Communiqué, the normalization of Sino-American relations in 1979 allowed Beijing to obtain Washington’s recognition of the PRC as the sole legal government of China, a pledge from the United States to withdraw military presence from Taiwan, and the U.S. acknowledgement “that there is but one China and Taiwan is part of China.”<sup>26</sup> Concerning the U.S. demand for a peaceful settlement of the Taiwan issue, Beijing reiterated in its 1978 statement on normalization of Sino-American relations that “as for the way of bringing Taiwan back to the embrace of the motherland and reunifying the country, it is entirely China’s internal affair.”<sup>27</sup> Having said that, Beijing stopped shelling Kinmen and Matsu, modified its language on “liberation” of Taiwan that was contained in the Shanghai Communiqué, and began to use a new term, “peaceful reunification.”

On the other side of the Taiwan Strait, as the conflict evolved into the 1990s, Taipei seemed to become content with the territories it controlled. Taipei claimed that the ROC has sovereignty over all of China but acknowledged that its jurisdiction is now

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<sup>25</sup> Ibid.

<sup>26</sup> Documents on the normalization of U.S.-China relations include the Joint Communiqué on the Establishment of Diplomatic Relations Between the United States of America and the People’s Republic of China, a U.S. Statement, and a Chinese Statement, all issued on December 15, 1978. These documents are easily available through the World Wide Web.

<sup>27</sup> Harry Harding, *A Fragile Relationship: The United States and China Since 1972* (Washington, DC: Brookings Institution, 1992), 381 (documents in Appendix C).

limited only to Taiwan, Penghu (the Pescadores), Kinmen, and Matsu.<sup>28</sup> Subsequently, Taipei gave up its claim to jurisdiction over the Chinese mainland and recognized the PRC as a legitimate political entity, thus it gave up the right to retake the mainland by force, and it demanded that China reciprocate by renouncing the use of force and recognizing Taiwan as a legitimate political entity. In recent years, the opinion that Taiwan's future should be determined by democratic means has received wide acceptance in Taiwan. One of the democratic means is referendum, which the Democratic Progressive Party (DPP) advocates.<sup>29</sup> But what if a referendum suggested that Taiwan should become a republic? Should the government act on the people's will and, if it did, would it be able to avoid provoking China? After Chen Shui-bian from the DPP was elected president in 2000, he found that he had to calm fears by immediately announcing that he would not carry out a referendum to decide on the matter of independence or unification.<sup>30</sup>

### 1. Beijing's Initiative and Taipei's Response, 1979

On the same day that China normalized relations with the United States, the

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<sup>28</sup> Taipei's Mainland Affairs Council (MAC), a cabinet-level agency that oversees mainland policy, published a position document entitled *Relations Across the Taiwan Strait* in 1994. The document thoroughly explained Taipei's stance. To see the document, visit MAC's website at [www.mac.gov.tw](http://www.mac.gov.tw).

<sup>29</sup> "Resolution Regarding Taiwan's Future," a document passed by the National Party Congress of the DPP on May 8, 1999, is now included in the DPP's political platform. The document said: "Taiwan is a sovereign and independent country. Any change in the independent status quo must be decided by all the residents of Taiwan by means of plebiscite." See the DPP's website at [www.dpp.org.tw](http://www.dpp.org.tw). Note that the DPP used the word "Taiwan" instead of "the ROC."

<sup>30</sup> Chen was elected president on March 18, 2000. During an interview with foreign media on March 24, Chen promised not to (1) declare independence, (2) change the national title, (3) incorporate Lee Teng-hui's 1999 "two states theory" into the constitution, and (4) carry out a referendum on independence or unification. See, for example, AFP dispatch from Tokyo, "Taiwan's New Leader Vows to Avoid Independence Call: Report," March 24, 2000. China later summed up these promises as the "four nos."

National People's Congress (NPC) Standing Committee issued a "Message to the Taiwan Compatriots," in which it did not use the term "liberation of Taiwan." Instead, Beijing's leaders said that they missed their "loved ones" in Taiwan as they celebrated the New Year's Day—"Our thoughts turn all the more to our kith and kin, our old folks and brothers and sisters in Taiwan." The message called for academic, cultural, sports and technological exchanges, as well as cross-Strait trade. "There is every reason for us to develop trade between us, each making up what the other lacks, and carry out economic exchanges. This is mutually required and will benefit both parties without doing any harm to either." The message also said that the Chinese Government had ordered the PLA to stop shelling Kinmen and other islands immediately.<sup>31</sup>

On January 30, 1979, addressing the U.S. Congress, Deng Xiaoping officially stated, "We no longer use the phrase 'liberate Taiwan'; so long as Taiwan returns to the motherland, we will respect the reality and the existing system there."<sup>32</sup> Thereafter, the PLA began to evacuate its combat troops from Fujian Province, and disbanded the powerful Fuzhou Military Unit, whose mission was to "take care" of Taiwan. The PLA also evacuated most of its air force from Fujian. Jun Zhan wrote in the early 1990s, "Now only a small number of planes are stationed there."<sup>33</sup> All signs showed that the United States was not alone in wishing to see stability and peace in the Taiwan Strait, for China also wanted a relaxed atmosphere there. Perhaps the removal of troops and aircraft

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<sup>31</sup> "A Message to the Taiwan Compatriots," *Beijing Review*, January 5, 1979, pp. 16-17.

<sup>32</sup> Zhan, 32.

<sup>33</sup> *Ibid.*, 92.

was also a goodwill gesture by China amid an amicable atmosphere created by the establishment of diplomatic ties.

According to Jun Zhan's observation, by late 1978 a fundamental change had taken place in Beijing's policy toward Taiwan: "Beijing decided to give up its decade-long goal of liberating Taiwan by military means and began to search seriously for peaceful reunification. This policy change marked the end of direct military confrontation between the Kuomintang and the Communists."<sup>34</sup> Zhan attributed this change to the Sino-American détente because, from Beijing's point of view, it made China's peaceful reunification possible:

Ever since 1949, Beijing had regarded the U.S. role in Taiwan as the major obstacle to reunification. The normalization of relations between the two countries partially eased this major obstacle. In normalizing relations, the United States committed itself, as Beijing had requested, to cease its diplomatic recognition of Taiwan as the representative of China, to withdraw its military presence from Taiwan, and to abrogate the Mutual Defense Treaty with Taiwan.<sup>35</sup>

The Taiwan authorities were shocked by the news that the United States wanted to cut ties. President Chiang Ching-kuo convened an emergency meeting of the Central Committee of the Nationalist Party on December 15, 1987. After the meeting, Taipei issued a statement saying that the U.S. move would have a tremendously adverse impact upon the free world, and Chiang issued a personal statement recalling past promises made to Taiwan by the United States, speaking contemptuously of "broken assurances."<sup>36</sup> Amid a sense of bitterness and disappointment, Taipei did not respond favorably to the

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<sup>34</sup> Ibid., 31.

<sup>35</sup> Ibid., 31-32.

<sup>36</sup> *China: U.S. Policy Since 1945*, p. 242.

1979 message from the NPC Standing Committee. Taiwan's Premier Sun Yuen-hsuan rejected the message, saying that it was a plot to soften his people's fighting will and to mislead the U.S. public and congress. Sun fired back by calling on China to get rid of Marxism-Leninism, renounce world revolution, abandon communism, abolish the People's Commune, and protect the people's rights and interests.<sup>37</sup>

On April 4, 1979, President Chiang Ching-kuo gave an instruction to the KMT in his capacity as party chairman. He said: "Based on our experience in fighting communism in the past, our party has adopted the position of no compromise, no contact, and no negotiation [with the communists]. This position is not only based on the lesson of blood but is also our consistent policy; it is the most effective weapon to subdue the enemy." Henceforth, this instruction became known as the KMT government's "three nos" policy.<sup>38</sup> Thus, Beijing's proposal for trade and exchanges was turned down.

## **2. Ye Jianying's Nine-Point Proposal and Taipei's Response, 1981**

Although Beijing received a cold shoulder from Taipei in 1979, it made another conciliatory move in 1981. NPC chairman Ye Jianying offered an olive branch through the Xinhua News Agency on September 30, 1981. Commonly known as Ye's nine-point proposal, the main points are summarized as follows:

1. the Communist Party of China (CPC) and the KMT should hold talks on equal footing; people from both sides may meet first for a full exchange of views;

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<sup>37</sup> Chang, 275-276.

<sup>38</sup> Ibid., 277.



2. both sides should reach an agreement on postal, commercial, and transport links, and open academic, cultural, and sports exchanges;
3. after reunification, Taiwan can enjoy a high degree of autonomy as a special administrative region, and retain its armed forces; the Central Government will not interfere with the local affairs on Taiwan;
4. Taiwan's current socio-economic system will remain unchanged, so will its way of life and its economic and cultural relations with foreign countries. There will be no encroachment on the proprietary rights and lawful right of inheritance over private property, houses, land, and enterprises, or on foreign investments;
5. people in authority, as well as representatives of various circles from Taiwan may take up posts of leadership in national political bodies and participate in running the state;
6. when Taiwan has financial difficulties, the Central Government may give subsidies as it sees fit;
7. if people from Taiwan want to resettle on the mainland, proper arrangement will be made; nondiscrimination and the freedoms of exit and entry will be guaranteed;
8. industrialists and business people in Taiwan are welcome to invest in the mainland and begin economic undertakings of various types; their legitimate rights, interests, and profits will be protected;

9. the people of Taiwan are welcome to make suggestions regarding reunification of the country and national affairs.<sup>39</sup>

This proposal seems generous because Taiwan can keep its armed forces, socio-economic system, and way of life, but it becomes clear that although the ruling parties on both sides may hold talks on an equal footing, the governments on the two sides are not seen to be equal. From Beijing's perspective, two equal governments on the two sides of the Taiwan Strait equal two Chinas, and this is something to be avoided.

Taipei rejected this proposal. Government spokesman Soong Chu-yu said the "proposal is essentially a continuation of their united front propaganda and contains nothing new. The intention is to subjugate the free Chinese in Taiwan, Penghu [the Pescadores], Jinmen [Kinmen] and Matsu under Communist rule." Soong reiterated that China must be united under a system that is "free, democratic, and in the interest of the people." Vice President Hsieh Tung-min and Premier Sun Yuen-hsuan agreed.<sup>40</sup>

### 3. "One Country, Two Systems," 1984-Present

The concept of "one country, two systems" was initiated by Deng Xiaoping and gradually took shape in the early 1980s. The earliest trace of such a concept came from a conversation in 1983 between Deng and Dr. Winston Yang, a Chinese-American professor who taught at Seton Hall University.<sup>41</sup> Deng's remarks, which indicated the

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<sup>39</sup> For full text, see "Chairman Ye's Elaborations on Policy Concerning Return of Taiwan to Motherland and Peaceful Reunification," *Beijing Review*, October 5, 1981, pp. 10-11.

<sup>40</sup> Zhan, 66.

<sup>41</sup> "Deng on China's Reunification," *Beijing Review*, August 8, 1983, pp. 5-6.

means and bounds China would use in solving the Taiwan issue and crystallized into a consistent policy toward Taiwan for more than two decades, were as follows:

We do not approve of “complete autonomy” for Taiwan. There must be limits to autonomy, and where there are limits, nothing can be complete. “Complete autonomy” means two Chinas, not one. Different systems may be practiced, but it must be the People’s Republic of China alone that represents China internationally. We recognize that the local government of Taiwan may have its own separate set of policies for domestic affairs. And although, as a special administrative region, Taiwan will have a local government, it will differ from local governments of other provinces, municipalities and autonomous regions. Provided the national interests are not impaired, it will enjoy certain powers of its own that the others do not possess.

After reunification with the motherland, the Taiwan special administrative region will assume a unique character and may practice *a social system different from that of the mainland* (emphasis mine). It will enjoy independent judicial power, and there will be no need to go to Beijing for final adjudication. What is more, it may maintain its own army, provided it does not threaten the mainland. The mainland will not station anyone in Taiwan. Neither troops nor administrative personnel will go there. The party, governmental and military systems of Taiwan will be administered by the Taiwan authorities themselves. A number of posts in the Central Government will be made available to Taiwan.

Peaceful reunification does not mean that the mainland will swallow up Taiwan. Needless to say, it does not mean that Taiwan will swallow up the mainland either.<sup>42</sup>

During the conversation, Deng called for talks between the CPC and the KMT on an equal footing, “rather than negotiations between the central and local authorities.”<sup>43</sup>

Obviously, Deng wanted to use party-to-party talks to get around the sensitive issue of equal statehood, equal sovereignty, or two Chinas on both sides of the Taiwan Strait, as would be implied by government-to-government talks.

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<sup>42</sup> The Bureau for the Compilation and Translation of Works of Marx, Engels, Lenin and Stalin under the Central Committee of the Communist Party of China, “An Idea for the Peaceful Reunification of the Chinese Mainland and Taiwan—Excerpt From a Talk With Professor Winston L.Y. Yang of Seton Hall University, South Orange, NJ, USA, June 26, 1983,” in *Selected Works of Deng Xiaoping, vol. III, 1982-1992* (Beijing: Foreign Language Press, 1994), 40-41.

<sup>43</sup> “Deng on China’s Reunification,” *Beijing Review*, August 8, 1983, p. 5.

Deng mentioned the concept of “one China, two systems” when he received a delegation from Georgetown University on February 22, 1984. Deng said, “There can be two political systems within one China,” and “neither side will harm the other.”<sup>44</sup> Deng explained that after reunification, “Taiwan practices capitalism, the mainland practices socialism, but there is a unified China—one China, two systems. Hong Kong is the same—one China, two systems.”<sup>45</sup> Following this hint, Chinese Premier Zhao Ziyang reported at the Second Session of the Sixth NPC on May 15, 1984, that “proceeding from the fundamental interests of the country and the nation and in view of historical experience and the present state of affairs in Taiwan, we have put forward the idea of ‘one country, two systems’ to be put into practice after the reunification of the country.” Thus, the term was coined, and policy fixed.<sup>46</sup>

But contradictions and difficulties are obvious in Deng’s proposal. Although Deng suggested that the KMT and CPC hold talks on an equal footing, the final outcome had been predetermined: Taiwan is a local government; the central government is in Beijing, which represents China in the international arena; and Taiwan will be downgraded from a *de facto* sovereign state to a special administrative region of the PRC. As Professor Tun-jen Cheng observed, “The ‘one country, two systems’ proposal was a non-starter, as under this arrangement, Taiwan could have autonomy, but not statehood, a condition that would be much worse than it is in now.”<sup>47</sup>

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<sup>44</sup> “Deng on Taiwan, International Policy,” *Beijing Review*, March 5, 1984, pp. 6-7.

<sup>45</sup> Chang, 255.

<sup>46</sup> “Main Points of Zhao’s Report,” *Beijing Review*, May 21, 1984, p. 20.

<sup>47</sup> Tun-jen Cheng, “Permutations Across the Taiwan Strait,” unpublished paper presented to a seminar at Portland State University, March 2001.

Taipei has rejected “one country, two systems” for all the obvious reasons. It would prefer the status quo to “one country, two systems” because it has already had full control of its own party, governmental, and military systems and does not need Beijing to confer upon it these rights. It is doubtful whether Taiwan is interested in sending someone to serve in the PRC government. Taipei has independent judicial power and does not need to go to Beijing for final adjudication. It is not known what Taiwan would gain from “one country, two systems” the things it does not have now, but it is clear that Taiwan would lose many of the things it now cherishes, including true autonomy, *de facto* independence, consulates and embassies, the right to conduct its own foreign and domestic affairs, and a final say in its own fate. Since 1991, the Mainland Affairs Council (MAC), a cabinet-level agency responsible for making China policy, has commissioned several research agencies to conduct opinion polls on “one country, two systems,” and the results consistently showed that about 70-80 percent of the respondents said the formula was not applicable to solving the problem across the Taiwan Strait (see Table 5.2 in Chapter 5). Taipei has published the results and used them to reject “one country, two systems.”

#### **4. Jiang Zemin’s Eight-Point Proposal, 1995**

On January 30, 1995, President Jiang Zemin launched another important peace offensive. By that time cross-Strait economic relations had developed to some extent, but cross-Strait political relations were not moving forward. By handing out an olive branch, Jiang hoped to receive echoes from Taiwan and thus activate a process of political

negotiation and reconciliation. Jiang put forward an eight-point proposal when making a speech in Beijing, and suggested:

1. adherence to the “one-China principle” is the premise for peaceful reunification; any words and deeds promoting “Taiwan independence,” “two split sides with separate rule” or “two Chinas over a period of time” will be opposed;
2. China will not oppose Taiwan when it develops economic and cultural ties with other countries, but is opposed to its activities in “expanding international living space” with the aim to create “two Chinas” or “one China, one Taiwan”;
3. talks on peaceful reunification should be held. As a first step, both sides may discuss how formally to end the state of hostility across the Strait, under the principle of one China; on that basis, both sides can work together to safeguard China’s sovereignty and territorial integrity, and derive plans for the future development of cross-Strait relations;
4. China does not undertake to renounce the use of force, but this does not aim at Taiwanese compatriots; it is aimed at the foreign forces that interfere in China’s peaceful reunification, as well as independence seekers;
5. both sides must vigorously develop economic exchanges and cooperation for common prosperity; political differences must not affect and disrupt cross-Strait economic cooperation; the mainland will continue to encourage investment from Taiwan, and protect the legitimate interests of Taiwanese investors under whatever circumstances; the “three links” should be opened;

6. both sides inherit and develop the outstanding traditions of Chinese culture;
7. the way of life of Taiwan compatriots, as well as their desire to be master of their own affairs, will be fully respected;
8. Taiwan's leaders are welcome to visit the mainland in an appropriate capacity; mainland leaders are willing to accept invitations to visit Taiwan.<sup>48</sup>

In the preamble of the eight-point proposal, Jiang reiterated the concept of “one country, two systems” and stressed that after reunification “the main part of the country upholds its socialist system; Taiwan keeps its current system.” The noteworthy points are (point 3) a call for a formal end to hostility, and (point 5) a suggestion that political disputes must not interfere with economic cooperation. While Deng's “one country, two systems” formula is generally viewed by commentators as a grand design for future cross-Straits relations, Jiang's proposal is regarded as a procedure for realizing that arrangement.

## 5. Lee Teng-hui's Six-Point Response, 1995

Two months after Jiang Zemin put forth his eight-point proposal, Taiwan's President Lee Teng-hui responded. On April 8, 1995, Lee unveiled a six-point proposal at a meeting of the National Unification Council, and he suggested:

1. the unification of China should be pursued on the basis of the reality that each side is ruled by a separate political entity; neither is subordinate to the other;

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<sup>48</sup> For full text in English, see Ralph Clough, *Cooperation or Conflict in the Taiwan Strait?* (New York: Rowman & Littlefield, 1999), annex 1. For full text in Chinese, see Wu Hsin-hsing, *Zhenghe Lilun yu Liang An Guangxi zhi Yanjiu (A Study of the Theory of Integration and Cross-Straits Relations)* (Taipei: Wu Nan Publisher, 1995) 483-488.

2. bilateral exchanges in culture, science, technology, and sports should be strengthened, so as to foster a sense of brotherhood;
3. Taiwan should use the mainland as its hinterland as it develops its economy; the mainland should borrow Taiwan's experience as it develops its economy; as for the issue of shipping and air links, it is a complex issue which requires more deliberation and planning, but both sides can exchange ideas when the time is ripe;
4. leaders from both sides should meet naturally in international settings; and both sides should join international organizations on an equal footing;
5. both sides can negotiate an end to the state of hostility when China formally renounces the use of force; Taiwan gave up the use of force and recognized the fact of a divided rule in 1991, China should reciprocate;
6. both sides should join hands to safeguard the prosperity of Hong Kong and Macao after their transitions in 1997 and 1999.<sup>49</sup>

Lee's six-point proposal can be viewed as a slap in Jiang's face. Lee did not respond to the concept of "one country, two systems," nor did he promise to open up direct shipping links. Instead, Lee asked China to recognize Taiwan as a legitimate political entity, stop blocking Taiwan's participation in international organizations, and renounce the use of force against Taiwan. None of these was acceptable to China.

Shortly after responding with this six-point proposal, Lee went to Cornell University, his alma mater, for a reunion. The visit of an incumbent ROC president to

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<sup>49</sup> Press release from the government, August 8, 1995. For full text in English, see Clough 1999, annex 2. For full text in Chinese, see Wu, 490-493.



the United States, though in a “private capacity,” and the making of a highly politicized speech at Cornell, plus the past record of Lee’s “pragmatic diplomacy,” proved to be too much for China. Beijing decided it was time to make the limit of its tolerance known to Taipei and Washington; hence, military exercises were held and missiles fired.<sup>50</sup>

## 6. Taipei’s Initiatives in the 1990s

President Chiang Ching-kuo died in 1988 and was succeeded by Lee Teng-hui. Lee adopted a different mainland policy that was characterized by “pragmatic diplomacy.” The emphasis was on substantive ties with foreign countries and organizations rather than formality and name. Thus, Taipei would not mind joining the Asian Development Bank under the title of “Taipei, China,” and Lee would not mind being called “the president from Taiwan” instead of “the president of the ROC” during a 1989 visit to Singapore.

In his inauguration speech in 1990, Lee said that if China can “renounce the use of force in the Taiwan Strait, and stand clear as we develop foreign relations on the premise of one China, we will be happy to establish dialogue channels on an equal footing, and fully open up academic, cultural, trade, economic, scientific, and technological exchanges.” This is a call for renunciation of force in solving the unification issue.<sup>51</sup>

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<sup>50</sup> According to Lee Kuan Yew’s memory, Jiang was furious during a conversation with Lee Kuan Yew because Jiang thought he was treated like a fool by Lee Teng-hui, who “had been saying one thing and doing another,” and who wanted “two Chinas” and thought Jiang could not read his true position. This seems to negate the suggestion that it was the military that forced Jiang to take action, and confirm that the Beijing leadership was united in taking the action. See Lee, *From Third World to First: the Singapore Story 1965-2000* (Singapore: Straits Times Press, 2000) 712.

<sup>51</sup> *Statement on Cross-Strait Relations* (Taipei: Mainland Affairs Council, 1994); quoted in Wu, 466.

In the early 1990s, Lee made a series of institutional arrangements for handling cross-Straits relations. In October 1990, Lee invited representatives of various political parties and circles to attend a meeting on forming the National Unification Council, a consultative body that would advise the president on cross-Straits relations. In January 1991, the presidential office issued a decree to establish the Mainland Affairs Council (MAC), a cabinet-level agency that would deliberate, draft, and oversee mainland policies. Since its establishment, the MAC has always been headed by a trusted aide of the president. In February 1991 the MAC approved the founding of the Straits Exchange Foundation (SEF), a nonofficial body authorized by the government to negotiate with China in the absence of official contacts. Koo Chen-fu, a billionaire and then Central Committee member of the KMT, has been SEF chairman since its founding. He was aided by a group of able negotiators. By February 23, 1991, the National Unification Council had drafted and adopted the Guidelines for National Unification, which envisioned three phases of development of cross-Straits ties. This document was approved by the Executive Yuan on March 14, 1991, and became a major initiative by Taipei to develop ties with China. However, it is doubtful whether the Chen administration took it seriously. Since taking office, Chen Shui-bian has not presided over any meeting of the National Unification Council and rarely mentioned the Guidelines for National Unification. In fact, Chen's negative view of the Council and the Guidelines was shown by his promise, in addition to the four promises mentioned earlier, not to abolish them.

On April 30, 1991, Lee announced an end to the "period of mobilization for quelling Communist rebellion," to take effect on May 1, 1991. Based on a resolution by

the National Assembly, the “temporary ordinance on the period of mobilization for quelling Communist rebellion” was abolished at the same time. The MAC interpreted this as a move that “does not see the Communists as a rebellious organization anymore, and this is a goodwill move toward the Communists after the promulgation of the ‘Guidelines for National Unification’ by the ROC.”<sup>52</sup> From Taipei’s perspective, this interpretation laid a foundation for the PRC to reciprocate.

Most importantly, the MAC explained that Lee’s announcement has two great meanings: “First, it shows that the ROC government formally renounces, and is the first to renounce, the use of force for national unification; second, the ROC government no longer struggles with the Communists for ‘the right to represent China’ in the international arena.”<sup>53</sup> An important message arises from the fact that the ROC government no longer struggles with the PRC government for the right to represent China internationally. Taipei was saying that from then on it would not bother itself with the right to represent China and would fight for the right to represent itself. This can be seen from Taiwan’s effort to join international organizations and its claim that it has no intention to challenge China’s membership in those organizations.

The Guidelines for National Unification is a short document that envisages the unification process in three phases: short term, medium term, and long term.

The *short term* is a *phase of exchanges and reciprocity*, in which efforts will be made to (1) enhance understanding through exchanges, eliminate hostility through reciprocity, and establish a benign relationship in which neither side’s security or stability

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<sup>52</sup> Ibid., 467.

<sup>53</sup> Ibid., 467.

is endangered, and neither side denies the other's existence as a political entity, (2) build an order for exchanges, draw up regulations for exchanges, and establish intermediary organizations to protect the people's rights and interests on both sides, (3) promote economic reforms, democracy, and rule of law on the mainland, and accelerate constitutional reform and economic development in Taiwan , and (4) end the state of hostility between the two sides, solve all disputes through peaceful means, and respect—not reject—each other in the international community.

The *medium term* is a *phase of mutual trust and cooperation*. In this phase, both sides should (1) establish official communication channels on an equal footing, (2) open direct postal, transport and commercial links, and jointly develop the southeastern coastal area of the Chinese mainland and then gradually extend this development to other areas of the mainland in order to narrow the gap in living standards between the two sides, (3) work together and assist each other in taking part in international organizations and activities, and (4) promote mutual visits by high-ranking officials on both sides so as to create favorable conditions for consultation and unification.

The *long term* is a *phase of consultation and unification*. In this phase a consultative body should be established through which both sides, in accordance with the will of the people, and adhering to the goals of democracy, economic freedom, social justice and nationalization of the armed forces, jointly discuss the grand task of unification and map out a constitutional system to establish a democratic, free, and equitably prosperous China.<sup>54</sup>

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<sup>54</sup> Full text in English can be found in Parris Chang and Martin Lasater, eds., *If China Crosses the Taiwan Strait* (Lanham, MD: University of America Press, 1993), 195-197; Chinese-language text can be found in Wu, 403-405, and Chang, 294-296. Alternatively, visit the MAC's website at [www.mac.gov.tw](http://www.mac.gov.tw).

These Guidelines constitute formidable obstacles to unification because these are difficult conditions for China to meet. For example, the first phase calls for democracy in China. But the Thirteenth National Congress of the CPC, held October 25-November 1, 1987, defined one central task and “two basic points” for the party. The central task is economic development; the “two basic points” are (1) adherence to the Four Cardinal Principles, and (2) adherence to the policies of reform and opening up. The Four Cardinal Principles are: (a) keep to the socialist road, (b) uphold the people’s democratic dictatorship, (c) leadership of the CPC, and (d) Marxism-Leninism and Mao Zedong Thought. These principles suggest continued monopoly of power by the CPC. With them in place it is not known when China will usher in democratization, and Taipei has said time and again that democratization on the mainland is one of the preconditions for unification with China. Furthermore, the first phase envisages that neither side’s security is endangered and that both sides recognize the other as political entity. This has yet to materialize. China and Taiwan have not entered the first phase, which is characterized by a formal end to hostility.

### **III. Taiwanization Complicates the Conflict**

In recent years, the conflict between Beijing and Taiwan has been complicated by the island’s Taiwanization, which can make China’s unification more difficult. The phenomenon has been described by different terms, such as the rise of Taiwanese nationalism, the emergence of Taiwanese awareness, aggressive localization programs,

and, most revealingly, by the title of a book written by President Lee Teng-hui, *Road to Democracy: Taiwan's Pursuit of Identity* (1999).

In the early years when the mainlanders, defined largely as those who crossed the sea in 1949, controlled the party and government in Taiwan, the island used textbooks that taught the history of China rather than the history of Taiwan, tracing back thousands of years through dynasties on the mainland. Actually, Taiwan has a rich history of its own, from the Portuguese arrival in 1517 to the Dutch occupation in 1624, and from recovery of the island in 1662 by a colorful figure called Koxinga (Cheng Cheng-kung, the son of a Chinese pirate and a Japanese woman) to Japanese colonization in 1895.<sup>55</sup> Native Taiwanese, who constitute the majority of the population, had criticized the teaching of mainland history at the expense of local history. Lee Teng-hui told Japanese writer Ryotaro Shiba, who was surprised to learn that students in Taiwan have to memorize names of Chinese emperors from the ancient to the modern time, that “it was useless” and that he had “demanded more teaching of Taiwan’s history and geography in the curriculum, more of our own roots; it is boring and meaningless for our children to memorize things on the mainland without learning things about Taiwan.”<sup>56</sup> In recent years, as native Taiwanese gained power and influence, Taiwan began to promote a localization program that, among other things, stressed the teaching of Taiwan’s history rather than the mainland’s history. Pro-Beijing press has accused the Taiwan authorities of *qu zhongguo hua* (getting rid of Chinese characteristics) in the Taiwanese society. But

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<sup>55</sup> See, for example, Murray Rubinstein, ed., *Taiwan: A New History* (Armonk, NY: M.E. Sharpe, 1999), pp. 84-260 for Taiwan’s history from the Dutch regime to the end of Japanese rule in 1945.

<sup>56</sup> Ryotaro Shiba, *Taiwan Ji Hsing* (A Trip to Taiwan) (Taipei: Taiwan Tung Fan, 1995), 530. Translated from Japanese into Chinese by Lee chin-sung.

Lee Teng-hui said that indigenization is respect for Taiwan's traditional culture, not getting rid of Chinese characteristics, because the two sides of the Strait are different countries.<sup>57</sup>

Minister of Education Ovid Tzeng, who served with the Chen administration, announced in October 2001 that "he will encourage all national universities to establish departments and graduate institutes of Taiwan history."<sup>58</sup> Although Tzeng encouraged the study of Taiwan's history, to some pro-independence groups he was not radical enough. In 2002, Lee Teng-hui, who had stepped down from presidency but found a meeting of minds with Chen Shui-bian in many affairs, was quoted by Chen I-shen, a scholar at Academia Sinica, "as saying that the Minister of Education Ovid Tzeng should be replaced for his failures in educational reform and for his reluctance to push for Taiwanization of the nation's textbooks."<sup>59</sup> The next month, Tzeng stepped down in a cabinet reshuffle, and his replacement by Huang Jong-tsun was widely reported by Taiwan's press as having something to do with his "pro-China ideology."

Tzeng had embroiled himself in the controversy over the island's official Mandarin Romanization system. Tzeng rejected Tongyong Pinyin and favored Hanyu Pinyin, a spelling system used in China and some other Mandarin-speaking communities, as well as the U.S. Library of Congress. Developed in 1998, Tongyong Pinyin is the product of a group of Taiwanese linguists who claim it preserves Taiwan's cultural sovereignty and accommodates sounds in Hoklo, Hakka, and aboriginal languages.

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<sup>57</sup> *World Journal* (New York), May 5, 2002, p. A6.

<sup>58</sup> Sandy Huang, "Tzeng said that Colleges Must Help Taiwanization Effort," *Taipei Times*, October 16, 2001.

<sup>59</sup> Lindy Yeh, "Lee Said to Not Like Tzeng," *Taipei Times*, January 8, 2002.

Hoklo and Hakka speakers are significant minorities in Taiwanese society. While Tzeng rejected the recommendation by the Mandarin Promotion Committee to use Tongyong Pinyin, Huang quickly adopted Tongyong Pinyin over Hanyu Pinyin, just a few months after taking office. Experts are now looking at ways to standardize the English spelling of street signs.<sup>60</sup> However, confusion has been caused by Taipei City's recent decision to switch back to Hanyu Pinyin, while the greater Taipei County area still uses Tongyong Pinyin; and to avoid puzzling foreign drivers, the words "Sin Dian," for example, are bracketed and put behind the words "Xin Dian" from Hanyu Pinyin.<sup>61</sup> Taipei is run by the charismatic mayor Ma Ying-jeou, whose party is the nominally pro-unification KMT.

Even the KMT finds the necessity to identify itself as a political party of Taiwan, albeit it came from the mainland in 1949. Huang Ta-chou, a former Taipei mayor speaking on behalf of the KMT, insisted that "the party has always embodied 'Taiwanism' by striving to enhance the welfare of the people."<sup>62</sup> Meanwhile, pro-independence newspapers vigorously promote indigenization. For example, the *Liberty Times*, which claims to have the largest circulation in Taiwan, has the slogan "Taiwan First; Liberty Foremost" on its front page, and this slogan also serves as its logo.<sup>63</sup> This newspaper differs from other pro-unification newspapers such as the *China Times* in addressing the PRC as China, not as the mainland, implying that Taiwan is outside China.

In the 1990s, Alan Wachman saw "a clash of nationalist visions: the Chinese nationalism manifested by the old guard in the KMT and their supporters, and the

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<sup>60</sup> Lin Mei-chun, "Minister of Education Gets an 'A' for Political Acumen," *Taipei Times*, July 22, 2002.

<sup>61</sup> "Taipei Uses Hanyu Pinyin for Road Signs," *Ming Pao*, April, 8, 2003.

<sup>62</sup> Crystal Hsu, "KMT Says It's a True Taiwanese Party," *Taipei Time*, July 5, 2001.

<sup>63</sup> See the newspaper's website at [www.libertytimes.com.tw](http://www.libertytimes.com.tw).

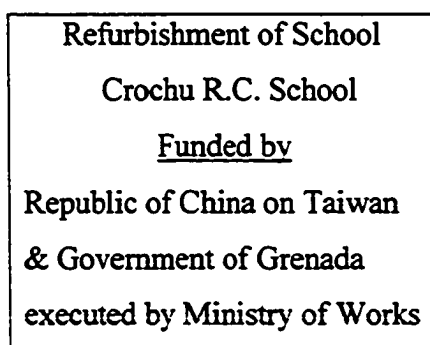


Taiwanese nationalism manifested by advocates of an independent Taiwanese state.”<sup>64</sup>

Shelley Rigger wrote on the competing conceptions of Taiwanese identity as an irreconcilable conflict in the relations between Beijing and Taipei.<sup>65</sup> In theory, the people on the island can be both Taiwanese and Chinese. They can be Taiwanese first and Chinese second, or they can be Chinese first and Taiwanese second, and in this way the two identities are not mutually exclusive. But for those advocating Taiwanese independence, the two terms have become incompatible, at least politically if not ethnically. Three examples show the rise of a nationalistic feeling on Taiwan.

The first example is found in a remote village in Grenada at the end of the twentieth century. In that village, an eye-catching billboard resembles Figure 2.0.

Figure 2.0. Billboard in Grenada



Under the billboard was a group of Grenadian children, who stood against the background of a row of apparently refurbished classrooms of a primary school.<sup>66</sup>

<sup>64</sup> Alan Wachman, *Taiwan: National Identity and Democratization* (Armonk, NY: M.E. Sharpe, 1994), 8.

<sup>65</sup> Shelley Rigger, "Competing Conceptions of Taiwan's Identity: The Irresolvable Conflict in Cross-Strait Relations," *Journal of Contemporary China*, vol. 6, no. 15 (Summer 1997): 307-317. Rigger tends to agree that when Taiwanese say, "We are Taiwanese, not Chinese," they are making a political statement like the American colonists did in the eighteenth century, not denying their ethnic ancestry.

<sup>66</sup> *Republic of China Yearbook 2000* (Taipei: Government Information Office), 151.

To the layman, the refurbishment project seemed to be funded by a country whose official name is “Republic of China on Taiwan.” In fact, this was a rather new name, which had rarely been seen before the 1980s. Such a name would now puzzle the most experienced China watchers if they were asked whether the emphasis was on “China” or on “Taiwan.”

The second example comes from 1995. In his reunion speech at Cornell University, Lee Teng-hui used this inflated name for Taiwan five times. Such a usage reflected a desire to distinguish the China on Taiwan from the China on the mainland. By using this name, Taipei is telling the world that there are two Chinas.

The third example is found outside governmental circles. A noteworthy phenomenon is that the government is not alone in using the name “Republic of China on Taiwan.” Sometimes journalistic and academic circles follow suit. For example, a book edited by a Taiwanese scholar was entitled *Foreign Policy of the Republic of China on Taiwan: An Unorthodox Approach*, in which it was explained that “The Republic of China (ROC) on Taiwan has been able to play an increasingly active role in the international arena in recent years because of its success in economic development and political democratization.”<sup>67</sup> French scholar Cabestan went so far as to replace ROC with ROCOT, which stands for Republic of China on Taiwan.<sup>68</sup>

Driven by the desire to have a separate identity from China, the Chen administration decided in early 2002 to issue passports that have the words “issued in Taiwan” on the cover. The meaning of this move was not lost on the mainland side,

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<sup>67</sup> Yu San Wang, ed., *Foreign Policy of the Republic of China on Taiwan: An Unorthodox Approach* (New York: Praeger, 1990), iv.

<sup>68</sup> See Cabestan’s article in the December 1996 issue of *China Quarterly*.

which said it was “a very dangerous move” toward “progressive independence of Taiwan.” Chen, however, said that the words “issued in Taiwan” merely serve the purpose of more clearly distinguishing Taiwan from China. Chen said that ROC passports have always been misread as PRC passports, a fact that cost Taiwan face and dignity. He said that although the Taiwanese themselves know what their passports represent, foreign governments often do not; and that to overcome this difficulty, those words are necessary. Taiwan’s foreign ministry expects that the passports with a new look will be issued in November 2002.<sup>69</sup>

Despite Beijing’s displeasure, Taipei continues to shift from the emphasis on cultural and historical links with the mainland to an emphasis on Taiwan. Chen Shui-bian spent some length in his new book to call for a maritime culture and suggested that Taiwanese should “search for Taiwan’s new values from a maritime culture.”<sup>70</sup> A maritime culture is certainly different from a continental culture, whichever way it is defined. Chen said: “Looking at Taiwan from the sea, one would exclaim that it is a beautiful island; looking at the sea from the seashore, one would feel that Taiwan is a big boat...which is sailing towards the ocean.”<sup>71</sup> Although Beijing knows that Taiwan cannot actually sail away, it would certainly pay attention to Chen’s suggestion that “at this time when Taiwan’s relations with China are unclear and ambiguous, Taiwan’s

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<sup>69</sup> Chen Shui-bian announced on January 13, 2002 that he approved the move; the Legislative Yuan endorsed it on January 18, 2002; thereafter, Beijing’s official Xinhua News Agency issued an article criticizing it as a “political move full of implications for Taiwan independence.” See *Ming Pao* (Hong Kong) January 14, 18, 19, 2002, at [www.mingpaonews.com](http://www.mingpaonews.com).

<sup>70</sup> Chen Shui-bian, *Shi Ji Shou Hang* (Maiden Voyage in the New Century) (Taipei: Yuan Shen, 2001), 309

<sup>71</sup> *Ibid.*, 40.

future should give priority to the ocean.”<sup>72</sup> Amid localization, the official *Free China Journal* has become *Taipei Journal*, and the avenue in front of the presidential office in Taipei has been changed from Chiehshou Road—a term wishing longevity to Chiang Kai-shek—to Ketagalan Boulevard, naming it after Taiwan’s oldest aboriginal tribe. In any case, a strong and separate identity on Taiwan will not help China’s national unification.

#### **IV. Beijing Has No Room to Back Down**

In China, the goal of reunifying with Taiwan remains firm, although the strategy to bring Taiwan back has evolved, from “liberation of Taiwan” to the peace offensive after 1979, and then to isolating Taiwan internationally to dash its hope of becoming independent and fostering economic ties with it to make it difficult to break away. To Beijing, reunification with Taiwan is a matter of fundamental national interest and a question of territorial integrity. National interest aside, passion plays a role, as Singapore’s veteran politician Lee Kuan Yew observed from the 1995-96 missile crisis, “No leadership in China will be able to survive if Taiwan moves away and becomes separate. It’s too big, too emotional a symbol of national unity. They have given a signal to the United States, Japan, and Taiwan that they are prepared to fight. They wanted everyone to know that this is important to them. This is not the theatrics. This is for

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<sup>72</sup> Ibid., 40-41.

real.”<sup>73</sup> Thus, reunifying with Taiwan is a great enterprise of a great nation that must succeed, and failure to prevent Taiwan from breaking away would have serious implications for the Beijing leadership.

Not only the Beijing leadership but the Chinese people too want reunification with Taiwan. A yearlong study by a group of scholars reveals the following observation:

From Beijing taxicab drivers to Shandong farmers to Sichuan intellectuals, the refrain is the same: Taiwan, Tibet, and Hong Kong are all parts of China. They can enjoy considerable autonomy within a Chinese framework, but the residents of those places cannot deny their heritage any more than a family member can deny his ancestors. As one Shandong county official explains his sentiment: “If Taiwan tries to deny it is part of China, we will have to kick their butt.” And as a Beijing taxicab driver put it, after expressing deep disenchantment with China’s top rulers: “Look how incompetent they are! Over forty years have passed, and still they haven’t gotten that little island of Taiwan back. Why do they deserve all the money they are getting?” This is not official rhetoric artificially implanted in the minds of the populace. It is popular opinion with which the leaders must reckon.<sup>74</sup>

In Taiwan, independence seekers may talk about the right of self-determination.

But the reality is that Beijing will have no room to back down if Taiwan declares independence. Pressure mounted before the 2000 presidential election in Taiwan, when in China a “poll for an official newspaper on the last day before Taiwan’s cliff-hanger presidential vote showed 95% backing for war” if Taiwan declares independence.<sup>75</sup>

Under such circumstances, in the words of Lee Kuan Yew, “No Chinese leader can survive if he is seen to ‘lose Taiwan.’”<sup>76</sup> Beijing’s leaders understand this. Addressing a

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<sup>73</sup> Interview with *Business Week* Assistant Managing Editor Robert Dowling, “Singapore’s Senior Minister on Asia’s Future,” *Business Week*, April 29, 1996, p. 57.

<sup>74</sup> Michel C. Oksenberg, Michael D. Swaine, and Daniel C. Lynch, “China Faces the Twenty-first Century,” in *The China Reader: the Reform Era*, ed. David Shambaugh and Orville Schell (New York: Vintage Books, 1999), 520-521.

<sup>75</sup> BBC (British Broadcasting Corporation) Online, “China Steps up War of Words,” March 17, 2000.

<sup>76</sup> Lee Kuan Yew, *From Third World to First*, 633.

Council on Foreign Relations conference in New York, Lee Kuan Yew said Jiang Zemin had told him that no Chinese leader could escape unscathed if Taiwan were lost during his term; and that without other options, China would sacrifice its economic modernization project for the use of force against Taiwan.<sup>77</sup>

Two days before Taiwanese cast their votes in the 2000 presidential election, Chinese Premier Zhu Rongji warned that China would not tolerate Taiwanese independence and that the Chinese people were ready to shed blood and sacrifice their lives to defend the unity of their motherland. “I want to make clear here that whoever comes into power in Taiwan after the election must not go about ‘Taiwan independence,’ nor will ‘Taiwan independence’ in whatever form be allowed,” Zhu said, adding that “this is the bottom line of the Chinese government and represents the common wish of the 1.25 billion people in China.”<sup>78</sup> Zhu rebuffed the assumption that China dare not use force to resolve the Taiwan question, and said, “Some people are calculating how many aircraft, missiles and warships China possesses, and have concluded that China dare not and will not use force,” but “according to such kind of calculation, Hitler would long have ruled the whole world,” and “the people making such calculations do not know about Chinese history.”<sup>79</sup> Zhu was usually reticent about the Taiwan issue, and his strongly worded message indicated an uncertainty about what Chen would do if he

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<sup>77</sup> *Ming Pao*, October 21, 2000, p. B10.

<sup>78</sup> From the official Xinhua News Agency, “Premier Zhu Warns Against ‘Taiwan Independence,’” March 15, 2000.

<sup>79</sup> *Ibid.*

became the new leader, and an anxiety over being forced into taking undesired military actions.<sup>80</sup>

In April 2000, after meeting Jiang Zemin and Zhu Rongji in Beijing, Singapore Prime Minister Goh Chok Tong said that mainland leaders have warned that they are prepared to “go all the way” militarily if Taiwanese president-elect Chen Shui-bian moves closer to declaring independence. Goh said, “The sense I came away with was that they were very serious about not allowing Chen Shui-bian to take steps that may suggest he is moving Taiwan closer to independence.” Goh warned, “In the short term, if, for example, Taiwan changes the constitution and declares independence, I think you can be sure that military action will be taken immediately.”<sup>81</sup> Premier Zhu told Prime Minister Goh: “We will by no means allow Taiwan to separate from China. That is an issue of principle, and we will never give in an inch in matters of principle.”<sup>82</sup>

Although Lee Teng-hui’s “pragmatic diplomacy,” weapons purchase programs, and foreign visits irritated Beijing, Lee and his KMT did not talk about independence for Taiwan.<sup>83</sup> Unlike the KMT, the DPP openly advocated Taiwan’s independence. Given the fact that Chen is from the DPP, it seems the Beijing leadership would not work well

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<sup>80</sup> Zhu’s portfolio has been economic development, both before and after he assumed premiership. Being called the “economic czar,” Zhu often left the Taiwan issue to President Jiang Zemin, and to Vice-Premier Qian Qichen, who oversees foreign policy.

<sup>81</sup> Barry Porter, “Beijing Serious About War Threat to Taiwan, Says Goh,” *South China Morning Post*, April 18, 2000.

<sup>82</sup> Daniel Kwan, “Mainland Urges Chen to Declare Allegiance,” *South China Morning Post*, April 11, 2000.

<sup>83</sup> Lee wrote, “There is no need [for Beijing] to warn against Taiwan’s declaring independence because the ROC has been sovereign and independent since 1912. It does not need to declare independence from the PRC, which is a much younger state that exercises effective jurisdiction over a totally different part of the Chinese nation.” See Lee Teng-hui, “Understanding Taiwan: Bridging the Perception Gap,” *Foreign Affairs*, vol. 78, no. 6 (November/December 1999), 10.

with him either. This was confirmed by a delegation of former U.S. officials to China. Former National Security Council members Kenneth Lieberthal and Douglas Paal, and former State Department senior China specialist Winston Lord met Chinese Vice-Premier Qian Qichen in Beijing in 2000. One of them said after the meeting, “The bad news is that they don’t want to work with Chen and the good news is that they are willing to wait and go with the status quo.”<sup>84</sup>

## V. U.S. Role in the Conflict

In light of the important role the United States plays in the conflict, a note on its policy and position must be included. Although the United States has said time and again that the Taiwan issue should be handled by the Chinese themselves, it was deeply involved in it from the very beginning. Before the issue emerged, the United States had already been enmeshed in the conflict between the Communists and the Nationalists. It provided transportation assistance for the Nationalists to take up the positions and facilities vacated by the Japanese after World War II, while the Communists demanded that the Japanese troops in China surrender to them and hand over their weapons. In 1945, “the American carriage of Nationalist troops to take over from the Japanese had turned into what was described by General Wedemeyer as the greatest air and sea transportation in history.”<sup>85</sup> When the civil war looked imminent, the United States tried to sponsor peace between the Communists and Nationalists. General George Marshall,

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<sup>84</sup> “China distrusts Chen, won’t work with him,” *South China Morning Post*, December 14, 2000, p. 1.

<sup>85</sup> Henry McAleavy, *The Modern History of China* (New York: Frederick A. Praeger, 1967), 320.



the former chief of staff of the U.S. Army, arrived in China as President Truman's special envoy in December 1945. His mission consisted of "trying to stave off civil war through a compromise between the two parties, and helping the Nationalists to establish their authority over as large a portion of China as possible."<sup>86</sup> But the Marshall mission failed quickly as a full-scale civil war broke out in 1946, turning the tides against the Nationalists.<sup>87</sup> Being defeated by the Communists, the Nationalist government fled to Taiwan in 1949. After the outbreak of the Korean War in 1950, President Truman ordered the Seventh Fleet into the Taiwan Strait, effectively protecting the Nationalists from Communist attack and giving them time to regroup and regain strength. In 1954, Washington signed a Mutual Defense Treaty with Taipei and, in subsequent years, provided military and economic aid to Taiwan. The treaty required the signatories to act to meet any armed attack "in the West Pacific area directed against the territories" of either the United States or the ROC, including Taiwan, the Pescadores, and "such other territories as may be determined by mutual agreement."<sup>88</sup> This amounted to backing Taiwan with full military might against a PRC attack.

During the 1960s, relations between China and the Soviet Union turned sour. In 1969 an armed clash erupted in Zhenbao Island, a small isle in the Wusuli (Ussuri) River dividing the two countries in China's northeast. To win over China to the U.S. side in the

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<sup>86</sup> Jean Chesneaux, Francoise Le Barbier, and Marie-Claire Bergere, *China: From the 1911 Revolution to Liberation* (New York: Pantheon Books, 1977), 318.

<sup>87</sup> If war is defined as large-scale fighting in which human lives are lost, then a civil war is no less bloody than an international one. The Chinese Communists published their claims of losses inflicted upon the Nationalists from July 1, 1946, to January 31, 1949, which showed that 4,959,000 personnel were killed, wounded, or taken prisoner, with the proportion of prisoners 75 percent. See Lionel Max Chassin, *The Communist Conquest of China: A History of the Civil War, 1945-1949* (Cambridge, MA: Harvard University Press, 1965), 208.

<sup>88</sup> *China: U.S. Policy Since 1945*, p. 311.

Cold War, U.S. Secretary of State Henry Kissinger flew to China secretly after visiting Pakistan in 1971. He arranged a meeting between Chairman Mao and President Nixon, which took place in 1972. The meeting resulted in the issuance of the Shanghai Communiqué, which expressed the wish from both sides to broaden the understanding between the two peoples through contacts and exchanges, and to promote trade between the two countries. Both sides also expressed the wish to normalize relations. Beijing and Washington agreed that “they will stay in contact through various channels, including the sending of a senior U.S. representative to Peking [Beijing] from time to time for concrete consultations to further the normalization of relations between the two countries.”<sup>89</sup> Thereafter, relations between China and the United States improved as the two countries cooperated in confronting the Soviet Union. Beijing and Washington established diplomatic ties on January 1, 1979. On that day, the United States severed diplomatic relations with the ROC and abrogated the Mutual Defense Treaty.

As mentioned earlier, the establishment of Sino-American diplomatic relations had an impact on how Beijing viewed the Taiwan issue. Beijing thought a major obstacle to national reunification had been removed. However, despite the cutting of diplomatic ties with Taipei, the United States maintained strong commercial, cultural, and even security ties with the island, and sold advanced weapons to it. Beijing’s leaders in 1979 could not have imagined that, in 2001, U.S. President George W. Bush would say during a television interview that the United States will do “what it takes” to help Taiwan defend

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<sup>89</sup> Ibid.

itself.<sup>90</sup> In other words, the “obstacle” has not been quite removed. Garver made an interesting observation and felt that the sentiment in American society would make it hard for the Americans to abandon Taiwan if it was attacked by China. He noted that although Taiwan no longer provides the strategic and political values to the United States as it did during the Cold War, “as a result of two decades of association as allies, many Americans came to feel a sense of moral obligation toward Taiwan. Many Americans developed the image of Taiwan as a loyal friend and ally. Small but brave Taiwan was seen as a country willing to stand by the United States in times of adversity, and to do some of the unpleasant, dirty work that sometimes needed to be done.” Furthermore, “robust military and civilian governmental links, advisory programs and exchanges, trade and economic ties, cultural ties, and growing emigration from Taiwan to the United States translated into personal friendships between many Americans and many Chinese from Taiwan.” As a result of all this history and activity, Garver reported that:

One common American belief, which developed during the alliance, was that the United States owed continuing friendship to Taiwan because Taiwan had been a loyal friend of the United States. The United States should repay friendship and loyalty in kind; it should not “betray” Taiwan. When the United States unilaterally terminated the alliance and began making friends with the PRC in 1971, there was a strong sense of guilt among Americans. While Americans might understand and approve of the diplomatic rationale for rapprochement with Beijing, many simultaneously felt guilty for “betraying” Taiwan. Members of the U.S. foreign policy elite might be able to dispose of Taiwan dispassionately. This was not so for many ordinary Americans.<sup>91</sup>

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<sup>90</sup> AFP dispatch, April 25, 2001. Bush made the remark during an appearance on ABC’s “Good Morning America.” He was asked: “If Taiwan were attacked by China, do we have an obligation to defend the Taiwanese?” He replied without hesitation: “Yes we do, and the Chinese must understand that.” Bush was then asked if he would use the “full force of American military.” He responded: “Whatever it took to help Taiwan defend herself.”

<sup>91</sup> Garver, *Sino-American Alliance*, 295-96.

With this sentiment in force, plus the Taiwan Relations Act, one has a good reason to expect that the U.S. Government would be compelled to react one way or another if Beijing decides to subdue Taiwan by force. No one knows in advance how the United States will react, but it seems probable that U.S. reaction will depend on the development of the situation (e.g., who initiates the conflict, the scale of force involved, etc.).<sup>92</sup>

In the Shanghai Communiqué of 1972, the U.S. side “reaffirms its interest in a peaceful settlement of the Taiwan question by the Chinese themselves.” This position was repeated by President Jimmy Carter as he made the statement on establishing diplomatic relations with China, and hence by the United States on many other occasions.<sup>93</sup> That is to say that any use of force by China to take Taiwan, and any use of force by Taiwan to retake the mainland, would be unacceptable to the United States. The net effect of this is, as Professor Lee Lai To at the National University of Singapore observed,

This clearly prevents Beijing from exercising the option of using force—the military offensive. The insistence in pursuing a peaceful approach to reunification actually helps Taiwan to a large extent. If Taiwan turns down the “peaceful” initiatives from Beijing, and this is precisely what is happening, *Beijing will not be able to press any further* [emphasis mine]. At most, it could use the diplomatic offensive to isolate Taipei in international affairs.<sup>94</sup>

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<sup>92</sup> An impression communicated to this author from mainland scholars during private conversations is that they do not believe the United States will defend Taiwan to the extent of sacrificing its own interest.

<sup>93</sup> On December 15, 1978, Carter first read the Joint Communiqué, which was simultaneously read in Beijing. In a statement that followed the communiqué, Carter said: “As the United States asserted in the Shanghai Communiqué of 1972, issued on President Nixon’s historic visit, we will continue to have an interest in the peaceful resolution of the Taiwan issue.” See *Public Papers of the President of the United States of America, 1978* (Washington, DC: United States Printing Office, 1979), 2265.

<sup>94</sup> Lee Lai To, *Reunification of China* (New York: Praeger, 1991), 68.

Based on this observation, Lee says, “It cannot be concluded that the United States is in fact against Taiwan’s independence or is seeking to prevent such a move.”<sup>95</sup>

To the Chinese, three important documents are seen to govern Sino-American relations: the Shanghai Communiqué of 1972, the Communiqué on Establishment of Diplomatic Relations in 1979, and the 1982 United States-China Joint Communiqué in which the United States pledged to reduce arms sales to Taiwan. To the U.S. government, however, there is another document that is equally or even more important: the Taiwan Relations Act (TRA) of 1979. Passed by Congress shortly after the establishment of Sino-American diplomatic relations, the TRA states that it is the policy of the United States to

1. make clear that the U.S. decision to establish diplomatic relations with China rests upon the expectation that the future of Taiwan will be determined by peaceful means;
2. consider any effort to determine the future of Taiwan by other than peaceful means, including by boycotts or embargoes, a threat to the peace and security of Western Pacific area and of grave concern to the United States;
3. provide Taiwan with arms of a defensive character;
4. maintain the capacity of the United States to resist any resort to force or other forms of coercion that would jeopardize the security, or the social or economic system, of the people on Taiwan.<sup>96</sup>

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<sup>95</sup> Ibid., 70.

<sup>96</sup> *China: U.S. Policy Since 1945*, pp. 343-345 for full text.

For some unknown reasons, when the TRA was being enacted, China did not vehemently oppose it. But resentment emerged as the United States kept selling sophisticated weapons to Taiwan. The TRA not only makes clear that establishment of Sino-American diplomatic relations is predicated on the understanding that the Taiwan issue will be solved peacefully, but also calls for U.S. preparedness to resist the use of force for a solution of the issue. It has also anticipated the steps China would use to coerce Taiwan into a settlement of the issue. Over time, the TRA has become so irritating to the Chinese that they ridiculed the United States for placing a domestic law above international agreements.<sup>97</sup> Chinese Vice Premier Qian Qichen, whose portfolio is to oversee foreign relations, once said that the TRA is a big “tail” not cut when China normalized relations with the United States. The Americans, however, replied that communiqués are documents of understanding, not laws.<sup>98</sup>

The Taiwan question is not just legalistic. It involves the threat of nuclear war. If the United States wants to support Taiwan by all means, as President Bush has declared, it will have to contemplate the use of nuclear weapons because it is confronted with a nuclear power. When the U.S. Nuclear Posture Review was leaked to the press, it was revealed that the Pentagon had anticipated new contingencies in which nuclear weapons

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<sup>97</sup> See, for instance, the State Council’s *White Paper on the Taiwan Question and China’s Reunification* (August 30, 1993), which accused the TRA as a domestic law of violating many stipulations in the Sino-American Communiqué on Establishment of Diplomatic Relations, as well as the principles of international law. See also *China Daily*, April 27, 2001, which quoted Professor Lin Wenzong at the Foreign Affairs College as saying that the three communiqués should have the status of treaties according to the 1969 Vienna Convention on the Law of Treaties.

<sup>98</sup> David R. Sands, “Powell Lectures China on Human Rights Issue,” *Washington Times*, January 25, 2001. Sands writes, “Mr. Powell repeated the past U.S. commitment to the three U.S.-China communiqués in 1972, 1978, and 1982. The communiqués are not treaties and must be reaffirmed or rejected each time a new administration comes into office. They are the basis for U.S. policy toward China.” However, it is not clear whether Colin Powell and other U.S. officials also adhere to this interpretation.

might be used, including a military confrontation over the status of Taiwan.<sup>99</sup> This may be an act of international politics, which is calling someone's bluff. However, the United States was not alone in calling someone's bluff. General Xiong Guangkai, deputy chief of staff of the PLA, made a veiled threat in 1995 by saying that the United States cares more about Los Angeles than Taiwan.<sup>100</sup>

Deng Xiaoping's replies to American television correspondent Mike Wallace on September 2, 1986, during an interview for the program "60 Minutes" on CBS, can be used to sum up the U.S. involvement in the conflict:

In the United States, people say the U.S. takes a position of "non-involvement" in the question of China's reunification, that is, the Taiwan question. This is not true. The fact is that the United States has been involved all along. In the 1950s, McArthur and Dulles regarded Taiwan as an unsinkable U.S. aircraft carrier in Asia and the Pacific. The Taiwan question was therefore the most important issue in the negotiations on the establishment of diplomatic relations between China and the United States.<sup>101</sup>

Finally, one intriguing aspect of the evolutionary process is that, although the United States says it adheres to the three Sino-American communiqués, at least one of these documents has become anachronistic in the eyes of a large number of Taiwanese. In the 1972 Shanghai Communiqué, the U.S. side "acknowledges" that all the Chinese on either side of the Taiwan Strait maintain that there is but one China and Taiwan is a part of China. The communiqué said that the U.S. government does not challenge that

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<sup>99</sup> Michael Gordon, "U.S. Nuclear Plan Sees New Targets and New Weapons," *New York Times*, March 10, 2002, p. 1.

<sup>100</sup> See Bill Gertz, "General Who Threatened L.A. Tours U.S. on Chinese Mission," *Washington Times*, December 18, 1996; and Bill Gertz, "China Warns U.S. of Missile Attack," *Washington Times*, February 29, 2000, at [www.washtimes.com](http://www.washtimes.com).

<sup>101</sup> Bureau for the Compilation and Translation of Works of Marx, Engels, Lenin and Stalin under the Central Committee of the Communist Party of China, "Replies to the American TV Correspondent Mike Wallace, September 2, 1986," *Selected Works of Deng Xiaoping, Vol. III, 1982-1992*, p. 172.

position. But recent developments on Taiwan showed that this position is being challenged by Taipei itself. Taipei's effort to win parallel recognition in the UN suggests that it does not mind two Chinas. Not all Taiwanese think they are Chinese in a sense that they are similar to those on the mainland; and to those who favor Taiwan's independence, Taiwan is not a part of China.<sup>102</sup> The coming to power of the DPP, which advocates the "establishing of a sovereign and independent Republic of Taiwan,"<sup>103</sup> makes the Shanghai Communiqué look more like a dated document, and the insistence on it by the United States an imposition of the U.S. position on Taiwan.

## VI. Conclusion

From the developments on both sides of the Taiwan Strait, it can be seen that the zero-sum nature of the conflict remains, although the conflict itself has evolved. Between the 1950s and the 1980s, both the PRC and the ROC claimed to rule all of China and tried to replace the other as the legal central government of China. Starting from the early 1990s, the conflict evolved into a new phase, as Taipei progressively moved away from the one-China principle and Beijing increasingly attacked the pro-independence tendency on Taiwan rather than trying to eliminate the ROC. Beijing did not need to worry too much about such a tendency before the 1980s as it does now because the KMT government would send independence seekers to jail. At present, a pro-independence

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<sup>102</sup> MAC figures show that about 15-20 percent of Taiwanese favor independence from 1994-2002, with the highest record of 28 percent in October 1999. See <http://www.mac.gov.tw/english/POS/p9107e.htm>.

<sup>103</sup> See DPP's political platform at [www.dpp.org.tw](http://www.dpp.org.tw).



party rules Taiwan, and although Taipei does not claim to rule the mainland anymore or to eliminate the Communist regime, the conflict remains zero-sum because Taiwan's success in separating from China equals Beijing's failure to bring Taiwan back to its fold.<sup>104</sup> Because Taiwan cannot succeed in separating from China (some may argue that Taiwan has *de facto* statehood), and China cannot bring Taiwan back to its fold, the conflict persists.

The policy positions of Beijing and Taipei also show the zero-sum nature of the conflict. On the mainland side were the 1979 message to the Taiwanese, the 1981 nine-point proposal by NPC Chairman Ye Jianying, the "one country, two systems" model that was formulated in 1984, and more recently Jiang Zemin's eight-point proposal in 1995. All these tried to downgrade the ROC on Taiwan to a special administrative region of the PRC. Taipei has rejected the arrangements that would deprive it of its *de facto* statehood. Lee Teng-hui's six-point response in 1995 urged Beijing to treat Taipei as an equal political entity and stop interfering in Taipei's participation in international organizations. He also refused to open the "three links" which would tie Taiwan more closely to the mainland. In short, although the ROC has ceased to claim jurisdiction over the mainland, it has also tried to maintain its position, protect its autonomy, and refuse to become a part of the PRC, making it difficult for Beijing to realize national reunification.

The conflict remains intractable but its zero-sum characteristic is not immutable. In a zero-sum situation, compromise is impossible. But things are never neat, and the conflict between Beijing and Taipei is not like New York's mayoral election, which is deliberately made a zero-sum game because several candidates compete, but only one can

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<sup>104</sup> In light of the coming to power of the DPP, the sentiment for a separate Taiwan on the island cannot be underestimated.

get the post. The Taipei-Beijing conflict is *made* zero-sum through the policies and positions on both sides, so with lots of imagination it can also be transformed to a non-zero sum situation. At present, both sides have incompatible policies, firm convictions, and strong resolve, and neither side is going to yield. This prompts an analyst to say that “finding a compromise acceptable to all parties may be impossible without some use of force.”<sup>105</sup> Professor Chu Yun-han at the National Taiwan University has also expressed his concern for the possibility of hostility. He foresees “a final military showdown ten or fifteen years into the future” if “the accumulation of distrust and animosity continues” and the two sides move farther and farther away from a negotiated peace.<sup>106</sup> However, both sides may also prefer the status quo to a vigorous contention to solve the problem, because they have other urgent tasks to perform. So long as the line separating peace from a *casus belli* is not crossed (i.e., Taiwan separating from China, or the PRC eliminating the ROC), war is not imminent. But if a war did erupt in the Taiwan Strait, it would likely be framed by the ruling DPP as a war of independence, although it would still be viewed by Beijing as a war to bring about national reunification.

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<sup>105</sup> Martin L. Lasater, “Principles of Deterrence in the Taiwan Strait,” in *If China Cross the Taiwan Strait: The International Response*, ed. Parris H. Chang and Martin L. Lasater (Lanham, Maryland: University Press of America, 1993), 155.

<sup>106</sup> Chu Yun-han, “The Political Economy of Taiwan’s Mainland Policy,” in *Across the Taiwan Strait*, ed. Suisheng Zhao (New York: Routledge, 1999), 191.

## **Chapter 3**

### **Development of Economic Ties**

This chapter identifies the extent of cross-Strait trade and investment in the 1990s. Knowing the volume of trade and the pattern of capital flows across the Strait establishes the level of Beijing-Taipei economic cooperation and lays a foundation for assessing the extent of cross-Strait economic interdependence. The data presented in this chapter are largely descriptive and will be used for analysis in Chapter 4. The economic exchanges between the two sides of the Strait can be divided into trade and investment; accordingly this chapter is divided into two parts, one on trade and one on investment.

#### **I. Trade across the Taiwan Strait**

Because Taipei made the policy of “no compromise, no contact, and no negotiation” with Beijing in 1979 (i.e., the “three nos policy”), adhered to that policy when cross-Strait trade began in the late 1980s, and continued to use it in the bargain for political concessions, a pattern of indirect trade has emerged. Trade must be routed through a third place, usually Hong Kong, which is an international financial center and has the world’s busiest seaport. With its great efficiency, excellent infrastructure and impeccable services, Hong Kong continues to serve as an entrepot for cross-Strait trade after Beijing regained sovereignty over the territory in 1997, and Taiwan continues to see

Hong Kong as a third place even though it has become a special administrative region of the PRC. No one has asked any question about this delicate arrangement.

### **1. Beginning of Cross-Strait Trade**

In 1985, Taipei announced that it would neither encourage nor interfere in the exports of goods by Taiwanese firms to China via Hong Kong. To some extent, this policy legalized Taiwanese exports to China. But most scholars think that 1987 was the year in which Taiwan opened indirect trade between the two sides, because the government made a series of moves that greatly facilitated cross-Strait trade in subsequent years. In July 1987, Martial Law was lifted and foreign-exchanges controls were liberalized, making it easier for business people to invest in the mainland. But the most important move was announced in October 1987 that the old soldiers who had followed Chiang Kai-shek to Taiwan would be allowed to return to China to visit their relatives. Thus, the ban on travel to China was partly lifted. It was reported that President Chiang Ching-kuo approved such a move out of humanitarian reasons, because these soldiers had reached old age, and since the KMT had failed to take them back to the mainland, they should be and were allowed to see their relatives before they died. Once the ban was lifted, the categories of eligible persons rapidly increased, from civilians to junior civil servants, middle government officials, and finally congressmen.<sup>1</sup> Hence, an increasing number of people went to China as tourists and for business opportunities.

In July 1988, Taipei announced that indirect exchanges between the two sides of the Strait would be opened provided that they are “unofficial, indirect, simple, and

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<sup>1</sup> Members of the armed forces and intelligence personnel were still banned.

gradual.” The next month the Ministry of Economic Affairs (MOEA) promulgated a set of “Principles Governing the Indirect Import of Goods from the Mainland” and approved 50 items of raw materials for indirect imports. In December the same year, a law court in Taiwan found businessman Liu Yi-chia, who was charged with “propping up the coffer of the bandits” for trading with China, not guilty.<sup>2</sup> The implication of the ruling was that it was no longer a crime to do business with China. Thus, the green light was given.

China called for trade in its “Message to the Taiwan Compatriots” in 1979. In order to solicit business from Taiwan, Beijing gave special preference for cross-Strait trade and adopted a series of measures to promote it.<sup>3</sup> Beijing also made a daring decision that products from Taiwan were domestic products and no tariffs would be levied. But such a provision soon caused reservations and was cancelled in 1982.<sup>4</sup>

In the early 1980s, the Chinese government established shelters along the coast for Taiwanese fishermen, and small-scale trade existed between Taiwanese fishing boats and some mainland ports. This kind of trading activity was not considered legal by the Taiwanese government, although Taiwanese firms had been exporting goods to Hong Kong that were understandably carried forward to the Chinese mainland. According to Hong Kong statistics, before 1987, trade between Taiwan and China via Hong Kong rarely exceeded US\$1 billion, but after 1987, the volume of trade increased rapidly and exceeded US\$10 billion in 2001 (see Table 3.01).

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<sup>2</sup> Chang, 377.

<sup>3</sup> For example, it adopted the “Temporary Stipulations Concerning the Broadening of Trade with Taiwan” in May 1979 and the “Supplementary Stipulations on Procuring Products from Taiwan” in June 1980. See Lee Lai To, 122.

<sup>4</sup> Barry Naughton, “Economic Policy Reform in the PRC and Taiwan,” in *The China Circle*, ed. Barry Naughton (Washington, DC: Brookings Institution), 84-85; and Lee Lai To, 121.

## 2. Trade Statistics

Three sources of statistics exist for cross-Strait trade: Hong Kong, China, and Taiwan. Because Hong Kong is an important entrepot between Taiwan and China, the statistics compiled by Hong Kong's Census and Statistics Department have been frequently used by Taipei to record the movement of cross-Strait goods. This is understandable because Taipei has no way to keep records of its goods once they reach Hong Kong and are carried from there to China, so Taipei has to rely on Hong Kong statistics. As can be seen from the statistics used by Taipei in reporting cross-Strait trade, Taiwan relied heavily on Hong Kong Customs statistics before 1993, but since 1994 it has developed its own statistical and estimation methods, and has relied on its own statistics. At present, the Mainland Affairs Council (MAC) is one of the most authoritative sources of cross-Strait trade and investment statistics. It publishes a *Cross-Strait Economic Statistics Monthly*, which reports on cross-Strait trade and investment trends. It also puts its statistics on the World Wide Web. On the mainland side, the National Bureau of Statistics (formerly State Statistics Bureau) publishes the *China Statistical Yearbook*, which contains data on trade and investment across the Taiwan Strait. This is one of the most authoritative sources that a researcher can use.

But the statistics from Hong Kong, Taiwan, and China do not match. In other words, comparing the statistics from these sources, a researcher would find that Taiwan's imports from China do not equal China's exports to Taiwan, or Taiwan's exports to China do not equal China's imports from Taiwan, and the statistical gap is large and cannot be explained by the difference between "free on board" (F.O.B.) calculation, which means the price of the goods when they leave the shore, and "cost, insurance,

freight" (C.I.F.) calculation, which means the price of the goods when they arrive at the shore. Table 3.01, based on Hong Kong statistics, shows that cross-Strait trade via Hong Kong increased from US\$77 million in 1979 to US\$10 billion in 2001.

Table 3.01. Taiwan's Trade with Hong Kong and Transit Trade with China, 1979-2001, Based on Hong Kong Statistics (in US\$millions)

|      | Taiwan Exports to Hong Kong |                     | Taiwan Imports from Hong Kong |                           | Total Trade between Taiwan and Hong Kong |                          |
|------|-----------------------------|---------------------|-------------------------------|---------------------------|------------------------------------------|--------------------------|
|      | Amount                      | Re-exports to China | Amount                        | Imports from China via HK | Amount                                   | Transit trade with China |
| 1979 | 1,207.0                     | 21.5                | 346.0                         | 56.3                      | 1,553.3                                  | 77.8                     |
| 1980 | 1,592.2                     | 235.0               | 445.8                         | 76.2                      | 2,038.0                                  | 311.2                    |
| 1981 | 1,921.8                     | 384.2               | 432.1                         | 75.2                      | 2,353.9                                  | 459.4                    |
| 1982 | 1,671.8                     | 194.5               | 436.4                         | 84.0                      | 2,108.2                                  | 278.5                    |
| 1983 | 1,705.2                     | 157.8               | 473.2                         | 89.9                      | 2,178.4                                  | 247.7                    |
| 1984 | 2,224.0                     | 425.5               | 624.1                         | 127.8                     | 2,848.1                                  | 553.2                    |
| 1985 | 2,679.2                     | 986.9               | 554.5                         | 115.9                     | 3,233.7                                  | 1,102.7                  |
| 1986 | 3,074.0                     | 811.3               | 761.4                         | 144.2                     | 3,835.4                                  | 955.6                    |
| 1987 | 4,274.0                     | 1,226.5             | 1,241.7                       | 288.9                     | 5,515.7                                  | 1,515.5                  |
| 1988 | 5,686.8                     | 2,242.2             | 1,811.5                       | 478.7                     | 7,498.3                                  | 2,720.9                  |
| 1989 | 6,613.7                     | 2,869.5             | 2,112.6                       | 586.9                     | 8,726.3                                  | 3,483.4                  |
| 1990 | 7,446.7                     | 3,278.3             | 2,724.1                       | 765.4                     | 10,170.8                                 | 4,043.6                  |
| 1991 | 9,563.0                     | 4,667.2             | 3,175.0                       | 1,126.0                   | 12,738.0                                 | 5,793.1                  |
| 1992 | 11,301.2                    | 6,287.9             | 3,396.9                       | 1,119.0                   | 14,698.1                                 | 7,406.9                  |
| 1993 | 12,203.7                    | 7,585.4             | 3,658.6                       | 1,103.6                   | 15,862.3                                 | 8,689.0                  |
| 1994 | 13,936.3                    | 8,517.2             | 3,700.3                       | 1,292.3                   | 17,636.6                                 | 9,809.5                  |
| 1995 | 16,572.6                    | 9,882.8             | 4,580.6                       | 1,574.2                   | 21,153.2                                 | 11,457.0                 |
| 1996 | 15,795.1                    | 9,717.6             | 4,274.8                       | 1,582.4                   | 20,069.9                                 | 11,300.0                 |
| 1997 | 15,967.6                    | 9,715.1             | 4,693.7                       | 1,743.8                   | 20,661.3                                 | 11,458.9                 |
| 1998 | 13,342.9                    | 8,364.1             | 4,342.7                       | 1,654.9                   | 17,685.6                                 | 10,019.0                 |
| 1999 | 12,875.2                    | 8,174.9             | 4,225.6                       | 1,628.1                   | 17,100.8                                 | 9,803.0                  |
| 2000 | 15,919.5                    | 9,593.1             | 5,102.6                       | 1,980.5                   | 21,022.1                                 | 11,573.7                 |
| 2001 | 13,873.0                    | 8,811.5             | 4,534.2                       | 1,693.3                   | 18,371.2                                 | 10,504.8                 |

Source: *Cross-Strait Economic Statistics Monthly* (Taipei: MAC), no. 101, January 2001, p. 17; and no. 113, January 2002, at [www.mac.gov.tw](http://www.mac.gov.tw). MAC used data from Hong Kong's Census and Statistics Department.

The figures in Table 3.01 represent a middle ground in reporting cross-Strait trade. The Council for Economic Planning and Development, a cabinet-level agency in Taiwan, still uses these figures to report cross-Strait trade.<sup>5</sup> But these figures are larger than those reported by Taiwanese Customs, and smaller than those reported by Chinese Customs, as shown in Table 3.02.

Table 3.02. Indirect Trade between China and Taiwan, 1989-2000, Based on Three Sources of Statistics (in US\$millions)

|      | Hong Kong Customs Statistics |         |          | Taiwan Customs Statistics |         |          | China Customs Statistics |         |          |
|------|------------------------------|---------|----------|---------------------------|---------|----------|--------------------------|---------|----------|
|      | Exports                      | Imports | Total    | Exports                   | Imports | Total    | Exports                  | Imports | Total    |
| 1989 | 2,896.5                      | 586.9   | 3,483.4  | ...                       | ...     | ...      | ...                      | ...     | ...      |
| 1990 | 3,278.3                      | 765.4   | 4,043.6  | ...                       | ...     | ...      | 2,255.0                  | 319.7   | 2,574.6  |
| 1991 | 4,667.2                      | 1,126.0 | 5,793.1  | ...                       | 597.5   | 597.5    | 3,639.0                  | 594.8   | 4,233.9  |
| 1992 | 6,287.9                      | 1,119.0 | 7,406.9  | 1.1                       | 747.1   | 748.1    | 5,881.0                  | 698.0   | 6,579.0  |
| 1993 | 7,585.4                      | 1,103.6 | 8,689.0  | 16.2                      | 1,015.5 | 1,031.7  | 12,933.1                 | 1,461.8 | 14,394.9 |
| 1994 | 8,517.2                      | 1,292.3 | 9,809.5  | 131.6                     | 1,858.7 | 1,990.3  | 14,084.8                 | 2,242.2 | 16,327.0 |
| 1995 | 9,882.8                      | 1,574.2 | 1,457.0  | 376.6                     | 3,091.4 | 3,468.0  | 14,783.9                 | 3,098.1 | 17,882.0 |
| 1996 | 9,717.6                      | 1,582.4 | 11,300.0 | 622.9                     | 3,059.8 | 3,682.7  | 16,182.2                 | 2,802.7 | 18,984.9 |
| 1997 | 9,715.1                      | 1,743.8 | 11,458.9 | 627.8                     | 3,915.4 | 4,543.2  | 16,441.7                 | 3,396.5 | 19,838.2 |
| 1998 | 8,364.1                      | 1,654.9 | 10,019.0 | 834.7                     | 4,110.5 | 4,945.2  | 16,629.6                 | 3,869.6 | 20,499.2 |
| 1999 | 8,174.0                      | 1,628.1 | 9,803.0  | 2,539.5                   | 4,522.2 | 7,061.7  | 19,537.5                 | 3,951.7 | 23,489.2 |
| 2000 | 9,593.1                      | 1,980.5 | 11,573.7 | 4,200.0                   | 6,223.3 | 10,443.2 | 25,497.1                 | 4,994.9 | 30,492.1 |

Source: *Cross-Strait Economic Statistics Monthly* (Taipei: MAC), no. 101, January 2001, p. 21.

Note: Exports means Taiwan's exports to China; imports, Taiwan's imports from China.

<sup>5</sup> See *Taiwan Statistical Data Book, 2001* (Taipei: Council for Economic Planning and Development, 2001), p. 19.



Figure 3.02 also shows a great difference in Taiwanese exports to China as reported by Hong Kong Customs and Taiwanese Customs. These statistical discrepancies have something to do with the methods by which the indirect trade was conducted. Currently, there are two methods through which cross-Strait trade is conducted: entrepot trade (*chuankou maoyi*) and transshipment trade (*chuanyun maoyi*).<sup>6</sup> In both entrepot and transshipment trade, the goods are shipped through an entrepot. According to Professor Leong Liew of Griffith University, the difference between these two types of trade is as follows. In entrepot trade, a buyer in the entrepot clears customs and takes legal possession of the goods before sending them to their final destination. Some value may be added to these goods at the entrepot but the amount of processing has to be limited so as not to attract country of origin status. Data on China-Taiwan entrepot trade through Hong Kong are collected by Hong Kong Customs. Goods on transshipment do not have to clear customs and are therefore not recorded by Hong Kong Customs, but these goods are declared by Taiwanese exporters to Taiwanese Customs as goods destined for Hong Kong, not for China. Thus, Taiwanese Customs underreported exports to China. Upon arrival in Hong Kong, these goods are transferred from the ship carrying the cargo from Taiwan to another ship destined for China. Liew reported that transshipment is the most popular form of Taiwanese exports to China because it saves time and storage costs. Moreover, since the goods are not officially re-exported, only one

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<sup>6</sup> Liew, 153.

set of documents has to be prepared at the first port of shipment. In entrepot trade, another set of documents has to be prepared at the entrepot for goods that are re-exported.<sup>7</sup>

Citing information from the secretary-general of Taiwan's Chinese Marine Research Association, Tse-kang Leng reported that the indirect trade through Hong Kong is conducted in three different ways: (1) commodities are shipped from Taiwan to Hong Kong, pass through Hong Kong Customs, and are then transferred to other ships heading for China; (2) commodities are exported from Taiwan to Hong Kong, and then transferred by land to China—the Hong Kong Customs will have import records but no export records for the indirect trade through this route; (3) exports from Taiwan are transferred in Hong Kong waters to another cargo vessel heading for China—the cargo neither enters the harbor nor passes through Hong Kong Customs. Of these three channels for trade through Hong Kong, only the first one is included in official statistics on the re-export trade issued by the Hong Kong Customs.<sup>8</sup>

Hong Kong economist Yun-wing Sung sees this transshipment trade as “direct trade.” Sung reported that this trade usually involves a switching of trade documents. Taiwanese exporters claim that their goods are destined for Hong Kong when the goods leave Taiwan. But on arrival in Hong Kong, the trade documents are switched, and the goods are declared as destined for China. Because the goods are consigned to a buyer in China, they do not go through Hong Kong Customs, and no Hong Kong firm can claim legal possession of the goods. Such goods are regarded as transshipment by the Hong

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<sup>7</sup> Ibid., 153-154.

<sup>8</sup> Leng 1996, p. 109.

Kong government and are not regarded as part of Hong Kong's trade. Such trade is considered by Sung as "direct trade" because no third party buys the goods involved for resale, and Sung reported that this trade also has the advantage of confidentiality because Hong Kong Customs does not keep records.<sup>9</sup> However, when Sung called the transshipment trade "direct trade," he ignored the fact that the goods have to go a zigzag way instead of directly across the Taiwan Strait.

Comparing Taiwan and Hong Kong statistics, it becomes clear that the figure for "Taiwan exports to Hong Kong" released by Taiwan Customs statistics is greater than that of "Hong Kong imports from Taiwan" published by Hong Kong Customs statistics. The reason is because Taiwanese exporters lump together their exports to Hong Kong and their exports to China through transshipment, which escape Hong Kong Customs statistical records. Consequently, if one only considers the figures from Hong Kong Customs statistics, cross-Strait trade would be underestimated.

In view of this, the MAC in Taipei has derived a method to estimate cross-Strait trade. This method is presented in Table 3.03. Comparing this table with Table 3.02, it can be seen that estimation of the indirect trade by the MAC is much larger than that reported by Hong Kong, and still larger than that reported by China. This research uses the figures in column (7) in Table 3.03 as a yardstick for later comparison; that is, it uses the largest trade volume reported by the four sources (Hong Kong Customs, Chinese Customs, Taiwan Customs, and the MAC), and in doing so it uses a hard case to assess cross-Strait economic interdependence.

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<sup>9</sup> Yun-wing Sung, "Hong Kong and the Economic Integration of the China Circle," in *The China Circle*, ed. Barry Naughton (Washington, DC: Brookings Institution, 1997), 61.

Table 3.03. Estimation of Indirect Trade between Taiwan and China by the Mainland Affairs Council, Taipei (in US\$millions)

|      | (1)                                 | (2)                          | (3)                             | (4)=(2)-(3)                    | (5)=(1)+(4)                           | (6)                       | (7)=(5)+(6)                                                 |
|------|-------------------------------------|------------------------------|---------------------------------|--------------------------------|---------------------------------------|---------------------------|-------------------------------------------------------------|
|      | Exports from Taiwan to China via HK | Taiwan Exports to HK (F.O.B) | HK Imports from Taiwan (C.I.F.) | Difference between (2) and (3) | Estimation of Taiwan Exports to China | Taiwan Imports from China | Estimation of Total Indirect Trade between Taiwan and China |
| 1981 | 384.2                               | 1,897.0                      | 1,896.4                         | 0.6                            | 384.8                                 | 75.2                      | 460.0                                                       |
| 1982 | 194.5                               | 1,565.3                      | 1,570.0                         | -4.8                           | 194.5                                 | 84.0                      | 278.5                                                       |
| 1983 | 157.8                               | 1,643.6                      | 1,600.0                         | 43.6                           | 201.4                                 | 89.9                      | 291.3                                                       |
| 1984 | 425.5                               | 2,087.1                      | 2,217.5                         | -130.4                         | 425.5                                 | 127.8                     | 553.3                                                       |
| 1985 | 986.8                               | 2,539.7                      | 2,682.4                         | -142.7                         | 986.8                                 | 115.9                     | 1,102.7                                                     |
| 1986 | 811.3                               | 2,921.3                      | 3,072.8                         | -151.5                         | 811.3                                 | 144.2                     | 955.5                                                       |
| 1987 | 1,226.5                             | 4,123.3                      | 4,275.1                         | -151.8                         | 1,226.5                               | 288.9                     | 1,515.4                                                     |
| 1988 | 2,242.2                             | 5,587.1                      | 5,682.4                         | -95.3                          | 2,242.2                               | 478.7                     | 2,720.9                                                     |
| 1989 | 2,896.5                             | 7,042.3                      | 6,606.9                         | 435.4                          | 3,331.9                               | 586.9                     | 3,918.8                                                     |
| 1990 | 3,278.3                             | 8,556.2                      | 7,439.9                         | 1,116.3                        | 4,394.6                               | 765.4                     | 5,160.0                                                     |
| 1991 | 4,667.2                             | 12,431.3                     | 9,605.0                         | 2,826.3                        | 7,493.5                               | 1,125.9                   | 8,619.4                                                     |
| 1992 | 6,287.9                             | 15,416.0                     | 11,156.3                        | 4,259.7                        | 10,547.6                              | 1,119.0                   | 11,666.6                                                    |
| 1993 | 7,585.4                             | 18,454.9                     | 12,047.2                        | 6,407.7                        | 13,993.1                              | 1,103.6                   | 15,096.7                                                    |
| 1994 | 8,517.2                             | 21,263.0                     | 13,757.7                        | 7,505.3                        | 16,022.5                              | 1,858.7                   | 17,881.2                                                    |
| 1995 | 9,882.8                             | 26,123.6                     | 16,572.6                        | 9,551.0                        | 19,433.8                              | 3,091.4                   | 22,525.2                                                    |
| 1996 | 9,717.6                             | 26,804.8                     | 15,795.1                        | 11,009.7                       | 20,727.3                              | 3,059.8                   | 23,787.1                                                    |
| 1997 | 9,715.1                             | 28,707.7                     | 15,967.6                        | 12,740.1                       | 22,455.2                              | 3,915.4                   | 26,370.6                                                    |
| 1998 | 8,364.1                             | 24,819.7                     | 13,342.9                        | 11,476.8                       | 19,840.9                              | 4,110.5                   | 23,951.4                                                    |
| 1999 | 8,174.9                             | 26,012.7                     | 12,875.2                        | 13,137.5                       | 21,312.5                              | 4,522.2                   | 25,834.7                                                    |
| 2000 | 9,593.1                             | 31,355.9                     | 15,919.5                        | 15,436.4                       | 25,029.5                              | 6,223.3                   | 31,252.8                                                    |

Source: *Cross-Strait Economic Statistics Monthly* (Taipei: MAC), no. 101, January 2001, p. 22

Note: (1) and (3) are from HK Customs statistics, (2) from Taiwan Customs statistics. (6) used HK Customs statistics before 1993; changed to Taiwan Customs statistics since 1994.

To understand the importance of cross-Strait trade to Taiwan, we need comparisons and percentages apart from absolute figures. According to the statistics from the MAC, Taiwan's trade with China increased from US\$460 million in 1981 to US\$31 billion in 2000. Taiwan's trade with China in 2000 accounted for 10.84 percent of Taiwan's foreign trade, with exports to China accounting for 16.87 percent of Taiwan's total exports, and imports from China accounting for 4.44 percent of Taiwan's total imports. Since 1994, China has become Taiwan's fourth largest trade partner (see Table 3.04). More importantly, since 1994 China has become Taiwan's third largest export market (see Appendix Table II). Taiwan has enjoyed huge surplus in its China trade; without China trade, its foreign trade would have suffered an unfavorable balance since 1993 (see Table 3.05).

Table 3.04. Taiwan's Major Trade Partners, 1990-2000 (in US\$billions)

|          | 1990  | 1991  | 1992  | 1993  | 1994  | 1995  | 1996  | 1997  | 1998  | 1999  | 2000  |
|----------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| US       | 34.35 | 36.43 | 39.34 | 40.19 | 42.38 | 47.19 | 46.84 | 52.79 | 49.06 | 50.59 | 59.95 |
| Japan    | 24.37 | 28.02 | 30.68 | 32.16 | 35.05 | 43.43 | 41.16 | 40.72 | 36.33 | 42.49 | 55.17 |
| HK       | 10.00 | 14.37 | 17.19 | 12.84 | 22.79 | 27.96 | 28.50 | 30.70 | 26.77 | 28.11 | 33.54 |
| China    | 4.04  | 5.79  | 7.40  | 15.09 | 17.88 | 22.52 | 23.78 | 26.37 | 23.95 | 25.83 | 31.25 |
| Korea    | 2.55  | 3.03  | 3.54  | 3.80  | 4.75  | 6.90  | 6.82  | 7.39  | 7.16  | 9.80  | 12.90 |
| S'pore   | 3.60  | 3.84  | 4.20  | 4.74  | 5.77  | 7.36  | 7.36  | 8.04  | 5.95  | 7.13  | 10.48 |
| Germany  | 5.85  | 6.88  | 7.52  | 7.72  | 8.03  | 9.52  | 8.66  | 9.06  | 9.23  | 9.39  | 10.43 |
| Malaysia | ...   | ...   | ...   | ...   | ...   | ...   | ...   | 7.26  | 5.91  | 6.87  | 8.94  |
| H'land   | 2.58  | 2.97  | 3.07  | 3.11  | 3.52  | 4.52  | 5.29  | 5.93  | 5.93  | 5.92  | 7.02  |
| UK       | 3.13  | 3.19  | 3.54  | 3.35  | 3.70  | 4.05  | 4.61  | 5.23  | 4.96  | 5.55  | 6.45  |
| France   | 2.26  | 2.49  | 2.63  | 2.34  | 2.41  | 2.98  | 4.26  | 6.12  | ...   | ...   | ...   |

Source: Extracted from Appendix Table II, which is based on MAC estimations.

Note: S'pore=Singapore; H'land=Holland; HK=Hong Kong.

Table 3.05. Taiwan's Trade Surplus with China, 1990-1999 (in US\$millions)

|       | Surplus with China | Total Surplus | Surplus without China |
|-------|--------------------|---------------|-----------------------|
| 1990  | 3,629.2            | 12,495.2      | 8,866.0               |
| 1991  | 6,367.6            | 13,299.1      | 6,931.5               |
| 1992  | 9,428.6            | 9,479.3       | 50.7                  |
| 1993  | 12,889.5           | 7,869.8       | -5,019.7              |
| 1994  | 14,163.8           | 7,690.0       | -6,473.8              |
| 1995  | 16,342.4           | 8,108.9       | -8,233.5              |
| 1996  | 17,667.5           | 13,571.4      | -4,096.1              |
| 1997  | 18,540.0           | 7,656.0       | -10,884.0             |
| 1998  | 15,756.8           | 5,918.1       | -9,838.7              |
| 1999  | 16,704.0           | 10,911.7      | -5,792.3              |
| Total | 131,489.4          | 96,999.5      | -34,489.9             |

Source: MOEA, *Statistics on Exports and Imports, 1990-2000* on the World Wide Web, and Ministry of Finance, *Monthly Statistics of Exports and Imports*, February 29, 1998; quoted in Ping Ding, "Taiwan's Restriction of Investment in China in the 1990s: A Relative Gains Approach," *Asian Survey*, vol. XL, no. 6 (November/December 2000), 963.

On the mainland side, Chinese statistics shows that in 2000, China's foreign trade totaled US\$474 billion and its trade with Taiwan amounted to US\$30 billion. This means that China's trade with Taiwan accounted for 6.39 percent of China's foreign trade. China's imports in 2000 totaled US\$225 billion and its imports from Taiwan amounted to US\$25 billion, which accounted for 11 percent of China's total imports. Also in 2000, China's exports totaled US\$249 billion and its exports to Taiwan amounted to US\$5.03 billion, which accounted for 2.02 percent of China's total exports.<sup>10</sup> From 1992-95 Taiwan was China's fourth largest trade partner; from 1996-2000 it was China's

<sup>10</sup> *China Statistical Yearbook 2001* (Beijing: National Bureau of Statistics, 2001), 591.

fifth largest trade partner, being overtaken by Korea (see Table 3.06). More comparisons will be carried out in Chapter 4 to determine the real magnitude of cross-Strait trade.

Table 3.06. China's Top 10 Trade Partners, 1991-2000 (in US\$billions)

|           | 1991  | 1992  | 1993  | 1994  | 1995  | 1996  | 1997  | 1998  | 1999  | 2000  |
|-----------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Japan     | 20.25 | 25.38 | 39.03 | 47.89 | 57.46 | 60.06 | 60.81 | 57.93 | 66.17 | 83.16 |
| US        | 14.16 | 17.49 | 27.65 | 35.35 | 40.82 | 42.83 | 48.99 | 54.83 | 61.42 | 74.46 |
| HK        | 49.60 | 58.04 | 32.53 | 41.82 | 44.57 | 40.73 | 50.77 | 45.39 | 43.75 | 53.94 |
| Korea     | 3.24  | 5.02  | 8.22  | 11.72 | 16.98 | 19.98 | 24.04 | 21.26 | 25.03 | 34.49 |
| Taiwan    | 4.23  | 6.55  | 14.39 | 16.32 | 17.88 | 18.98 | 19.83 | 20.49 | 23.47 | 30.53 |
| Germany   | 5.40  | 6.46  | 10.00 | 11.89 | 13.70 | 13.16 | 12.67 | 14.37 | 16.11 | 19.68 |
| Singapore | 3.07  | 3.26  | 4.89  | 5.04  | 6.89  | 7.34  | 8.78  | 8.17  | 8.56  | 10.82 |
| UK        | ...   | ...   | 3.59  | 4.18  | 4.76  | 5.08  | 5.79  | 6.58  | 7.87  | 9.90  |
| Australia | ...   | ...   | ...   | ...   | ...   | 5.10  | ...   | ...   | ...   | 8.45  |
| Russia    | ...   | 5.86  | 7.67  | 5.07  | 5.46  | 6.84  | 6.11  | ...   | ...   | 8.00  |
| Holland   | ...   | ...   | ...   | ...   | ...   | ...   | ...   | 5.99  | 6.42  | ...   |
| France    | 2.30  | ...   | ...   | ...   | ...   | ...   | 5.57  | 6.02  | 6.70  | ...   |
| Italy     | 2.38  | 2.84  | 4.04  | 4.65  | 5.18  | ...   | ...   | ...   | ...   | ...   |
| Canada    | 2.20  | 2.57  | ...   | ...   | ...   | ...   | ...   | ...   | ...   | ...   |

Source: Extracted from Appendix Table I, which is based on Chinese statistics.

Note: ... denotes trade volume not ranking that country (territory) among the top 10.

Taiwan's surplus in cross-Strait trade can be attributed to its restrictions on mainland goods, and to China's deliberate effort to absorb Taiwanese goods. In Taipei,

the 1993 “Regulations Governing Trade between Taiwan and the Chinese Mainland” set out three principles for goods to be imported: (1) the goods shall not pose any threat to national security; (2) they shall not have any adverse effect on related industries in the domestic market; and (3) they shall have the positive effect of sharpening the competitive edge of local products in the international market.<sup>11</sup> Taipei has used a system of “positive listing” to specify what goods could be imported from China. Goods not found on the list are considered to be prohibited. At the end of 1994, about 2,637 items were allowed to be imported from China.<sup>12</sup> On July 1, 1996, the MOEA eased restrictions on imports from China and allowed the number of items permitted entry to increase to 3,900; by November 1997 the number of approved import categories had increased to 5,365.<sup>13</sup> Meanwhile, Nicholas Lardy reported that Taiwan maintains “important nontariff barriers on Chinese goods, notably the ban on the import of 5,691 goods from China, 44 percent of all of the lines in its tariff schedule.”<sup>14</sup> Taipei has been quite effective in controlling the imports of mainland goods, and this has contributed to the large surplus it has in China trade. At present, major import items include industrial raw materials. In 2001, soft coal topped the list of goods shipped from China to Taiwan, amounting to US\$47.6 million and accounting for 9.97 percent of Taiwan’s total imports from China.<sup>15</sup>

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<sup>11</sup> Leng 1996, p. 106.

<sup>12</sup> *Ibid.*, 106.

<sup>13</sup> *Free China Journal*, April 19, 1996, and Central News Agency (Taiwan), November 11, 1997; quoted in Clough 1999, p. 57.

<sup>14</sup> Nicholas Lardy, *Integrating China Into the Global Economy* (Washington, DC: Brookings Institution, 2002), 166.

<sup>15</sup> *Cross-Strait Economic Statistics Monthly* (Taipei: MAC), no. 113, January 2002 (Table 4) at [www.mac.gov.tw](http://www.mac.gov.tw).



Taipei has restricted mainland-bound exports. It used a “negative listing.” The 1993 Regulations mentioned above prohibited three categories of exports: (1) rare animals and plants; (2) high-tech products; and (3) commodities with an impact on national security.<sup>16</sup> Over time, more categories of goods have been permitted to go to China. Meanwhile, cross-Strait trade was largely investment-driven because most of Taiwan’s exports to China were materials, parts, accessories, machinery and equipment needed and imported by Taiwanese firms on the mainland. It is estimated that 54 percent of the materials and 75 percent of the machinery and equipment needed by Taiwanese firms in China are imported from Taiwan.<sup>17</sup>

There is no longer the need for the goods to switch vessels in transshipment trade. This means that ships registered in a place other than China and Taiwan can carry goods across the Taiwan Strait, provided they make a port call in a third place before going to their destinations. Clough reported that in 1998, representatives from the Taipei-based Taiwan Strait Shipping Association met in Bangkok with those from the Beijing-based Strait Shipping Exchange Association, accompanied by government officials who acted as advisers, to discuss ways of improving cross-Strait transportation. As a result of this meeting, Taiwan’s Ministry of Transportation and Communications announced that cargo ships would be permitted to travel between Shanghai and Keelung with a brief stop at the Japanese island of Ishigaki, about 150 miles east of Keelung.<sup>18</sup>

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<sup>16</sup> Leng 1996, p. 107.

<sup>17</sup> *Ibid.*, 116.

<sup>18</sup> Clough 1999, p. 43.

### 3. Summary

Cross-Strait trade began to pick up in 1987. By 2000, China had become Taiwan's fourth largest trade partner; and Taiwan, China's fifth largest trade partner. The volume of cross-Strait trade had exceeded US\$31 billion, based on MAC estimation. Taiwan has enjoyed a huge surplus in cross-Strait trade, and its third largest export market is now China. On the mainland side, trade with Taiwan accounted for 6.39 percent of China's foreign trade in 2000, but exports to Taiwan remained insignificant because Taipei restricted mainland goods, while imports from Taiwan were quite large, accounting for 11 percent of China's total imports. The large imports volume is attributable to China's preferential policies toward Taiwanese investors, who buy from Taiwan the machinery and equipment they need for production on the mainland. Although the policy to treat Taiwanese products as domestic products was cancelled in 1982, China continues to allow production factors to be imported duty-free by Taiwanese firms, and acquiesces in the trade surplus Taiwan enjoys. The reason is two fold: economically, Taiwanese factories on the mainland create wealth by boosting China's exports, creating jobs, and generating revenue; politically, Taiwan's economic dependence on China would make it difficult for the island to break away, because a dense web of ties would bind the two places together, and thus economic integration would facilitate political unification.

Although both sides are important trade partners to the other side, cross-Strait trade remains indirect and must be routed through Hong Kong. Owing to the complicated nature of this indirect trade, different sources of statistics show great discrepancies. This research chooses the figures released by the MAC, bearing in mind

that (1) they are estimated figures, (2) they represent the highest end in all reporting, and thus (3) they resemble a hard case in assessing cross-Strait economic cooperation.

## II. Cross-Strait Investment

Investment across the Taiwan Strait has been one-way; it goes from Taiwan to China only, because the island restricts investment from the mainland. Taipei lifted the ban on indirect investment in China in 1990.<sup>19</sup> Chang Tsan-ho, a Taiwanese scholar, held that “Taiwanese investments on the mainland started in 1983.”<sup>20</sup> Apparently, Chang was referring to the investments not officially sanctioned. These investments were small-scale and made in the labor-intensive export-processing industries in the four special economic zones—Shenzhen, Zhuhai, Shantou, Xiamen—in Guangdong and Fujian. From 1983 to 1987, the total amount was approximately US\$100 million.<sup>21</sup> The targeted industries included textiles, shoes, umbrellas, bicycles, travel accessories and electric appliances. Over time, Taiwanese investment has diversified into different fields, grown in size, and become technology intensive. Taiwanese investors have ventured from processing industries and manufacturing to real estate, tourism, finance, entertainment, and other service sectors. From the coastal region they have gone further inland. Increasingly, advanced technology has been employed in such projects as chemicals, automobiles, computers, and building materials. Large corporations in Taiwan, such as

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<sup>19</sup> See the Website for the Investment Commission, MOEA at [www.moeaic.gov.tw](http://www.moeaic.gov.tw).

<sup>20</sup> Chang, 380.

<sup>21</sup> *Ibid.*, 380.

Formosa Plastics and the President Group (a food company), have invested in China. Taipei allows the island's listed companies to invest in China, provided that they raise the funds from overseas and do not invest in China more than a certain percentage of the raised funds or of their fixed assets. It was reported that about 40 percent of Taiwan's listed companies have some form of investment in China.

Taiwan's computer industry has relocated a significant part of its hardware production to China. Taiwan is famed for its computer industry. In the early 1990s, Taiwan supplied more than half of the world's demand for computer monitors. By the mid-1990s, Taiwan had become the world's third largest source of computer hardware, just behind the United States and Japan. By 1999, the island's computer companies had become the world's largest source of monitors, modems, motherboards, keyboards, power supplies, and scanners.<sup>22</sup> Amazingly, it was reported that one-third of the output of Taiwan's information industry is produced in plants located in China.<sup>23</sup> Taiwanese firms such as Acer, Mitac, and First International Computer began to shift the production of desktop computers to China in the mid-1990s, and by 2000 four of the five most important Taiwanese notebook computer makers, Inventec, Acer, Compal Electronics, and Arima Computer, had plants producing computer components in China.<sup>24</sup> As a result of the relocation of Taiwan's computer industry to the mainland, China displaced Taiwan

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<sup>22</sup> Lynn T. White III, "Taiwan and Globalization," in *East Asia and Globalization*, ed. Samuel Kim (Lanham, MD: Rowman & Littlefield, 2000), 154.

<sup>23</sup> Clough 1999, p. 54.

<sup>24</sup> Lardy, 52-53.

to become the world's third largest producer of information technology hardware in 2000, just after the United States and Japan.<sup>25</sup>

Lite-On Technology, Taiwan's third largest contract manufacturer of electronics equipment, provides an example of how Taiwan's computer industry maintains competitiveness by capitalizing on China's cheap labor. Lite-On makes printers, flat-panel monitors, DVD players and cell phones, for global giants such as Dell, Hewlett-Packard, Sony Ericsson and Alcatel. Lite-On is one of the early investors to cross the Taiwan Strait and, together with its rivals such as Hon Hai Precision Industry and Quanta Computer, has grabbed a large slice of the global outsourcing pie. Lite-On has 18 factories in China, mainly in Guangdong, where it has a science-park factory, which has neat assembly lines in a spotless environment. Lite-On's China operations account for about 80 percent of its output and 29,000 of its 37,800 employees, with the rest in Taiwan, North America, and Europe. Lite-On competes by offering cost reductions and passing on to its customers the money it saves by moving to China. But as one Lite-On executive observed, "Since everyone has moved there, China is no longer becoming a low-cost area any more, because everyone has the same cost structure."<sup>26</sup> The rush to the mainland of Taiwan's computer industry is therefore likely to slow down.

Taipei-based Chung-hua Institute for Economic Research researcher Chin Chung suggested that the relocation of Taiwan's computer industry to China means only a "division of labor," not a drain of the island's computer technology and know-how across

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<sup>25</sup> Lardy, 52.

<sup>26</sup> Jason Dean, "China's Role in Taiwan's Lite-On," *Far Eastern Economic Review*, March 27, 2003, p. 36.

the strait.<sup>27</sup> This is because the mainland will remain a manufacturing base, while R&D (research and development), planning, and marketing will still be done offshore or in Taiwan.<sup>28</sup> Other analysts have pointed out that China's attractiveness is low cost, not high technology, and that traditional industries will still dominate. Given that this is the case, the "division of labor" in computer industry between the two sides of the Taiwan Strait will remain for years to come, and the relocation of the island's computer hardware production to the mainland will not threaten the "lifeblood" of Taiwan.

In March 2002, Taiwan Premier Yu Shyi-kun deliberated a policy regarding investment by Taiwanese companies in semiconductor manufacturing facilities in China. The new policy would allow Taiwanese firms to set up 8-inch wafer plants on the mainland by 2005, provided that they transfer only obsolete 8-inch equipment to these plants and that they have built more advanced 12-inch wafer foundries in Taiwan. The policy was apparently trying to prevent the loss of Taiwan's core technologies and maintaining Taiwan's ascendancy.<sup>29</sup> A year later, Taiwan Semiconductor Manufacturing Company (TSMC), the world's largest chipmaker, was the only one company to obtain the green light from the Investment Commission to start its project in Shanghai, after pledging "to invest NT\$200 billion in Taiwan to build three more 12-inch wafer fabs [plants] over the next five years to convince the government that the most advanced

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<sup>27</sup> Chin Chung, "Division of Labor across the Taiwan Strait: Macro Overview and Analysis of the Electronics Industry," in *The China Circle*, 164-209.

<sup>28</sup> This resembles Rosecrance's thesis that China is the "body" country, Taiwan is the "head" country.

<sup>29</sup> Ko Shu-ling, "Decision of chips may come today," *Taipei Times*, March 29, 2002.

technology will remain” in Taiwan.<sup>30</sup> At present, mainland companies do not have the technology to build and run 8-inch wafer plants.

### **1. Regulations Governing Investment: Taipei**

Taiwanese investments in China must be made indirectly. According to the “Methods for Approving Investment in and Technological Cooperation with the Mainland Area,” promulgated by the MOEA on March 1, 1993, any of the following activities by Taiwanese firms would constitute investment in China; (1) providing capital to the mainland; (2) pooling funds with a mainland firm on the mainland; and (3) investing in a company located in a third place and thus becoming the director or shareholder who exercises actual control of that company, which has behavior listed in (1) and (2).<sup>31</sup>

For behavior listed in (1) and (2) above, investments must be made through establishing a company in a third place. This company will then invest in China in the following ways: (1) establishing a company or opening a business in China; (2) investing in a company or business preexisting in China; (3) acquiring shares of a company or business preexisting in China; and (4) establishing a branch or expanding its business in China. However, for the first three methods, that is, from (1) to (3), if the capital involved is less than US\$1 million, the requirement of establishing a company in a third place is now waived, but funds must still be routed through a third place.<sup>32</sup>

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<sup>30</sup> Bill Heaney, “TSMC gets China go-ahead,” *Taipei Times*, February 27, 2003.

<sup>31</sup> See information from the Ministry of Economic Affairs at [www.moeaic.gov.tw/Upload/docs/201.doc](http://www.moeaic.gov.tw/Upload/docs/201.doc) (accessed May 18, 2002).

<sup>32</sup> *Ibid.*

Article 6 of this document specified that a Taiwanese firm can invest in China by providing (1) cash; (2) machinery and component parts; (3) raw materials, semi-finished products, and finished products; and (4) technology, patents, trade marks, or copyrights.

Article 7 stated that the products to receive Taiwanese investments and the projects for technological cooperation are divided into the ordinary and prohibited categories. It said that a list of these products and projects, as well as the principles for screening and approval, would be decided and promulgated by the government.<sup>33</sup>

Based on article 7 mentioned above, the Taiwanese government drafted the “Principles on Screening and Approving Investment and Technological Cooperation in the Mainland Area.” (date not clear)<sup>34</sup> According to this document, the prohibited category includes the products and projects that are banned for reasons of national defense, national security, industrial development, and infrastructure construction. Whatever is not banned is in the ordinary category. Annual and ad hoc meetings of a special panel of representatives from industries, government, and academia will be held to decide on what is to be prohibited and what is to be allowed. In principle, (1) investments that can increase Taiwan’s industrial competitiveness and enhance the ability of Taiwanese businesses to operate globally, will be allowed; (2) industries that have no room to develop at home and must seek survival by investing in China, will not be restricted from making such investments; and (3) investments in China that may result in the transfer or loss of core technologies will be screened prudently.

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<sup>33</sup> Ibid.

<sup>34</sup> See information from the Ministry of Economic Affairs at [www.moeaic.gov.tw/Upload/docs/213.doc](http://www.moeaic.gov.tw/Upload/docs/213.doc) (accessed May 18, 2002).



Regarding the screening procedure, it is divided into the “simple” and “special case” categories. At present, for a project involving an accumulated investment of less than US\$20 million, the “simple” screening procedure will be used. This procedure evaluates possible loss of technologies and the investor’s financial situation. It requires a decision within a month. For an investment project involving an accumulated amount of more than US\$20 million, the “special case” procedure will be used. This procedure requires an evaluation by the Investment Commission under the MOEA, in which more stringent standards, including the impacts of such investment on domestic employment, national security, economic development, and Taiwan’s globalization strategy will be used. The document requires the MAC, the MOEA, the Ministry of Finance, the Central Bank, the Council for Economic Planning and Development, the Council of Labor Affairs, and the Council of Agriculture to meet annually, and whenever is required, to review the risk of investing in China, with reference to such factors as the proportion of Taiwanese investment in China to Taiwan’s gross domestic product (GDP), the proportion of Taiwanese investment in China to domestic investment, the proportion of Taiwanese investment in China to Taiwan’s total outward investment, the situation of remittances back home by Taiwanese investors on the mainland, the situation of foreign exchange reserves in Taiwan, and the situation of cross-Straits relations.<sup>35</sup>

Taipei has amended minor details many times. Initially, only the investment projects with less than US\$3 million could enjoy the “simple” screening procedure.<sup>36</sup> In the early years, indirect investments in China were divided into three categories—those

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<sup>35</sup> Ibid.

<sup>36</sup> “Renouncing ‘Go Slow, Be Patient,’ Taiwan Cancels Investment Ceiling for the Mainland,” *Ming Pao*, November 11, 2001.

on the permitted list, those on the prohibited list, and special cases.<sup>37</sup> Investments would be approved if (1) they do not compete with Taiwan's domestic industries in the international market; (2) they are labor-intensive in nature; (3) they use raw materials produced in China; and (4) the line of business would lose competitiveness if continued in Taiwan.<sup>38</sup>

It is apparent that the permitted list, the prohibited list, and the special cases in the early years have evolved into the prohibited category and the ordinary category. The screening process is now divided into the "special case" procedure for projects exceeding US\$20 million, and the "simple case" procedure for projects under US\$20million. Whatever is not found in the prohibited category is in the ordinary category and thus is eligible for assessment for the purpose of investment in China. The prohibited category now bans investments in 102 manufactures that include such products as military helicopters, aircraft, landing gear, propellers, spacecraft, satellites, nuclear reactors, electronic modules, ethylene, acrylics, and chemicals for fire extinguishers.<sup>39</sup>

The tensions in the Taiwan Strait in 1995-96 led to an effort by the Taiwanese government to cool down investments in China. In August 1996, Lee Teng-hui warned private firms of the risk in doing business with China, and the Taiwanese government continued to try to divert the island's investment to Southeast Asia. The misgivings of the Lee administration in doing business with China crystallized into a policy called "no haste, be patient" (*jie ji yong ren*). Large corporations with investment plans for China

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<sup>37</sup> Leng 1996, p. 107.

<sup>38</sup> Ibid.

<sup>39</sup> See MOEA's Web site at <http://www.moeaic.gov.tw/Upload/docs/minus.xls> (accessed May 23, 2002).

were persuaded to put their projects on hold. The business people who had invested in China but had not reported their investments to the government were given a period of three months to register their investments without penalty. By the end of this amnesty period, which ended on September 30, 1997, 7,739 investments amounting to US\$2.91 billion had been registered; those failing to register could be fined from US\$35,000 to US\$175,000.<sup>40</sup>

Taipei announced that beginning July 1, 1997, investments in infrastructure such as railways, highways, airports, power plants, and port facilities on the mainland would be banned, because investments in these projects could increase its adversary's capability in a potential conflict. Limits were placed on investments by large firms, and single projects could not exceed US\$50 million.<sup>41</sup>

In anticipation of WTO membership, the Chen administration abandoned the “no haste, be patient” policy and removed the US\$50 million investment ceiling for single projects in November 2001. In August 2001, the three-day Economic Development Advisory Conference (EDAC) in Taipei, in which government officials, business people, and scholars participated, reached consensus on a package of items. It was decided that (1) the “no haste, be patient” policy should be replaced by a policy of effective management and active opening up; (2) the government should ease restrictions on individual investment exceeding US\$50 million; (3) enterprises would be allowed to invest directly in China in the future; (4) offshore banking units (OBU) serving Taiwanese businesses on the mainland and abroad would be established, and remittances

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<sup>40</sup> Clough 1999, p. 58.

<sup>41</sup> Ibid.

between OBUs and mainland financial institutions would be opened up; (5) plans for direct cross-Strait capital remittances would be developed, implementation of direct remittances between designated foreign-exchange banks and financial institutions on the mainland would be planned and evaluated; (6) the ban on domestic financial services establishing branch offices or subsidiaries on the mainland according to international practices would be lifted; (7) Taiwan would first open up its real estate market to mainland investors, then open up Taiwanese businesses in accordance with WTO rules, and then open up its securities market for funds from the mainland; and (8) direct links for trade, transportation and communication (i.e., the “three links”) will be opened between the two sides.<sup>42</sup> However, no date was set for opening the “three links,” which are expected to involve sensitive issues and tough negotiations. In November 2001, the Executive Yuan in Taipei approved and adopted most of the suggestions, thus ending the “no haste, be patient” policy, removing the US\$50 million investment ceiling, and activating the “simple” assessment procedure for individual investment projects of less than US\$20 million.<sup>43</sup> However, direct transportation links, Chinese investment in Taiwan, and direct remittances are not issues that can be solved by Taiwan alone and must await negotiations. At the time of this writing, two years have passed and there is still no sign indicating that the “three links” will be opened soon.

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<sup>42</sup> “EDAC Outlines Cross-Strait Ties,” *Taipei Journal*, September 7, 2001, p. 3.

<sup>43</sup> *Ming Pao*, November 8, 2001.

## **2. Regulations Soliciting Investment: Beijing**

On the mainland side, three major documents are important in governing cross-Strait investments:

1. Regulations on Encouraging Investments from Taiwanese Compatriots, 1988.
2. Law on Protecting Investments by Taiwanese Compatriots, 1994.
3. Implementation Procedure for the Law on Protecting Investments by Taiwanese Compatriots, 1999.

The State Council promulgated the first document on July 3, 1988. This document has 22 articles and has become the backbone document protecting Taiwanese investment on the mainland. Commonly known as “the 22 articles,” it stated that Taiwanese business people can invest in various provinces, regions, and municipalities; that they can solely own their businesses, enter into joint ventures with mainland firms, or engage in processing industries with imported materials; that they can acquire shares of enterprises, purchase houses and factories, and obtain land use rights; that Taiwanese investments, assets, profits can be transferred and inherited; that no nationalization of Taiwanese assets will be carried out, but if such confiscation is indeed necessary, the Taiwanese business people concerned will be compensated; that the profits obtained by Taiwanese investors can be remitted overseas; that the raw materials, fuel, component parts, accessories, vehicles, and machines needed for production by Taiwanese firms can be imported duty-free; that Taiwanese investors can appoint their relatives in China as managers of their businesses; that they can establish Taiwanese business associations (for negotiation, and to voice concerns and suggestions); and that when business disputes arise, mainland and Hong Kong arbitrating agencies can be invited to arbitrate.

But this document was only a directive from the State Council. In order to instill confidence in Taiwanese investors, legislation was needed. On March 5, 1994, the National People's Congress (NPC) adopted the "Law on Protecting Investments by Taiwanese Compatriots." This law has 15 articles and reaffirmed the rights and interests of Taiwanese investors by incorporating "the 22 articles" into it. It guaranteed their rights to run businesses at their discretion and free from interference.

On December 15, 1999, the State Council promulgated the "Implementation Procedure for the Law on Protecting Investments by Taiwanese Compatriots." This document has 31 articles. In addition to reaffirming the old stipulations, it added preferential treatments for Taiwanese investors, such as allowing Taiwanese children to enroll in schools and universities. The document said that, other than Chinese and Hong Kong arbitrators, Taiwanese arbitrators could be invited to arbitrate business disputes.<sup>44</sup> This is a significant difference from the previous two documents.

### 3. Investment Statistics

Like the statistical gap for trade, there is also a gap in investment statistics released by China and Taiwan. One reason for the discrepancy is that some Taiwanese have invested in China without the knowledge of their government; another reason has something to do with the methods of calculation and confusion that may arise depending on which method a researcher is using. In China, two methods are used to calculate incoming investments: (1) the contracted amount; and (2) the actually used, or realized,

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<sup>44</sup> The Ministry of Foreign Trade and Economic Cooperation, *zhong guo dui wai jing ji mao yi bai pi shu 2000* (*China's White Paper on Foreign Trade and Economic cooperation, 2000*) (Beijing: China Social Science Press House, 2000), 652-56.

amount. The contracted amount of investment is the negotiated amount of investment between business partners—an amount of investment a foreign investor promises to make within a period of time in a project in China. The realized amount of investment refers to the amount that has actually been furnished by the foreign investor. The contracted amount seldom matches the realized amount, because an investor might run into financial trouble in the course of cooperation and cannot provide the capital as promised, or business disputes may arise. Based on the data provided by Nicholas Lardy, a calculation shows that from 1979 to 1994 the average ratio of the realized amount of foreign direct investment (FDI) to the contracted amount of FDI in China was 1-3.<sup>45</sup> In other words, for every three dollars that were pledged, only one dollar was used. However, the contracted amount is a good indicator of investment trends and intentions. Nevertheless, what matters is the realized amount.

Since Taipei officially approved China-bound investment in 1990, research on cross-Straits investment may focus on the period after 1990. Using statistics from both sides, the situation of the one-way cross-Straits capital flows is presented in Table 3.07.

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<sup>45</sup> Nicholas Lardy, "The Role of Foreign Trade and Investment in China's Economy Transformation," *China Quarterly*, no. 144 (December 1995), 1066.

Table 3.07. Taiwanese Investment in China, 1991-2000 (value in US\$millions; ratio in percent)

|       | Approved by Ministry of Economic Affairs, Taiwan |                        |                | Official Data from China |                            |                |                 |                       |
|-------|--------------------------------------------------|------------------------|----------------|--------------------------|----------------------------|----------------|-----------------|-----------------------|
|       | Cases                                            | Amount                 | Average Amount | Projects                 | Contracted Amount          | Average Amount | Realized Amount | Realization Ratio (%) |
| 1991  | 237                                              | 174.16                 | 0.73           | 3,446                    | 2,783                      | 0.81           | 844             | 30.33                 |
|       |                                                  |                        |                |                          | (include data before 1991) |                |                 |                       |
| 1992  | 264                                              | 246.99                 | 0.94           | 6,430                    | 5,543                      | 0.86           | 1,050           | 18.94                 |
| 1993* | 1,262<br>(8,067)                                 | 1,140.37<br>(2,028.05) | 0.90<br>(0.25) | 10,948                   | 9,965                      | 0.91           | 3,139           | 31.50                 |
| 1994  | 934                                              | 962.21                 | 1.03           | 6,247                    | 5,395                      | 0.86           | 3,391           | 62.85                 |
| 1995  | 490                                              | 1,092.71               | 2.23           | 4,778                    | 5,777                      | 1.21           | 3,162           | 54.73                 |
| 1996  | 383                                              | 1,229.24               | 3.21           | 3,184                    | 5,141                      | 1.61           | 3,475           | 67.59                 |
| 1997* | 728<br>(7,997)                                   | 1,614.54<br>(2,719.77) | 2.22<br>(0.34) | 3,014                    | 2,814                      | 0.93           | 3,289           | 116.88                |
| 1998* | 641<br>(643)                                     | 1,519.21<br>(515.41)   | 2.37<br>(0.80) | 2,970                    | 2,982                      | 1.00           | 2,915           | 97.75                 |
| 1999  | 488                                              | 1,252.78               | 2.57           | 2,499                    | 3,374                      | 1.35           | 2,599           | 77.01                 |
| 2000  | 840                                              | 2,607.14               | 3.10           | 3,108                    | 4,042                      | 1.30           | 2,296           | 56.81                 |
| total | 22,974                                           | 17,102.58              | 0.74           | 46,624                   | 47,816                     | 1.03           | 26,160          | 54.71                 |

Source: *Cross-Strait Economic Statistics Monthly* (Taipei: MAC), no. 101, January 2001, p. 26. MAC used data from the Investment Commission, Ministry of Economic Affairs, ROC, and from the Ministry of Foreign Trade and Economic Cooperation, PRC.

Note: \*Figures in ( ) are lagged reports.

Table 3.07 shows that, according to Taiwanese statistics, Taipei approved a total of US\$17 billion of China-bound investment from 1991 to 2000; and according to Chinese statistics, the mainland had negotiated US\$47 billion of Taiwanese capital and actually used US\$26 billion by 2000. The discrepancy cannot be solely explained by the fact that Chinese data included funds prior to 1991, because that amount was small. It



shows that many Taiwanese have invested in China without registering such investment with their government. The actually used amount of Taiwanese capital on the mainland could have been larger than US\$26 billion, because some of the foreign investment in China that were registered as coming from Hong Kong or other places, could have been Taiwanese in origin.

Taiwanese investments on the mainland, approved by Taiwan's MOEA, were concentrated on several major industries. Electronic and electrical appliances take the lead, with an accumulated amount of US\$6 billion from 1991 to 2001. Basic metals products occupy the second place, with an accumulated amount of US\$1.6 billion for the same period. Plastic products come next, followed by food and beverage processing (see Table 3.08).

Table 3.08. Taiwanese Investment on the Mainland, 1991-2001, by Industry  
(value in US\$1,000)

|       | Total      | By Industry                            |                             |                     |                                  |                          |           |
|-------|------------|----------------------------------------|-----------------------------|---------------------|----------------------------------|--------------------------|-----------|
|       |            | Electronic<br>& Electric<br>Appliances | Basic<br>Metals<br>Products | Plastic<br>Products | Food &<br>Beverage<br>Processing | Precision<br>Instruments | Others    |
| 1991  | 174,158    | 31,568                                 | 9,319                       | 22,485              | 19,308                           | 3,982                    | 87,496    |
| 1992  | 246,992    | 34,555                                 | 10,664                      | 44,961              | 46,415                           | 18,015                   | 92,382    |
| 1993  | 3,168,411  | 445,008                                | 256,501                     | 375,920             | 324,555                          | 286,492                  | 1,479,935 |
| 1994  | 962,209    | 157,011                                | 90,328                      | 73,302              | 145,846                          | 44,162                   | 451,560   |
| 1995  | 1,092,713  | 214,796                                | 116,805                     | 62,736              | 117,447                          | 29,454                   | 551,475   |
| 1996  | 1,229,241  | 276,862                                | 128,123                     | 63,645              | 121,702                          | 39,898                   | 599,011   |
| 1997  | 4,334,313  | 875,044                                | 395,967                     | 349,116             | 333,073                          | 247,249                  | 2,133,864 |
| 1998  | 2,034,621  | 758,975                                | 126,849                     | 64,184              | 70,045                           | 74,617                   | 939,951   |
| 1999  | 1,252,780  | 537,751                                | 104,494                     | 99,074              | 58,250                           | 28,073                   | 425,138   |
| 2000  | 2,607,142  | 1,464,775                              | 183,854                     | 184,776             | 43,253                           | 84,797                   | 645,687   |
| 2001  | 2,784,147  | 1,254,834                              | 193,797                     | 156,067             | 58,420                           | 125,997                  | 995,032   |
| total | 19,886,727 | 6,051,179                              | 1,616,701                   | 1,496,266           | 1,338,314                        | 982,736                  | 8,401,531 |

Source: Investment Commission, MOEA, Taipei at  
<http://www.moea.gov.tw/~meco/stat/four/english/d6.htm> (accessed May 21, 2002), and  
the author's own calculations.

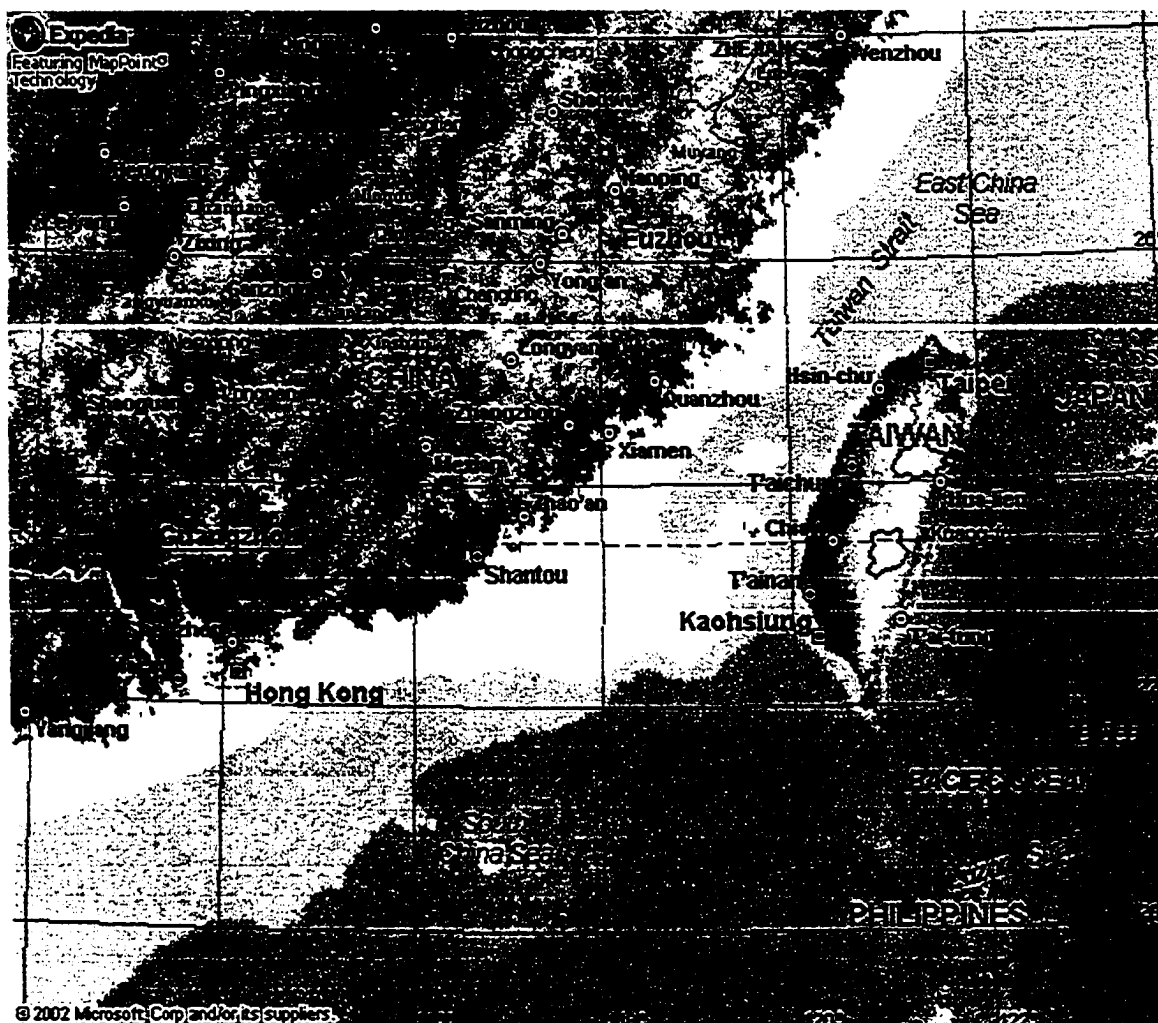
The most popular destinations of Taiwanese investments on the mainland are Guangdong and Zhejiang (see Table 3.09). From 1991-2000, these two provinces attracted US\$7.4 billion and US\$7.3 billion of Taiwanese capital respectively. Surprisingly, Fujian received only US\$1.7 billion and occupied the third position. A misperception by many people is that since the majority of Taiwanese people trace their

ancestral roots to Fujian, the largest amount of Taiwanese investment must be found there. In fact, the mainland government set up a special economic zone in Xiamen, Fujian province, in the early years specifically to attract Taiwanese investments.<sup>46</sup> The poor performance of Fujian may be explained by the fact that capital, materials, machines, and personnel from Taiwan must be routed through Hong Kong instead of being sent directly across the Strait, thus a 100-mile journey becomes a 1,000-mile journey, and goods and personnel must go southwest and then northeast before they can reach Fuzhou, the capital city of Fujian province. A glance at the atlas would show how ridiculous such a route is. Guangdong, however, is situated on the doorstep of Hong Kong, and the “indirect” transshipments through Hong Kong to Guangdong are almost direct because they do not have to go a zigzag way. This is particularly true in the Pearl River Delta region south of Guangzhou (Canton), where many Taiwanese enterprises can be found. After making a port call in Hong Kong, a foreign-registered vessel carrying Taiwanese exports can sail upstream along the Pearl River to its final destination. Second, although the ancestors of many Taiwanese came from Fujian, the Taiwanese nowadays see themselves as Taiwanese, not Fujianese. Their love for Fujian may not take precedence over their interest in convenience. As far as shipments of goods and travel of personnel across the Taiwan Strait are concerned, those going to Guangdong are almost “direct,” those going to Fujian are really “indirect.” (See Map 3.1)

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<sup>46</sup> For details, see Sung Shou Wei and Lishui Zhu, “The Growth of Foreign and Taiwan Investment in the Xiamen Special Economic Zone,” in Summer J. La Croix, et al, eds., *Emerging Patterns of East Asian Investment in China from Korea, Taiwan, and Hong Kong* (Armonk, NY: M.E. Sharpe 1995), 113-22; see also, Summer J. La Croix and Yibo Xu, “Political Uncertainty and Taiwan’s Investment in Xiamen’s Special Economic Zone,” in the same book, pp. 123-41.

Map 3.1. Taiwan and South China Coast



Source: Expedia Map

Table 3.09. Mainland-Bound Investments Approved by Taiwan, 1991-2000, by Region  
(value in US\$1,000)

|       | Guangdong | Jiangsu   | Fujian    | Hebei     | Hainan  | Northeast Region | Others    |
|-------|-----------|-----------|-----------|-----------|---------|------------------|-----------|
| 1991  | 733,325   | 24,398    | 55,961    | 7,475     | 412     | 455              | 12,132    |
| 1992  | 112,038   | 34,389    | 29,584    | 22,271    | 1,535   | 15,839           | 31,336    |
| 1993  | 1,047,811 | 833,307   | 473,800   | 194,299   | 61,954  | 68,345           | 488,895   |
| 1994  | 230,927   | 391,814   | 96,624    | 56,814    | 9,115   | 11,488           | 165,427   |
| 1995  | 222,748   | 394,772   | 121,656   | 83,194    | 649     | 43,539           | 226,155   |
| 1996  | 282,816   | 541,991   | 110,884   | 132,903   | ...     | 26,269           | 134,378   |
| 1997  | 1,720,900 | 1,247,297 | 472,229   | 233,565   | 37,984  | 62,768           | 559,570   |
| 1998  | 824,419   | 694,751   | 150,793   | 92,421    | 12,997  | 10,499           | 248,741   |
| 1999  | 500,114   | 475,008   | 58,899    | 57,281    | 388     | 10,289           | 150,801   |
| 2000  | 1,019,703 | 1,251,623 | 99,486    | 92,630    | 1,595   | 14,380           | 127,725   |
| total | 7,482,772 | 7,311,940 | 1,790,038 | 1,098,081 | 129,032 | 282,821          | 2,452,043 |

Source: Investment Commission, MOEA, Taipei at <http://www.moea.gov.tw/~meco/stat/four/english/d6-2.htm> (accessed May 22, 2002), and the author's own calculations.

A juxtaposition of Taiwan's investments in China and in some other countries during the period of 1991-2001 shows that China has been the most popular destination for Taiwanese investors in that period. While the accumulated amount of China-bound investments approved by Taipei during that period stood at US\$19.88 billion, those for the United States totaled US\$5.2 billion; those for Singapore, US\$1.6 billion; and those for Malaysia, US\$1.1 billion (see Table 3.10). Taiwan's investment in China was larger than the combined amount of investments approved for the selected recipients in Table 3.10. There can be no doubt that China attracts Taiwanese investment like a magnet.

Table 3.10. Taiwan's Approved Outward Investment by Selected Areas, 1991-2001  
(value in US\$1,000)

|       | China      | US        | S'pore    | HK        | Malaysia  | Vietnam | Japan   |
|-------|------------|-----------|-----------|-----------|-----------|---------|---------|
| 1991  | 174,160    | 297,795   | 12,540    | 199,630   | 442,011   | 17,139  | 3,431   |
| 1992  | 246,990    | 193,026   | 8,790     | 54,447    | 155,727   | 20,167  | 5,321   |
| 1993  | 3,168,420* | 529,063   | 69,473    | 161,918   | 64,542    | 158,396 | 63,297  |
| 1994  | 962,210    | 143,884   | 100,732   | 127,284   | 101,127   | 108,378 | 22,731  |
| 1995  | 1,092,710  | 248,213   | 31,649    | 99,555    | 67,302    | 108,146 | 8,811   |
| 1996  | 1,229,240  | 271,329   | 164,978   | 69,427    | 93,534    | 100,479 | 6,798   |
| 1997  | 4,334,310* | 547,416   | 230,310   | 214,320   | 85,088    | 85,414  | 32,342  |
| 1998  | 2,034,620* | 598,666   | 158,176   | 68,643    | 19,736    | 110,078 | 29,596  |
| 1999  | 1,252,780  | 445,081   | 324,524   | 121,718   | 13,700    | 34,567  | 121,867 |
| 2000  | 2,607,140  | 861,638   | 219,531   | 110,719   | 19,406    | 54,046  | 312,222 |
| 2001  | 2,780,000  | 1,092,748 | 378,300   | 94,900    | 45,515    | 30,911  | 169,033 |
| total | 19,882,580 | 5,228,859 | 1,699,003 | 1,322,561 | 1,107,688 | 827,721 | 775,449 |

Source: Investment Commission, MOEA, Taipei at <http://www.moea.gov.tw/~meco/stat/four/english/d4-2.htm> (accessed May 22, 2002); *Cross-Strait Economic Statistics Monthly* (Taipei: MAC), no. 113, January 2002, at <http://www.chinabiz.org.tw/maz/Eco-Month/home.htm> (accessed September 4, 2002); and the author's own calculations.

\*Includes lagged reports on investments.

The data presented in this chapter show that China and Taiwan are seemingly important economic partners to each other. The extent of economic cooperation between the two sides seems to warrant the term "economic interdependence" as a description of cross-Strait relations. This situation leads to two thoughts: (1) perhaps the political

conflict between Beijing and Taipei is no longer real, relevant, or serious; and (2) perhaps the so-called economic interdependence between the two sides is not real, and a closer scrutiny will reveal that it is shallow. Chapter 2 has shown that a zero-sum political conflict does exist between the two sides, and therefore the second thought should be the correct one. Finding out whether it really is the correct one is the purpose of the next chapter, which takes a closer look at Beijing-Taipei economic cooperation from a number of perspectives.

## Chapter 4

### The Effects of Politics on Economics

How much can a political relationship affect the economic cooperation between two partners? The case of Taiwan provides a good answer. Prior to 1895, Taiwan was Chinese territory. In the 1894 Sino-Japanese War, China was defeated by Japan and forced to sign the Treaty of Shimonoseki, which ceded Taiwan to Japan, and hence Taiwan became a Japanese colony. From 1899 to the 1930s, Taiwan's exports to Japan and Korea—a Japanese colony—accounted for 56.5 to 91.7 percent of Taiwan's total exports. From the outbreak of the Sino-Japanese War in 1937 to the outbreak of World War II in 1941, Taiwan's exports to Japan and Korea ranged from 79.5 to 90.3 percent of Taiwan's total exports (see Table 4.01). In other words, when Taiwan was a Japanese colony, it exported very little to China, and its political ties with Japan during this period dictated that it sent almost all of its goods to Japan and its colonized territories.

This pattern was turned up side down after World War II. From 1946 to 1948, Taiwan's exports to China accounted for 82.7 to 93.0 percent of Taiwan's total exports.<sup>1</sup> During this period, Taiwan was reunified with China. In other words, Taiwan exported very little to Japan after it severed its colonial ties with Japan. Taiwan's renewed

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<sup>1</sup> In using the word "exports," I follow the usage by Lin Ching-yuan. "Exports to Mainland" as described by Lin should be regarded as shipments of goods to the mainland during the period of 1946–48, a time when Taiwan was reunified with China. Economically, using a different term does not change the direction of trade flows.



political ties with China resulted in the exportation of almost all of its goods to the Chinese mainland.

Table 4.01. Taiwanese Exports: Selected Years and Destinations

| Year      | To Japan and Korea as a share of all exports | To China as a share of all exports | Taiwan's status                                                                                                                                                                                                                                            |
|-----------|----------------------------------------------|------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1899-1909 | 56.5                                         |                                    | Taiwan became a Japanese colony in 1895 after China was defeated in the Sino-Japanese war and signed the Treaty of Shimonoseki, which ceded Taiwan to Japan. Korea was a Japanese protectorate from 1905 to 1910, and a Japanese colony from 1910 to 1945. |
| 1910-1914 | 78.0                                         |                                    |                                                                                                                                                                                                                                                            |
| 1915-1919 | 76.0                                         |                                    |                                                                                                                                                                                                                                                            |
| 1920-1924 | 83.6                                         |                                    |                                                                                                                                                                                                                                                            |
| 1925-1929 | 83.7                                         |                                    |                                                                                                                                                                                                                                                            |
| 1930-1934 | 91.7                                         |                                    |                                                                                                                                                                                                                                                            |
| 1935-1939 | 90.3                                         |                                    |                                                                                                                                                                                                                                                            |
| 1940-1942 | 79.5                                         |                                    |                                                                                                                                                                                                                                                            |
| 1946      |                                              | 93.0                               | Taiwan was reunified with China after Japan was defeated in World War II.                                                                                                                                                                                  |
| 1947      |                                              | 92.3                               |                                                                                                                                                                                                                                                            |
| 1948      |                                              | 82.7                               |                                                                                                                                                                                                                                                            |

Source: Data for 1899-1942 from George Barclay, *Colonial Development and Population in Taiwan* (Princeton: Princeton University Press, 1954), p. 21; data for 1946-48 from Lin Ching-yuan, *Industrialization in Taiwan, 1946-72: Trade and Import-Substitution Policies for Developing Countries* (New York: Praeger Publishers, 1973), p. 28.

After the Communist and the Nationalist regimes settled down on the two sides of the Taiwan Strait in 1949, a third pattern emerged. Amid the military confrontation in the 1950s and the 1960s, Taiwan could not export its goods to the mainland. Amazingly, Japan emerged as Taiwan's largest export market again, and it remained so from the mid-1950s to the mid-1960s, only to be replaced by the United States in 1967 (see Table 4.02). During this period, Taiwan was an American ally in the Cold War, and the two sides even signed a Mutual Defense Treaty in 1954. From the late 1960s to the mid-1980s, Taiwan's exports to the United States often came close, or surpassed 40 percent of

Table 4.02. Taiwan's Exports to Japan, the United States, and China, 1958-1987  
(value in millions of U.S. dollar)

|      | Total exports | To U.S. | To Japan | To China | To U.S.<br>as % of<br>total<br>exports | To Japan<br>as % of<br>total<br>exports | To China<br>as % as<br>total<br>exports |
|------|---------------|---------|----------|----------|----------------------------------------|-----------------------------------------|-----------------------------------------|
| 1958 | 148.7         | 9.8     | 65.3     | ....     | 6.59                                   | 43.91                                   | ....                                    |
| 1959 | 156.8         | 13.7    | 65.1     | ....     | 8.74                                   | 41.52                                   | ....                                    |
| 1960 | 164.8         | 18.9    | 61.8     | ....     | 11.47                                  | 37.50                                   | ....                                    |
| 1961 | 195.2         | 43.9    | 56.5     | ....     | 22.49                                  | 28.94                                   | ....                                    |
| 1962 | 212.7         | 53.1    | 52.2     | ....     | 24.96                                  | 24.54                                   | ....                                    |
| 1963 | 327.1         | 54.1    | 105.1    | ....     | 16.54                                  | 32.13                                   | ....                                    |
| 1964 | 430.3         | 81.0    | 133.7    | ....     | 18.82                                  | 31.07                                   | ....                                    |
| 1965 | 449.6         | 99.1    | 139.8    | ....     | 22.04                                  | 31.09                                   | ....                                    |
| 1966 | 534.0         | 119.5   | 130.7    | ....     | 22.38                                  | 24.48                                   | ....                                    |
| 1967 | 632.8         | 169.7   | 112.1    | ....     | 26.82                                  | 17.71                                   | ....                                    |
| 1968 | 789.0         | 284.9   | 127.6    | ....     | 36.11                                  | 16.17                                   | ....                                    |
| 1969 | 1037.7        | 398.8   | 157.0    | ....     | 38.43                                  | 15.13                                   | ....                                    |
| 1970 | 1424.5        | 567.3   | 215.1    | ....     | 39.82                                  | 15.10                                   | ....                                    |
| 1971 | 1993.6        | 865.4   | 244.4    | ....     | 43.41                                  | 12.26                                   | ....                                    |
| 1972 | 2856.7        | 1258.6  | 373.6    | ....     | 44.06                                  | 13.08                                   | ....                                    |
| 1973 | 4376.6        | 1690.4  | 828.1    | ....     | 38.62                                  | 18.92                                   | ....                                    |
| 1974 | 5510.1        | 2049.3  | 845.4    | ....     | 37.19                                  | 15.34                                   | ....                                    |
| 1975 | 5291.5        | 1829.6  | 698.8    | ....     | 34.58                                  | 13.21                                   | ....                                    |
| 1976 | 8155.6        | 3060.2  | 1102.5   | ....     | 37.52                                  | 13.52                                   | ....                                    |
| 1977 | 9348.1        | 3655.0  | 1128.3   | ....     | 39.10                                  | 12.07                                   | ....                                    |
| 1978 | 12682.0       | 5035.0  | 1583.0   | ....     | 39.70                                  | 12.48                                   | ....                                    |
| 1979 | 16103.0       | 5652.0  | 2249.0   | ....     | 35.09                                  | 13.96                                   | ....                                    |
| 1980 | 19811.0       | 6760.0  | 2173.0   | ....     | 34.12                                  | 10.97                                   | ....                                    |
| 1981 | 22611.0       | 8158.0  | 2454.0   | 384.8    | 36.08                                  | 10.85                                   | 1.70                                    |
| 1982 | 22204.0       | 8758.0  | 2365.0   | 194.5    | 39.44                                  | 10.65                                   | 0.88                                    |
| 1983 | 25123.0       | 11334.0 | 2477.0   | 201.4    | 45.11                                  | 9.86                                    | 0.80                                    |
| 1984 | 30456.0       | 14868.0 | 3187.0   | 425.5    | 48.82                                  | 10.46                                   | 1.40                                    |
| 1985 | 30726.0       | 14773.0 | 3461.0   | 986.8    | 48.08                                  | 11.26                                   | 3.21                                    |
| 1986 | 39862.0       | 19014.0 | 4560.0   | 811.3    | 47.70                                  | 11.44                                   | 2.04                                    |
| 1987 | 53679.0       | 23685.0 | 6986.0   | 1,226.5  | 44.12                                  | 13.01                                   | 2.28                                    |

Source: Data for 1958-62 from the International Monetary Fund (IMF) and International Bank of Reconstruction and Development, *Direction of Trade, 1958-62*, p. 337; data for 1963-67 from IMF, *Direction of Trade, 1963-67*, p. 153; data for 1968-72 from IMF, *Direction of Trade, 1968-72*, p. 252; data for 1973-77 from IMF, *Direction of Trade, 1971-77*, p. 100; data for 1978 from IMF, *Direction of Trade Statistics Yearbook 1979*, p. 100; data for 1979 from the Asian Development Bank (ADB), *Key Indicators of Developing Asian and Pacific Countries 1997*, p. 322; data for 1980-82 from ADB, *Key Indicators 1998*, pp. 329-30; data for 1983-87 from ADB, *Key Indicators 2001*, pp. 364-65; data on Taiwan's exports to China from Table 3.03.

Taiwan's total exports. Meanwhile, as the conflict between Beijing and Taipei persisted, Taiwan exported almost nothing to China before the 1980s, and up to the mid-1980s Taiwan's exports to China accounted for only 1 or 2 percent of Taiwan's total exports.

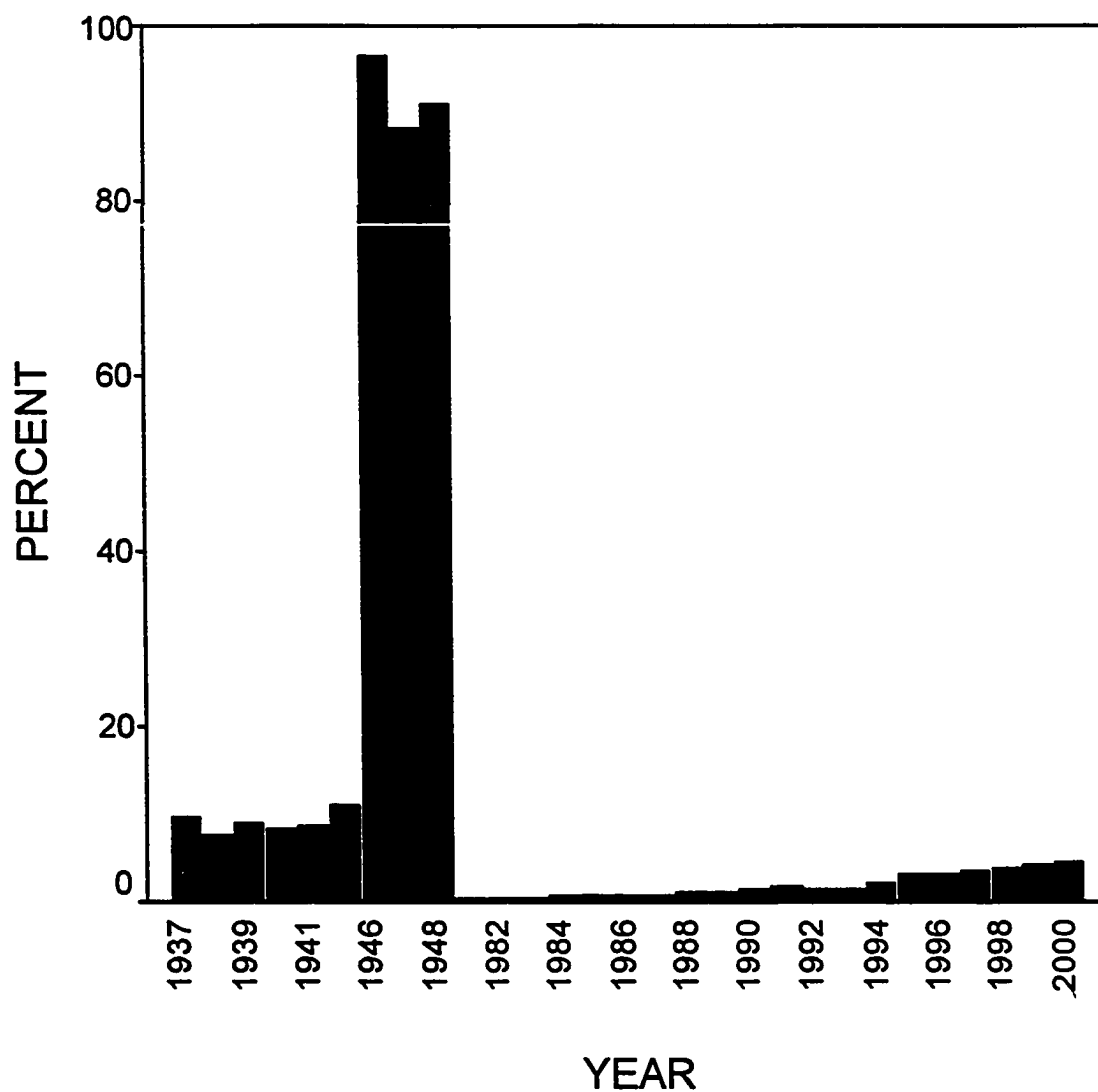
As mentioned in Chapter 1, Pollins suggested a correlation between a country's imports and its relations with the exporting country, the reason being that importers take account of the political relationship between the importing and exporting country for risk management, and that importers desire to express goodwill or solidarity with those whom they identify as friends. A point Pollins did not mention, which is nevertheless important, is that a state's control over imports is generally greater than its control over exports. This is because (1) a spender is always welcome, thus it can decide from where to buy, and (2) a state can restrict imports into its territory more easily than prohibiting exports from being forwarded to undesired destinations. Thus, Table 4.03 uses Taiwan's imports from China to show how much a political relationship can affect trade. From 1937 to 1942, that is, from the outbreak of the Sino-Japanese War to the outbreak of World War II, Taiwan's imports from China accounted for only 7.5 to 11.2 percent of Taiwan's total imports. During this period Taiwan was a Japanese colony, and Japan was at war with China. But after the war, that is, during the period of 1946-48 when Taiwan was reunified with China, Taiwan imported 88.3 to 96.4 percent of the goods it needed from the Chinese mainland. This period can be contrasted with the period of 1981-2000, in which Taiwan bought 0.35 to 4.44 percent of the goods it needed from China. During this later period, a conflict existed between Taipei and Beijing. Surprisingly, Taiwan's imports from China were higher during the wartime from 1937 to 1942 than in the peacetime from 1981 to 2000 (for visual presentation, see Figure 4.1).

Table 4.03. Taiwan's Imports from China, Before and After World War II

| Year | Imports from China as percent of all imports | Status of Taiwan                                          |
|------|----------------------------------------------|-----------------------------------------------------------|
| 1937 | 9.5                                          | Taiwan was a Japanese colony; Japan was at war with China |
| 1938 | 7.5                                          |                                                           |
| 1939 | 9.0                                          |                                                           |
| 1940 | 8.3                                          |                                                           |
| 1941 | 8.6                                          |                                                           |
| 1942 | 11.2                                         |                                                           |
| 1946 | 96.4                                         | Reunified with China                                      |
| 1947 | 88.3                                         |                                                           |
| 1948 | 91.0                                         |                                                           |
| 1981 | 0.35                                         | In a zero-sum political conflict with Beijing             |
| 1982 | 0.44                                         |                                                           |
| 1983 | 0.44                                         |                                                           |
| 1984 | 0.58                                         |                                                           |
| 1985 | 0.58                                         |                                                           |
| 1986 | 0.60                                         |                                                           |
| 1987 | 0.83                                         |                                                           |
| 1988 | 0.96                                         |                                                           |
| 1989 | 1.12                                         |                                                           |
| 1990 | 1.40                                         |                                                           |
| 1991 | 1.79                                         |                                                           |
| 1992 | 1.55                                         |                                                           |
| 1993 | 1.43                                         |                                                           |
| 1994 | 2.18                                         |                                                           |
| 1995 | 2.98                                         |                                                           |
| 1996 | 3.02                                         |                                                           |
| 1997 | 3.42                                         |                                                           |
| 1998 | 3.93                                         |                                                           |
| 1999 | 4.09                                         |                                                           |
| 2000 | 4.44                                         |                                                           |

Source: Data for 1937-1948 from Lin Ching-yuan, *Industrialization in Taiwan, 1946-72: Trade and Import-Substitution Policies for Developing Countries* (New York: Praeger Publishers, 1973), p. 28; data for 1981-2000 from *Cross-Strait Economic Statistics Monthly* (Taipei: Mainland Affairs Council, 2001), no. 101, January 2001, p. 24.

Figure 4.1. Taiwan's Imports from China as Percent of All Imports, Selected Years



The political conflict manifests itself in the economic realm. First, mirroring a call for military ties with the United States and Japan, Taipei calls for free trade agreements with these two countries, not with China. In August 2001, Chen Shui-bian urged the United States and Japan to join hands with Taiwan in dealing with the threat

from Chinese missiles.<sup>2</sup> In August 2002, concluding a two-day meeting at the Ta Shee Resort, in which top officials participated, Chen said that “all economic and diplomatic departments within the government should expedite the signing of free-trade agreements with our trade allies, including the United States, Japan and ASEAN countries.”<sup>3</sup> On the other hand, Taipei does not seek a free trade agreement with China, because it wants to keep Beijing at arm’s length. From Taipei’s perspective, allowing Beijing to get too close may provide it with an opportunity to coerce Taiwan into accepting undesirable political arrangements.

Second, as mentioned earlier, Taipei uses a “negative listing” to ban the exports of high-tech products to China. It also uses a “positive listing” to restrict the imports of Chinese goods. As will be shown later, Taiwan buys more from Japan and the United States than from China. Also, Taipei once set up a 10 percent “warning line” for export dependence on China, reflecting its desire to avoid relying on China as its export market. Such a warning line does not exist for Japan and the United States.

Third, Taipei holds back direct transportation links with China in order to pressure Beijing to (1) give Taipei an equal footing for negotiation, (2) renounce the use of force against Taiwan, and (3) stop blocking Taiwan’s effort to join international organizations. Thus, cargo shipments, as well as travel of personnel, must be routed through Hong Kong, increasing the cost of doing business.

Fourth, since 1993, Taipei has pursued a “southward policy,” which aims at diverting investment away from China to Southeast Asia. The investment ceiling and the

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<sup>2</sup> Catherine Hsieh, “Chen Calls for Military Ties with US, Japan,” *Taipei Journal*, August 3, 2001, p. 2

<sup>3</sup> Lin Chieh-yu, “President Makes Pitch for FTAs at Summit,” *Taipei Times*, August 26, 2002.

screening process for investment in China, as well as many other regulations, are not applied in Southeast Asia. After the missile crisis in 1996, Lee Teng-hui formulated the “no haste, be patient” policy to discourage investment in China. Although the Economic Development Advisory Conference (EDAC) in August 2001 announced an end to that policy, the “southward policy” remained intact. In August 2002, when meeting Philippine Trade and Industry Secretary Manuel Roxas, who was in Taipei for the tenth Taiwan-Philippines Economic Cooperation Conference, Chen Shui-bian said that in the past the Taiwanese government had a “southward policy,” which is now called the “policy of investing in Southeast Asia.”<sup>4</sup> It was revealed that Taiwan is the Philippines’ fifth largest investor, and that investment is expected to increase when the policy of investing in Southeast Asia is reactivated. Legislative Yuan Vice President Chiang Ping-kun, who used to serve as the head of the Council for Economic Planning and Development, and as minister of economic affairs, revealed that the “southward policy” has never been abolished.<sup>5</sup>

Fifth, in addition to the lack of direct air and shipping links, Taiwanese banks were not allowed by their government to open branches in China until 2001, and Chinese banks are not allowed to open branches in Taiwan until this moment. This greatly increases inconvenience and the cost of business transactions across the Taiwan Strait, because remittances must be routed through a third place. For example, the Overseas

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<sup>4</sup> “Chen Shui-bian Meets Philippine Trade and Industry Secretary,” *Ming Pao*, August 19, 2002; and Central News Agency (Taiwan), “President Chen Monday Received Philippine Trade and Industry Secretary Manuel A. Roxas,” August 19, 2002.

<sup>5</sup> Central News Agency (Taiwan), “Chiang Ping-kun Said Promotion of ‘Southward Policy’ Does Not Evade the Issue of ‘Three Links,’” August 19, 2002.

Union Bank of Singapore opened its Beijing and Shenzhen offices in 1986.<sup>6</sup> Taipei was 15 years later than Singapore when it lifted the ban in June 2001.<sup>7</sup> It was confirmed in March 2002 that Beijing had granted approval to two Taiwanese banks to open offices in China: the United World Chinese Commercial Bank would open an office in Shanghai, and the Changhua Commercial Bank would open one in Kunshan in Jiangsu province.<sup>8</sup>

## I. Operationalization of the Research

Following the establishment of the level of cross-Strait trade and investment in the previous chapter, this chapter takes a closer look at the economic transactions between the two sides, with the aim to detect the effects of the political conflict on economic cooperation. At first glance, the level of economic cooperation between Beijing and Taipei seems high, as has been revealed by the trade and investment statistics in Chapter 3, and this seems to justify the use of the term “economic interdependence” by some observers to describe cross-Strait economic relations. This chapter treats the Beijing-Taipei conflict as the independent variable; and cross-Strait economic cooperation, the dependent variable, to demonstrate the extent to which the political conflict has affected economic exchanges. The research is conducted in the following way.

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<sup>6</sup> *Beijing Review*, March 24, 1986, p. 28.

<sup>7</sup> He Jing-ping, “Two Former Ministers of Economic Affairs Led Delegation to Beijing,” *World Journal*, August 20, 2001, p. A2.

<sup>8</sup> “Two Taiwanese Banks Permitted to Enter the Mainland,” *Ming Pao*, March 11, 2002.



First, a bilateral approach will be used to further analyze cross-Strait trade, with the purpose of determining the real magnitude of such trade. This approach involves (1) comparing cross-strait trade dependence with a set of nominal criteria, and (2) comparing cross-strait trade growth with China's world trade growth, and with Taiwan's world trade growth, to see which rate grows faster. In this approach an effort will be made to identify cross-Strait trade dependence since the mid-1980s, or at least since 1987, the year when Taipei officially approved indirect trade. There are two ways to determine external trade dependence: (1) trade dependence is defined as country A's volume of trade with country B as a percentage of country A's foreign trade; and (2) trade dependence is defined as Country A's volume of trade with country B as a percentage of Country A's gross national product (GNP). The Taiwanese government uses the first definition in evaluating cross-Strait trade. The Ministry of Economic Affairs in Taipei once set up a "warning line" of 10 percent for export dependence on China, implying that anything more than that would be excessive. Some researchers prefer the second definition.<sup>9</sup> This research will employ both definitions. The concept of GNP is one of income; the concept of trade is one of commercial activity. A trading state may have a great deal of trade but earn a marginal profit from such trade. Consequently, its trade transaction may be greater than its GNP in monetary terms. As can be seen later, in 2000 Singapore's foreign trade (US\$272 billion) is much larger than Singapore's GNP (US\$98 billion); China's foreign trade (US\$474 billion) is smaller than China's GNP (US\$1,065 billion). It is therefore useful to employ both concepts. The aspects to be identified will be:

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<sup>9</sup> Samuel S. Kim: "External trade dependence, defined as the sum of imports and exports as a percentage of gross national product..." See Kim, "China and the World," in *The China Reader: the Reform Era*, ed. Orville Schell and David Shambaugh (New York: Vintage Books, 1999), 450-451.

1. Taiwan's trade with China as a share of Taiwan's foreign trade;
2. China's trade with Taiwan as a share of China's foreign trade;
3. Taiwan's trade with China as a percentage of Taiwan's GNP;
4. China's trade with Taiwan as a percentage of China's GNP.

After finding out these percentages, an assessment can be made according to some nominal criteria. Kenneth Waltz has suggested that if country A's trade with country B exceeds 15 percent of country A's GNP, country A is dependent on country B.<sup>10</sup> The research finds out whether cross-Strait trade has exceeded 15 percent of the GNP on either side, and whether it has exceeded 15 percent of the foreign trade on either side.

As mentioned, the growth rate of China's world trade will be compared with the growth rate of China's trade with Taiwan. Conversely, the growth rate of Taiwan's world trade will be compared with the growth rate of Taiwan's trade with China. Given geographic proximity between China and Taiwan, if it is found that China's Taiwan trade grows slower than China's world trade, or that Taiwan's China trade grows slower than Taiwan's world trade, the obstacles to cross-Strait trade, such as the lack of direct transportation links, are shown to have taken a toll. The bilateral approach will then be relaxed to examine the top trading partners of China and Taiwan respectively.

Second, a comparative approach will be used and more players in the region will be included for comparison. The rationale for this approach is as follows. There are two

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<sup>10</sup> The 15 percent threshold is suggested by renowned international politics scholar Kenneth Waltz, who writes, "States that import and export 15 percent or more of their gross national products yearly...depend heavily on having reliable access to markets outside their borders. Two or more parties involved in such relations are interdependent in the sense of being mutually vulnerable to the disruption of their exchanges." See Waltz, *Theory of International Politics* (New York: McGraw-Hill, 1979), 142.

pairs of trade partners. In one pair, a good political relationship exists; in another, a severe political conflict dominates. If geographic and cultural factors can be held constant, the former pair is expected to have a larger trade volume. An example is the trade between Singapore and Malaysia, and between Taiwan and China. Neither Singapore nor Malaysia lays claim to each other in a political conflict resembling the one between Beijing and Taipei. Both Singapore and Malaysia are members of the regional cooperation organization called the Association of Southeast Asian Nations (ASEAN). Singapore does not feel the need to keep Malaysia at arm's length and has not complained about its trade dependence on Malaysia as Taiwan complains about its trade dependence on China. Taipei keeps saying in its government publication, "A worry looms large for Taiwan: trade dependence on the mainland is rising,"<sup>11</sup> and "Taiwan's worry over trade dependence on the mainland is rising."<sup>12</sup> Assuming that Singapore and Malaysia enjoy better political ties, and therefore many of the aforesaid restrictions do not apply to them, they should have a trade volume larger than that between Beijing and Taipei.

Two criteria are used for comparison. First, the comparison must be between a lesser state and a strong state, because this resembles the ties between Taipei and Beijing. If two states are equally strong—like France and Britain—the worry over dependence might not exist as it does in the case of a lesser state. Thus, Singapore, Korea, and Taiwan are selected in this research because they are lesser states relative to China and

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<sup>11</sup> *Republic of China Yearbook 1999* (Taipei: Government Information Office, 1999), 168.

<sup>12</sup> *Republic of China Yearbook 2000* (Taipei: Government Information Office, 2000), 163.

because they are in the region.<sup>13</sup> Second, any Chinese state other than Taiwan in the region is a hard case and will be given more weight. Singapore serves this purpose.<sup>14</sup> The reason is because China lays claim to Taiwan but does not lay claim to Singapore, despite academic talks on forming a Greater China Economic Circle, including China, Hong Kong, Taiwan, and Singapore that could potentially lead to some sort of political union.<sup>15</sup> Because China does not lay claim to the Chinese state of Singapore, the Singaporean mind is set at ease in trading with and investing in China, and therefore Singapore's economic cooperation with China should be closer than that between Taiwan and China, despite the fact that Singapore is thousands of miles away from the south China coast. In short, our hypothesis can be vigorously tested by comparing Singapore-China economic cooperation with Taiwan-China economic cooperation.

Finally, since Taiwan calls for military ties with Japan and the United States, its trade ties with these two countries are expected to be better. The research finds out the trade flows between Taiwan and these two countries and compares them with cross-Strait trade. Both Japan and China are great powers in the region, but the fact that Taiwan seeks military ties with Japan shows that it does not feel threatened by Japan. Thus, Taiwan's trade volume with Japan should be greater than its trade volume with China.

The third approach in assessing the degree of economic interdependence between Beijing and Taipei takes a closer look at Taiwan's investment in China, as well as mutual

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<sup>13</sup> Korea in this research refers to South Korea.

<sup>14</sup> Singapore is considered by many as a Chinese state, culturally and ethnically. See for example, Samuel P. Huntington, *The Clash of Civilizations and the Remaking of World Order* (New York: Simon & Schuster, 1996), 127.

<sup>15</sup> See for example, Lee Lai To, 130. Lee cautioned "a rise to the idea of some sort of Pan-Chinese Economic Community or Circle" which would resemble the European Community and include "Taiwan, mainland China, Hong Kong, Macao, and even Singapore to promote economic cooperation."

cooperation in other areas. In this approach, Taiwan as an investor in China will be compared with other foreign investors in order to determine the importance of Taiwanese capital in the mainland. It has already been noted that there is little Chinese investment in Taiwan because the Taiwanese government restricts it.

## II. Bilateral Trade Revisited: Approach 1

To measure China's trade relations with Taiwan, its exports to Taiwan as well as imports from Taiwan and total trade with Taiwan must be identified, and then divided by its total exports volume, total imports volume, and total foreign trade volume respectively. This will yield three things: (1) China's export dependence on Taiwan, (2) China's import dependence on Taiwan, and (3) China's total trade dependence on Taiwan. Table 4.04 illustrates this method.

Table 4.04. China's Trade Dependence on Taiwan, 1996-2000  
(value in US\$billions; dependence rates in percent)

| China                       | 1996   | 1997   | 1998   | 1999   | 2000   |
|-----------------------------|--------|--------|--------|--------|--------|
| Total Imports               | 138.83 | 142.37 | 140.16 | 165.69 | 225.09 |
| Total Exports               | 151.04 | 182.79 | 183.75 | 194.93 | 249.20 |
| Total Trade                 | 289.88 | 325.16 | 323.92 | 360.62 | 474.29 |
| Imports from Taiwan         | 20.72  | 22.45  | 19.84  | 21.31  | 25.02  |
| Exports to Taiwan           | 3.05   | 3.91   | 4.11   | 4.52   | 6.22   |
| Total Trade with Taiwan     | 23.78  | 26.37  | 23.95  | 25.83  | 31.25  |
| Import Dependence on Taiwan | 14.92  | 15.76  | 14.15  | 12.86  | 11.11  |
| Export Dependence on Taiwan | 2.01   | 2.13   | 2.23   | 2.31   | 2.49   |
| Trade Dependence on Taiwan  | 8.20   | 8.10   | 7.39   | 7.16   | 6.58   |

Source: China's import, export, and total trade figures from *China Statistical Yearbook* (Beijing: National Bureau of Statistics, 1998-2001); data on China's trade with Taiwan from Taipei-based Mainland Affairs Council's estimation as presented in Table 3.03.

Table 4.04 shows that China's trade dependence on Taiwan decreased from 8.20 percent in 1996 to 6.58 percent in 2000. This contradicts the common impression that cross-Straits trade has been growing rapidly. Table 4.04 also shows the extremely small volume of Chinese exports to Taiwan, resulting in China's extremely low export dependence on the island.

Using this method, the Mainland Affairs Council (MAC) in Taipei estimated cross-Straits trade dependence for the period of 1981-2000. The ready-made information provided by the MAC is presented in Table 4.05.

Table 4.05. Cross-Straits Trade Dependence, 1981-2000, MAC estimation (in percent)

|      | Taiwan's Trade Dependence on China |              |                   | China's Trade Dependence on Taiwan |              |                   |
|------|------------------------------------|--------------|-------------------|------------------------------------|--------------|-------------------|
|      | Export Share                       | Import Share | Total Trade Share | Export Share                       | Import Share | Total Trade Share |
| 1981 | 1.70                               | 0.35         | 1.05              | 0.34                               | 1.75         | 1.04              |
| 1982 | 0.88                               | 0.44         | 0.68              | 0.38                               | 1.01         | 0.67              |
| 1983 | 0.80                               | 0.44         | 0.64              | 0.40                               | 0.94         | 0.67              |
| 1984 | 1.40                               | 0.58         | 1.06              | 0.49                               | 1.55         | 1.03              |
| 1985 | 3.21                               | 0.58         | 2.17              | 0.42                               | 2.34         | 1.58              |
| 1986 | 2.04                               | 0.60         | 1.49              | 0.47                               | 1.89         | 1.29              |
| 1987 | 2.28                               | 0.83         | 1.71              | 0.73                               | 2.84         | 2.06              |
| 1988 | 3.70                               | 0.96         | 2.47              | 1.01                               | 4.06         | 2.65              |
| 1989 | 5.03                               | 1.12         | 3.31              | 1.12                               | 5.63         | 3.51              |
| 1990 | 6.54                               | 1.40         | 4.23              | 1.23                               | 8.24         | 4.47              |
| 1991 | 9.84                               | 1.79         | 6.20              | 1.57                               | 11.75        | 6.35              |
| 1992 | 12.95                              | 1.55         | 7.60              | 1.32                               | 13.09        | 7.05              |
| 1993 | 16.47                              | 1.43         | 9.32              | 1.20                               | 13.46        | 7.71              |
| 1994 | 17.22                              | 2.18         | 10.02             | 1.54                               | 13.85        | 7.55              |
| 1995 | 17.40                              | 2.98         | 10.46             | 2.08                               | 14.71        | 8.02              |
| 1996 | 17.87                              | 3.02         | 10.95             | 2.03                               | 14.93        | 8.21              |
| 1997 | 18.39                              | 3.42         | 11.15             | 2.14                               | 15.77        | 8.11              |
| 1998 | 17.94                              | 3.93         | 11.13             | 2.24                               | 14.16        | 7.39              |
| 1999 | 17.52                              | 4.09         | 11.12             | 2.32                               | 12.86        | 7.16              |
| 2000 | 16.87                              | 4.44         | 10.84             | 2.49                               | 11.18        | 6.60              |

Source: Adopted from *Cross-Straits Economic Statistics Monthly* (Taipei: MAC), no. 101, January 2001, pp. 24-25.

According to Table 4.05, Taiwan's trade dependence on China increased from 1.05 percent in 1981 to 10.84 percent in 2000, and its export dependence on China passed the 10 percent "warning line" in 1992. However, because Taiwan restricted imports from China, its import dependence on China was very low, ranging from 1 to 3 percent throughout most of the 1990s. On the other hand, China's trade dependence on Taiwan ranged from 4 to 8 percent throughout the 1990s, and stood at 6.6 percent in 2000. China's export dependence on Taiwan has always been low, owing to Taiwan's reluctance to import mainland goods; in 2000 it stood at merely 2.49 percent. China's import dependence on Taiwan in 2000 was 11.8 percent, a result of China's deliberate effort to import Taiwanese goods. The only eye-catching figures in the table are Taiwan's export dependence rates with China since the early 1990s. This rate increased from 2.28 percent in 1987 to over 17 percent in the mid-1990s, providing grounds for Taipei to say that, "A worry looms large for Taiwan: trade dependence on the mainland is rising."<sup>16</sup> Taipei is concerned that if Taiwan depends too much on the mainland as its export market, which is an important source of trade surplus, China will acquire the ability to economically boycott Taiwan in order to coerce the island into accepting political arrangements on Beijing's terms. This view is reflected by the works of some Taiwanese scholars and in the statements by the MAC (see Chapter 6).

As mentioned earlier, apart from measuring bilateral trade as a share of total trade, the research also measures bilateral trade as a share of GNP. China's trade with Taiwan as a share of China's GNP for the period of 1986-2000 is presented in Table 4.06, which shows that the percentage increased from 0.33 in 1986 to 3.25 in 1995, and then dropped back to 2.93 in 2000. These figures are rather small in absolute terms.

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<sup>16</sup> *Republic of China Yearbook 1999* (Taipei: Government Information Office, 1999), 168.

Table 4.06. China's Trade with Taiwan as percentage of China's GNP, 1986-2000  
(value in billions of Yuan and US dollar; dependence rates in percent)

|      | China's<br>GNP<br><br>(Yuan) | Exchange<br>Rates | China's<br>GNP<br><br>(US\$) | China's<br>Trade with<br>Taiwan<br><br>(Taiwan's<br>statistics) | China's<br>Trade with<br>Taiwan as<br>% of<br>China's<br>GNP |
|------|------------------------------|-------------------|------------------------------|-----------------------------------------------------------------|--------------------------------------------------------------|
| 1986 | 1020.14                      | 3.7221            | 274.08                       | 0.90                                                            | 0.33                                                         |
| 1987 | 1195.45                      | 3.7221            | 321.18                       | 1.50                                                            | 0.47                                                         |
| 1988 | 1492.23                      | 3.7221            | 400.91                       | 2.70                                                            | 0.67                                                         |
| 1989 | 1691.78                      | 4.7221            | 358.27                       | 3.90                                                            | 1.09                                                         |
| 1990 | 1859.84                      | 5.2221            | 356.15                       | 5.10                                                            | 1.43                                                         |
| 1991 | 2166.25                      | 5.4343            | 398.63                       | 8.60                                                            | 2.16                                                         |
| 1992 | 2665.19                      | 5.7518            | 463.37                       | 11.60                                                           | 2.50                                                         |
| 1993 | 3456.05                      | 5.8000            | 595.87                       | 15.00                                                           | 2.52                                                         |
| 1994 | 4667.00                      | 8.4462            | 552.56                       | 17.80                                                           | 3.22                                                         |
| 1995 | 5749.49                      | 8.3174            | 691.26                       | 22.50                                                           | 3.25                                                         |
| 1996 | 6685.05                      | 8.2982            | 805.60                       | 23.70                                                           | 2.94                                                         |
| 1997 | 7314.27                      | 8.2798            | 883.39                       | 26.30                                                           | 2.98                                                         |
| 1998 | 7696.72                      | 8.2787            | 929.70                       | 23.90                                                           | 2.57                                                         |
| 1999 | 8057.94                      | 8.2795            | 973.24                       | 25.80                                                           | 2.65                                                         |
| 2000 | 8818.96                      | 8.2774            | 1,065.43                     | 31.20                                                           | 2.93                                                         |

Source: China's GNP figures in Chinese currency from *China Statistical Yearbook 2001* (Beijing: National Bureau of Statistics, 2001), p. 49; exchange rates from the Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 2001* (New York: Oxford University Press, 2001), pp. 128-129; China's trade with Taiwan from Table 3.03.

Note: Exchange rates are "end of period" rates, not "average of period" rates. GNP at purchasing power parity is not used in this research.

Taiwan's trade with China as a percentage of Taiwan's GNP for the period of 1990-2000 is presented in Table 4.07. This table shows that from 1990 to 1997 the percentage increased gradually and steadily. However, during the 11-year period, all figures are single-digit figures; that is, they never exceeded 10 percent.



Table 4.07. Taiwan's trade with China as Percent of Taiwan's GNP, 1990-2000  
(value in US\$millions; ratios in percent)

|      | Taiwan's<br>GNP | Taiwan's<br>Trade with<br>China | As Percent of<br>Taiwan's<br>GNP |
|------|-----------------|---------------------------------|----------------------------------|
| 1990 | 164,076         | 5,160                           | 3.14                             |
| 1991 | 183,736         | 8,619                           | 4.69                             |
| 1992 | 217,004         | 11,666                          | 5.37                             |
| 1993 | 228,578         | 15,096                          | 6.60                             |
| 1994 | 248,337         | 17,881                          | 7.20                             |
| 1995 | 269,125         | 22,525                          | 8.36                             |
| 1996 | 283,599         | 23,787                          | 8.38                             |
| 1997 | 293,289         | 26,370                          | 8.99                             |
| 1998 | 269,176         | 23,951                          | 8.89                             |
| 1999 | 290,544         | 25,834                          | 8.89                             |
| 2000 | 314,421         | 31,252                          | 9.93                             |

Source: Taiwan's GNP figures from *Taiwan Statistical Data Book 2001* (Taipei: Council for Economic Planning and Development, 2001), p. 15. Taiwan's trade with China based on Table 3.03.

From the data above, it is clear that since the indirect trade began to take off in the mid-1980s, China's trade dependence on Taiwan never exceeded 9 percent of China's foreign trade, nor did it exceed 4 percent of China's GNP. Taiwan's trade dependence on China never exceeded 12 percent of Taiwan's foreign trade, nor did it exceed 10 percent of Taiwan's GNP. Judged from the GNP perspective, neither side's trade with the other side has passed the 15 percent threshold set up by Waltz. In fact, by any fair standard, China's trade with Taiwan cannot be considered as constituting a significant portion of the Chinese economy.

Some people think that cross-Strait trade has been developing extremely rapidly. Actually, they are influenced by the journalistic focus on cross-Strait commerce. Trade across the Taiwan Strait developed rapidly in the late 1980s or the early 1990s when

Taipei lifted the ban on China trade. However, in the light of the data presented above, it is necessary to take a closer look at the growth of cross-Straits trade. Table 4.08 compares the growth of China's foreign trade with the growth of China's trade with Taiwan. In Table 4.08, Taiwan's data (column 5) show that cross-Straits trade indeed experienced a takeoff in the late 1980s and the early 1990s, but a turning point occurred in 1994 when China's foreign trade (column 4) grew more rapidly than its trade with Taiwan (column 5). In the next two years (1995-96) China's trade with Taiwan developed slightly faster than China's world trade, but the difference between the two growth rates was not great. Then, in four consecutive years from 1997, China's foreign trade developed more rapidly than its trade with Taiwan. Table 4.08 also shows that, based on Chinese data, China's trade with the rest of the world developed more rapidly than its trade with Taiwan for four out of nine years from 1992 to 2000 (comparing column 4 with column 6). In sum, Table 4.08 shows that from a comparative perspective, the so-called rapidly developing cross-Straits trade is not often an accurate description of the situation.

Table 4.08. Growth of China's Foreign Trade Compared with Growth of China's Trade with Taiwan, 1987-2000 (in US\$millions; ratios in percent)

|      | (1)                         | (2)                                                          | (3)                                                         | (4)                                                                                                                         | (5)                                                                                                                             | (6)                                                                                                                             |
|------|-----------------------------|--------------------------------------------------------------|-------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------|
|      | China's<br>Foreign<br>Trade | China's<br>Trade<br>with<br>Taiwan<br><br>(Taiwan's<br>data) | China's<br>Trade<br>with<br>Taiwan<br><br>(China's<br>data) | Growth of<br>China's<br>Foreign<br>Trade = %<br>change over<br>the previous<br>year<br><br>(calculated<br>from<br>column 1) | Growth of<br>China's<br>Trade with<br>Taiwan = %<br>change over<br>the previous<br>year<br><br>(calculated<br>from<br>column 2) | Growth of<br>China's<br>Trade with<br>Taiwan = %<br>change over<br>the previous<br>year<br><br>(calculated<br>from<br>column 3) |
| 1987 | 82,653                      | 1,515                                                        | ...                                                         | ...                                                                                                                         | ...                                                                                                                             | ...                                                                                                                             |
| 1988 | 102,784                     | 2,720                                                        | ...                                                         | 24.35                                                                                                                       | 79.53                                                                                                                           | ...                                                                                                                             |
| 1989 | 111,678                     | 3,918                                                        | ...                                                         | 8.65                                                                                                                        | 44.04                                                                                                                           | ...                                                                                                                             |
| 1990 | 115,436                     | 5,160                                                        | ...                                                         | 3.36                                                                                                                        | 31.69                                                                                                                           | ...                                                                                                                             |
| 1991 | 135,701                     | 8,619                                                        | 4,234                                                       | 17.55                                                                                                                       | 67.03                                                                                                                           | ...                                                                                                                             |
| 1992 | 165,525                     | 11,666                                                       | 6,560                                                       | 21.97                                                                                                                       | 35.35                                                                                                                           | 54.92                                                                                                                           |
| 1993 | 194,058                     | 15,096                                                       | 14,393                                                      | 17.23                                                                                                                       | 29.40                                                                                                                           | 119.42                                                                                                                          |
| 1994 | 236,728                     | 17,881                                                       | 16,328                                                      | 21.98                                                                                                                       | 18.44                                                                                                                           | 13.44                                                                                                                           |
| 1995 | 277,910                     | 22,525                                                       | 17,882                                                      | 17.39                                                                                                                       | 25.97                                                                                                                           | 9.51                                                                                                                            |
| 1996 | 290,141                     | 23,787                                                       | 18,982                                                      | 4.40                                                                                                                        | 5.60                                                                                                                            | 6.15                                                                                                                            |
| 1997 | 325,066                     | 26,370                                                       | 19,838                                                      | 12.03                                                                                                                       | 10.85                                                                                                                           | 4.50                                                                                                                            |
| 1998 | 323,894                     | 23,951                                                       | 20,500                                                      | -0.36                                                                                                                       | -9.17                                                                                                                           | 3.33                                                                                                                            |
| 1999 | 360,938                     | 25,834                                                       | 23,477                                                      | 11.43                                                                                                                       | 7.86                                                                                                                            | 14.52                                                                                                                           |
| 2000 | 474,296                     | 31,252                                                       | 30,533                                                      | 31.40                                                                                                                       | 20.97                                                                                                                           | 30.05                                                                                                                           |

Source: China's foreign trade for the period of 1987-1999 from summing up China's exports and imports in the *International Financial Statistics Yearbook 2001* (Washington, DC: IMF, 2001), p. 356-357; China's trade figure for 2000 from *China Statistical Yearbook 2001* (Beijing: National Bureau of Statistics, 2001), p. 591. China's trade with Taiwan (Taiwan's data) from MAC estimation as presented in Table 3.03. China's trade with Taiwan (China's data) from *China Statistical Yearbook*, various issues.

Note: China's foreign trade includes trade with Taiwan; figures are rounded.

Taiwan's foreign trade growth compared with the growth of its China trade is presented in Table 4.09. The table shows that after Taipei lifted the ban on China trade, Taiwan's trade with China developed rapidly, but from 1998 to 2000 Taiwan's trade with the world developed faster than its trade with China. It also shows that a turning point took place in 1994 when the difference between percentage points significantly narrowed. In 1993 there was a difference of 23.75 percentage points between the two growth rates, but in 1994 the difference decreased to 8.43 percentage points. It went down to 5.34 percentage points in 1995. After 1997, which witnessed a slight difference of 2.52 percentage points, Taiwan's world trade gained more momentum. It seems that after the craze in the late 1980s and the early 1990s, the growth pattern of cross-Strait trade has now settled down. Unless there is a drastic change in the political relationship between Beijing and Taipei, a drastic change of this pattern is not expected.

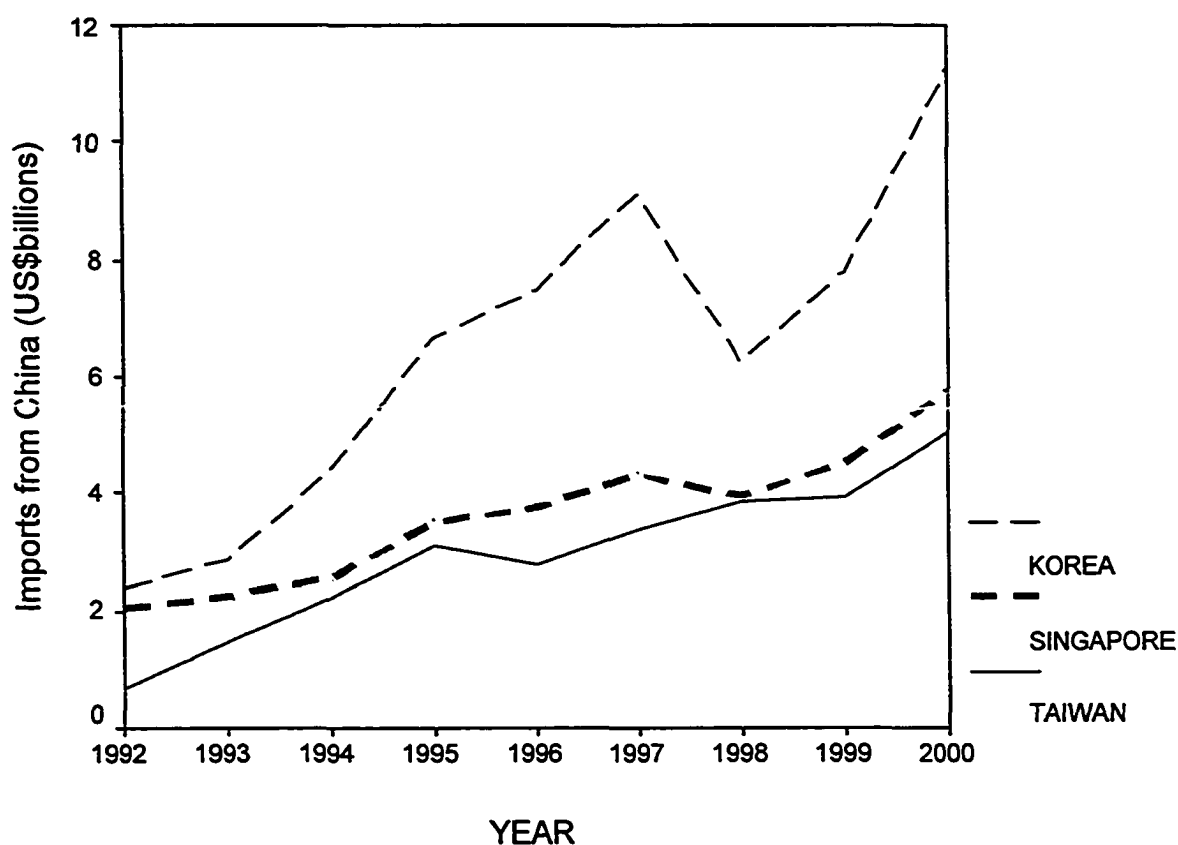
Table 4.09. Taiwan's Foreign Trade Growth Compared with Taiwan's China Trade Growth, 1987-2000 (value in US\$millions; ratios in percent)

|      | Taiwan's Foreign Trade |         |         | Taiwan's Trade with China<br>(Taiwan's Data) | Growth of Taiwan's Foreign Trade = % change over the previous year | Growth of Taiwan's China Trade = % change over the previous year |
|------|------------------------|---------|---------|----------------------------------------------|--------------------------------------------------------------------|------------------------------------------------------------------|
|      | Exports                | Imports | Total   |                                              |                                                                    |                                                                  |
| 1987 | 53,679                 | 34,983  | 88,662  | 1,515.4                                      | ...                                                                | ...                                                              |
| 1988 | 60,667                 | 49,673  | 110,340 | 2,720.9                                      | 24.45                                                              | 79.53                                                            |
| 1989 | 66,304                 | 52,265  | 118,569 | 3,918.8                                      | 7.45                                                               | 44.04                                                            |
| 1990 | 67,214                 | 54,716  | 121,930 | 5,160.0                                      | 2.83                                                               | 31.69                                                            |
| 1991 | 76,178                 | 62,861  | 139,039 | 8,619.4                                      | 14.03                                                              | 67.03                                                            |
| 1992 | 81,470                 | 72,007  | 153,477 | 11,666.6                                     | 10.38                                                              | 35.35                                                            |
| 1993 | 85,091                 | 77,061  | 162,152 | 15,096.7                                     | 5.65                                                               | 29.40                                                            |
| 1994 | 93,049                 | 85,349  | 178,398 | 17,881.2                                     | 10.01                                                              | 18.44                                                            |
| 1995 | 111,659                | 103,550 | 215,209 | 22,525.2                                     | 20.63                                                              | 25.97                                                            |
| 1996 | 115,942                | 102,370 | 218,312 | 23,787.1                                     | 1.44                                                               | 5.60                                                             |
| 1997 | 122,081                | 114,425 | 236,506 | 26,370.6                                     | 8.33                                                               | 10.85                                                            |
| 1998 | 110,582                | 104,665 | 215,247 | 23,951.4                                     | -8.98                                                              | -9.17                                                            |
| 1999 | 121,591                | 110,690 | 232,281 | 25,834.7                                     | 7.91                                                               | 7.86                                                             |
| 2000 | 148,321                | 140,011 | 288,332 | 31,252.8                                     | 24.13                                                              | 20.97                                                            |

Source: Taiwan's foreign trade data from the *Statistical Yearbook of the Republic of China 2001* (Taipei: Directorate-General of Budget, Accounting and Statistics, Executive Yuan, 2001), pp. 208-209; Taiwan's trade with China based on Table 3.03; growth rate of Taiwan's trade with China based on column 5 in Table 4.08.

In the light of Taiwan's restriction on Chinese goods, there is a reason to expect that other relevant players in the region buy more Chinese goods than Taiwan does. As mentioned before, this research uses Singapore, Korea, and Taiwan as lesser states in comparing their trade ties with China. Figure 4.2 is based on Appendix Table I and shows that from 1992 to 2000, even Singapore, which is thousands of miles away from China and has a population of 4 million compared with Taiwan's 23 million, bought more goods from China than Taiwan did.

Figure 4.2. Taiwan, Singapore, Korea as Buyers of Chinese Products, 1992-2000



Source: Based on Chinese Exports in Appendix Table I.

Note: Taiwan's data would show a slightly smaller volume for Taiwan prior to 1995, and a slightly larger volume for Taiwan from 1996.

Table 4.10, which is based on Appendix Table I, identifies the top 10 purchasers of Chinese products. The table shows that prior to 1993, Taiwan was not among the top 10. In 1993 it ranked last among the top 10. The best performance Taiwan had was in 1995, when it ranked eighth. From 1996 to 2000, Taiwan occupied the ninth position—a position that would further cast doubt on the suggestion regarding cross-Strait economic interdependence.

Table 4.10. Top 10 Purchasers of Chinese Products, 1992-2000

| 1992   | 1993   | 1994   | 1995   | 1996   | 1997   | 1998   | 1999   | 2000   |
|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| HK     | HK     | HK     | HK     | HK     | HK     | HK     | US     | US     |
| Japan  | US     | Japan  | Japan  | Japan  | US     | US     | HK     | HK     |
| US     | Japan  | US     | US     | US     | Japan  | Japan  | Japan  | Japan  |
| Germ   | Germ   | Germ   | Korea  | Korea  | Korea  | Germ   | Korea  | Korea  |
| Korea  | Korea  | Korea  | Germ   | Germ   | Germ   | Korea  | Germ   | Germ   |
| Russia | Russia | S'pore | S'pore | S'pore | H'land | H'land | H'land | H'land |
| S'pore | S'pore | UK     | H'land | H'land | S'pore | UK     | UK     | UK     |
| H'land | UK     | H'land | Taiwan | UK     | UK     | S'pore | S'pore | S'pore |
| Italy  | H'land | Taiwan | UK     | Taiwan | Taiwan | Taiwan | Taiwan | Taiwan |
| UK     | Taiwan | Italy  | Italy  | France | France | France | France | Italy  |

Source: Extracted from Appendix Table I.

Note: Germ=Germany; S'pore=Singapore; H'land=Holland.

Throughout the 1990s, Taiwan preferred to buy from Japan and the United States, and there is no indication that it will stop doing so. As mentioned earlier, if a spender can decide on where to spend its money, it will buy from friends rather than from foes. This is a good indicator of the state of political relations. In 2000, Taiwan imported US\$38.6 billion worth of goods from Japan, and US\$25.13 billion worth of goods from the United States. In the same year it imported US\$6.22 billion worth of goods from China and another US\$2.19 billion from Hong Kong (see Appendix Table II). Taiwan's importation from Japan or the United States has always been larger than the combined total of its

imports from China and Hong Kong. There is no doubt that Taiwan's trading economy is geared more toward Japan and the United States than toward China.

Table 4.11 shows five selected suppliers of goods to Taiwan during the 1990s. Note the huge difference between Japan and China. It shows that, for example, Japan's volume of exports to Taiwan in 2000 was approximately five times that of China's, and that the United States and Korea shipped more goods to Taiwan than China did. Table 4.12 ranks the top five suppliers of goods to Taiwan. It shows that China was not one of the top five before 1995 and was not among the top five in 1997 and 1999; that China ranked fifth for three times, in 1995, 1996, and 1998 respectively; that China ranked fourth in 2000; that even Korea consistently ranked higher than China as goods supplier to Taiwan; and that even the city state of Singapore ranked higher than continental China for three years during the period of 1990-2000. This further casts doubt on cross-Strait economic interdependence.

Table 4.11. Selected Suppliers of Goods to Taiwan, 1990-2000 (US\$billions)

|       | Japan  | US     | Korea | HK    | China |
|-------|--------|--------|-------|-------|-------|
| 1990  | 15.99  | 12.61  | 1.74  | 1.44  | 0.76  |
| 1991  | 9.16   | 14.11  | 1.34  | 1.94  | 1.12  |
| 1992  | 21.79  | 15.77  | 2.30  | 1.78  | 1.11  |
| 1993  | 23.19  | 16.72  | 2.53  | 0.80  | 1.10  |
| 1994  | 24.79  | 18.04  | 1.53  | 3.01  | 1.85  |
| 1995  | 30.27  | 20.76  | 4.32  | 1.84  | 3.09  |
| 1996  | 27.49  | 19.97  | 4.16  | 1.70  | 3.05  |
| 1997  | 29.02  | 23.24  | 5.02  | 1.99  | 3.91  |
| 1998  | 27.00  | 19.68  | 5.67  | 1.95  | 4.11  |
| 1999  | 30.59  | 19.69  | 7.19  | 2.09  | 4.52  |
| 2000  | 38.56  | 25.13  | 8.99  | 2.19  | 6.22  |
| total | 277.85 | 205.72 | 44.79 | 20.73 | 30.84 |

Source: Extracted from Appendix Table II.



Table 4.12. Top Five Suppliers of Goods to Taiwan, 1990-2000

| 1990  | 1991   | 1992  | 1993   | 1994   | 1995  | 1996  | 1997   | 1998  | 1999  | 2000  |
|-------|--------|-------|--------|--------|-------|-------|--------|-------|-------|-------|
| Japan | US     | Japan | Japan  | Japan  | Japan | Japan | Japan  | Japan | Japan | Japan |
| US    | Japan  | US    | US     | US     | US    | US    | US     | US    | US    | US    |
| Germ  | Germ   | Germ  | Germ   | Germ   | Germ  | Germ  | Germ   | Korea | Korea | Korea |
| Korea | HK     | Korea | Korea  | Korea  | Korea | Korea | Korea  | Germ  | Germ  | China |
| HK    | S'pore | HK    | S'pore | S'pore | China | China | France | China | Malay | Germ  |

Source: Extracted from Appendix Table II.

Note: Germ=Germany; S'pore=Singapore; Malay=Malaysia.

### Summary

Despite the fact that in 2000, China was Taiwan's fourth largest trade partner, and Taiwan was China fifth largest trade partner, a refined measurement of their trade relations reveals the following facts:

1. China's trade with Taiwan as a share of China's foreign trade was 6.6 percent.
2. China's trade with Taiwan as a share of China's GNP was 2.93 percent.
3. Taiwan's trade with China as a share of Taiwan's foreign trade was 10.84 percent.
4. Taiwan's trade with China as a share of Taiwan's GNP was 9.93 percent.

In other words, none of the indicators passes the 15 percent threshold set up for close economic ties. Even if the threshold is lowered to 10 percent, only one of the indicators mentioned above had barely passed it by 2000. This is the case when the research uses the largest volume of cross-Strait trade estimated by the MAC for calculation. If a smaller volume that is reported by another source is used, none of the indicators would have exceeded 10 percent.

In addition, the research found that:

5. Singapore and Korea bought more Chinese goods than Taiwan did throughout the 1990s.
6. Taiwan bought more goods from Japan and the United States than from China throughout the 1990s.
7. Even Korea, which cut diplomatic ties with Taiwan in 1992 and has no aviation links with Taiwan ever since, shipped more goods to Taiwan than China did throughout the 1990s.
8. Taiwan ranked ninth as a supplier of goods to China in 2000.
9. China's export dependence on Taiwan stood at merely 2.49 percent in 2000.

### **III. Comparing Trade Dependence Rates: Approach 2**

Mexico and Canada are lesser states relative to the United States, so they may shed some light on our comparison. Since these three countries are in the North American Free Trade Area (NAFTA), we expect a lot of trade to take place among them.

For the sake of comparison, Korea and Japan may also be included. These two countries are not NAFTA members and are not in the Western Hemisphere, so they resemble a hard case. It will be interesting to know their trade dependencies on the United States and compare them with Taiwan's trade dependence on China. Table 4.13 shows that in 2000, Mexico's trade dependence on the United States was extremely high (80.73 percent), that Mexico shipped 88.72 percent of its exports to the United States, and that Mexico imported 73.1 percent of the goods it needed from the United States. Canada's trade dependence on the United States was also high (76.72 percent), and it exported 87.45 percent of its goods to the United States and imported 64.35 percent of the goods it needed from the United States. The trade dependence rates for Korea and Japan both exceeded 20 percent. By comparison, Taiwan's trade dependence rate with China was only 10.84 percent in 2000. All four countries in Table 4.13 had a higher export dependence rate with the United States than Taiwan had with China. However, none of these countries complains about its trade dependence on the United States.

Table 4.13. Trade Dependence on the United States, Selected Countries, 2000  
(value in millions of US dollar, dependence rates in percent)

|                             | Mexico  | Canada  | Japan   | Korea   |
|-----------------------------|---------|---------|---------|---------|
| Total Imports               | 174,458 | 238,838 | 377,153 | 160,479 |
| Total Exports               | 166,455 | 275,183 | 447,333 | 171,826 |
| Total Trade                 | 340,913 | 514,021 | 824,486 | 332,305 |
| Imports from US             | 127,534 | 153,690 | 72,514  | 29,286  |
| Exports to US               | 147,686 | 240,645 | 144,009 | 37,806  |
| Total Trade with US         | 275,220 | 394,335 | 216,523 | 67,092  |
| Import Dependence on US (%) | 73.10   | 64.35   | 19.23   | 18.25   |
| Export Dependence on US (%) | 88.72   | 87.45   | 32.19   | 22.00   |
| Trade Dependence on US (%)  | 80.73   | 76.72   | 26.26   | 20.19   |

Source: *Direction of Trade Statistics Yearbook 2001* (Washington, DC: IMF, 2001). Data for Mexico from p. 273, data for Canada from p. 156, data for Japan from p. 276, data for Korea from p. 285. Percentages are the author's own calculations.

Note: Statistics are those reported by individual countries and show slight differences from those reported by the United States.

The correlation between trade volume and political relations among these players can be summed up as follows: (1) a free trade area, denoting a high degree of political amicability, is related to the high trade dependence rates Canada and Mexico had with the United States; (2) the military and political cooperation between Japan and Korea on the one hand, and the United States on the other hand, is related to the moderate trade dependence rates, despite geographic distance; and (3) a zero-sum political conflict between Beijing and Taipei is related to their lowest trade dependence rates, despite geographic proximity.

A comparison between Singapore and Malaysia is also appropriate because Singapore can be considered a lesser state relative to Malaysia. These two countries used to have strained relations but they do not have a zero-sum conflict. From time to time

Singapore may feel anxious as it sees itself as a small boat in the high sea of the Muslim world, but Malaysia does not lay claim to Singapore, and Singapore feels more secure in its relations with Malaysia than Taipei feels about its ties with Beijing, which it sees as a major threat to its survival. Mutual trade dependence between Singapore and Malaysia during a five-year period is summed up in Table 4.14 and Table 4.15.

Table 4.14. Singapore's Trade Dependence on Malaysia, 1996-2000  
(value in millions of US dollar, dependence rates in percent)

| Singapore                       | 1996    | 1997    | 1998    | 1999    | 2000    |
|---------------------------------|---------|---------|---------|---------|---------|
| Total Imports                   | 131,329 | 132,591 | 101,606 | 111,071 | 134,630 |
| Total Exports                   | 125,125 | 125,326 | 109,886 | 114,730 | 137,932 |
| Total Trade                     | 256,454 | 257,917 | 211,492 | 225,801 | 272,535 |
| Imports from Malaysia           | 19,722  | 19,955  | 15,691  | 17,292  | 22,848  |
| Exports to Malaysia             | 22,511  | 21,879  | 16,726  | 18,994  | 25,041  |
| Total Trade with Malaysia       | 42,233  | 41,834  | 32,417  | 36,286  | 47,889  |
| Import Dependence on Malaysia   | 15.02   | 15.05   | 15.44   | 15.57   | 16.97   |
| Export Dependence on Malaysia   | 17.99   | 17.46   | 15.22   | 16.56   | 18.15   |
| Trade Dependence on Malaysia    | 16.47   | 16.22   | 15.33   | 16.07   | 17.57   |
| Trade with Malaysia as % of GNP | 45.40   | 46.91   | 36.85   | 39.49   | 39.49   |

Source: *Direction of Trade Statistics Yearbook 2001* (Washington, DC: IMF, 2001), p. 411. Percentages are the author's own calculations. For Singapore's GNP, see Table 4.18.

Table 4.15. Malaysia's Trade Dependence on Singapore, 1996-2000  
(value in millions of US dollar; dependence rates in percent)

| Malaysia                         | 1996    | 1997    | 1998    | 1999    | 2000    |
|----------------------------------|---------|---------|---------|---------|---------|
| Total Imports                    | 78,441  | 79,047  | 58,319  | 65,491  | 82,195  |
| Total Exports                    | 78,214  | 78,909  | 73,470  | 84,550  | 98,153  |
| Total Trade                      | 156,655 | 157,956 | 131,789 | 150,041 | 180,348 |
| Imports from Singapore           | 10,475  | 10,434  | 7,902   | 9,165   | 11,763  |
| Exports to Singapore             | 16,018  | 15,869  | 12,444  | 13,974  | 18,050  |
| Total Trade with Singapore       | 26,493  | 26,303  | 20,346  | 23,139  | 29,813  |
| Import Dependence on Singapore   | 13.35   | 13.20   | 13.55   | 13.99   | 14.31   |
| Export Dependence on Singapore   | 20.48   | 20.11   | 16.94   | 16.53   | 18.39   |
| Trade Dependence on Singapore    | 16.91   | 16.65   | 15.44   | 15.42   | 16.53   |
| Trade with Singapore as % of GNP | 27.69   | 38.38   | 28.86   | 31.46   | 36.29   |
| Malaysia's GNP                   | 95,663  | 68,527  | 70,506  | 73,540  | 82,145  |

Source: *Direction of Trade Statistics Yearbook 2001* (Washington, DC: IMF, 2001), pp. 312-313. Percentages are the author's own calculations.

Note: Malaysia's GNP figures are taken from Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 2001*, p. 229, and converted to US dollar according to the exchange rates listed in *International Financial Statistics Yearbook 2001*, p. 689.

Table 4.14 shows that Singapore's trade with Malaysia as a share of Singapore's GNP during 1996-2000 ranged from 36.85 to 45.40 percent, and that Singapore's trade with Malaysia as a share of Singapore's foreign trade ranged from 15.33 to 17.57 percent. Table 4.15 shows that Malaysia's trade with Singapore as a share of Malaysia's GNP ranged from 27.69 to 38.38 percent, and that Malaysia's trade with Singapore as a share of Malaysia's foreign trade ranged from 15.42 to 16.91 percent. These figures show that the mutual trade dependence between Malaysia and Singapore is higher than that between Taiwan and China.

Comparing Singapore-China trade with Taiwan-China trade can find out whether Singapore has closer trade ties with China. Since Singapore and Beijing enjoy better relations with each other, they should have closer trade ties. Table 4.16 describes the bilateral trade between Singapore and China during the period of 1990-2000. According to Chinese statistics, China's trade with Singapore amounted to US\$3 billion in 1991; Singaporean statistics show the same volume. In 2000, Chinese data show that China's trade with Singapore rose to US\$10.82 billion, while Singaporean data show that it was US\$12.49 billion. Taiwan's trade with China amounted to US\$8.6 billion in 1991 and increased to US\$31.2 billion in 2000 (see Table 3.03). This means that China-Taiwan trade is roughly two times larger than China-Singapore trade. However, Singapore is far away from China and has a smaller population and economy. While Taiwan is only 100 miles from Fuzhou across the Strait and has a population of 23 million, Singapore is 2,000 miles from Fuzhou and has a population of 4 million. Seen from this perspective, Singapore has closer trade ties with China than Taiwan does.

Table 4.16. China-Singapore Trade, 1990-2000 (in US\$millions)

|      | Chinese Statistics   |                        |                            | Singaporean Statistics |                    |                        |
|------|----------------------|------------------------|----------------------------|------------------------|--------------------|------------------------|
|      | Exports to Singapore | Imports from Singapore | Total Trade with Singapore | Exports to China       | Imports from China | Total Trade with China |
| 1990 | ...                  | ...                    | ...                        | 799                    | 2,095              | 2,894                  |
| 1991 | 2,014                | 1,062                  | 3,076                      | 858                    | 2,227              | 3,085                  |
| 1992 | 2,030                | 1,236                  | 3,267                      | 1,113                  | 2,253              | 3,366                  |
| 1993 | 2,245                | 2,645                  | 4,891                      | 1,905                  | 2,404              | 4,309                  |
| 1994 | 2,558                | 2,482                  | 5,040                      | 2,098                  | 2,885              | 4,983                  |
| 1995 | 3,500                | 3,397                  | 6,898                      | 2,759                  | 4,042              | 6,801                  |
| 1996 | 3,749                | 3,601                  | 7,350                      | 3,395                  | 4,439              | 7,834                  |
| 1997 | 4,323                | 4,464                  | 8,788                      | 4,053                  | 5,668              | 9,721                  |
| 1998 | 3,930                | 4,224                  | 8,154                      | 4,065                  | 4,851              | 8,916                  |
| 1999 | 4,502                | 4,061                  | 8,563                      | 3,920                  | 5,697              | 9,617                  |
| 2000 | 5,761                | 5,059                  | 10,820                     | 5,377                  | 7,116              | 12,493                 |

Source: Chinese statistics from *China Statistical Yearbook* (Beijing: National Bureau of Statistics, 1993-2001); Singaporean statistics from *Direction of Trade Statistics Yearbook* (Washington, DC: IMF, 1996, 2001), p. 390 (1996 issue), p. 411 (2001 issue).

Table 4.17 identifies Singapore's export dependence, import dependence, and trade dependence on China respectively. It shows that Singapore's trade dependence on China (defined as a share of foreign trade) was lower than Taiwan's trade dependence on China in the period of 1990-2000. But this lower dependence rate has something to do with Singapore's large trade volume with the world. Singapore's import dependence on China throughout the 1990s was consistently higher than Taiwan's import dependence on China. This occurred because Taipei restricted mainland goods. Taiwan's higher trade dependence on China (defined as a share of foreign trade) is also attributable to its large volume of exports to China.



Table 4.17. Singapore's Trade Dependence on China, 1990-2000  
(value in US\$millions; dependence rates in percent)

|      | Singapore's<br>Exports | Singapore's<br>Imports | Singapore's<br>Foreign<br>Trade | Export<br>Dependence<br>on China =<br>exports to<br>China over<br>total<br>exports<br>(%) | Import<br>Dependence<br>on China =<br>imports<br>from China<br>over total<br>imports<br>(%) | Trade<br>Dependence<br>on China =<br>trade with<br>China over<br>foreign<br>trade<br>(%) |
|------|------------------------|------------------------|---------------------------------|-------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------|
| 1990 | 52,753                 | 60,954                 | 113,707                         | 1.51                                                                                      | 3.44                                                                                        | 2.55                                                                                     |
| 1991 | 59,219                 | 66,271                 | 125,490                         | 1.45                                                                                      | 3.36                                                                                        | 2.46                                                                                     |
| 1992 | 63,475                 | 72,181                 | 135,656                         | 1.75                                                                                      | 3.12                                                                                        | 2.48                                                                                     |
| 1993 | 74,071                 | 85,393                 | 159,464                         | 2.57                                                                                      | 2.82                                                                                        | 2.70                                                                                     |
| 1994 | 96,911                 | 102,642                | 199,553                         | 2.16                                                                                      | 2.81                                                                                        | 2.50                                                                                     |
| 1995 | 118,187                | 124,394                | 242,581                         | 2.33                                                                                      | 3.25                                                                                        | 2.80                                                                                     |
| 1996 | 125,125                | 131,329                | 256,454                         | 2.71                                                                                      | 3.38                                                                                        | 3.05                                                                                     |
| 1997 | 125,326                | 132,591                | 257,917                         | 3.23                                                                                      | 4.27                                                                                        | 3.77                                                                                     |
| 1998 | 109,886                | 101,606                | 211,492                         | 3.70                                                                                      | 4.77                                                                                        | 4.22                                                                                     |
| 1999 | 114,730                | 111,071                | 225,801                         | 3.42                                                                                      | 5.13                                                                                        | 4.26                                                                                     |
| 2000 | 137,932                | 134,630                | 272,562                         | 3.90                                                                                      | 5.29                                                                                        | 4.58                                                                                     |

Source: *Direction of Trade Statistics Yearbook* (Washington, DC: IMF, 1996, 2001), p. 390 (1996 issue), and p. 411 (2001 issue). Percentages are the author's calculations using Singaporean figures in Table 4.16.

Table 4.18 compares Singapore's China trade as a share of Singapore's GNP with Taiwan's China trade as a share of Taiwan's GNP. It shows that in the whole period of 11 years, Singapore's ratios were larger than Taiwan's for all but two years. In other words, the importance of China trade to Singapore is greater than the importance of China trade to Taiwan when measured in terms of GNP, which is real income rather than the trading activity that is to bring about such income.

Table 4.18. Singapore's Trade with China as Percentage of Singapore's GNP, and Taiwan's Trade with China as Percentage of Taiwan's GNP, 1990-2000  
(value in US\$millions; ratios in percentage)

|      | Singapore's<br>GNP | Singapore's<br>Trade with<br>China as %<br>of<br>Singapore's<br>GNP | Taiwan's<br>GNP | Taiwan's<br>Trade with<br>China as % of<br>Taiwan's GNP |
|------|--------------------|---------------------------------------------------------------------|-----------------|---------------------------------------------------------|
| 1990 | 39,246             | 7.37                                                                | 164,076         | 3.14                                                    |
| 1991 | 46,212             | 6.68                                                                | 183,736         | 4.69                                                    |
| 1992 | 50,274             | 6.70                                                                | 217,004         | 5.37                                                    |
| 1993 | 58,071             | 7.42                                                                | 228,578         | 6.60                                                    |
| 1994 | 74,683             | 6.67                                                                | 248,337         | 7.20                                                    |
| 1995 | 86,065             | 7.90                                                                | 269,125         | 8.36                                                    |
| 1996 | 93,023             | 8.42                                                                | 283,599         | 8.38                                                    |
| 1997 | 89,183             | 10.90                                                               | 293,289         | 8.99                                                    |
| 1998 | 87,978             | 10.13                                                               | 269,176         | 8.89                                                    |
| 1999 | 91,898             | 10.46                                                               | 290,544         | 8.89                                                    |
| 2000 | 98,033             | 12.74                                                               | 314,421         | 9.93                                                    |

Source: Singapore's GNP figures in Singaporean currency are taken from the Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 2001* (New York: Oxford University Press, 2001), pp. 236-237, and converted to US dollar according to the exchange rates listed in the *Statistical Yearbook for Asia and the Pacific 2000* (Bangkok: United Nations), p. 518, and the *International Financial Statistics Yearbook 2001* (Washington, DC: IMF, 2001), p.897; Taiwan's GNP figures from Table 4.07; Singapore's trade with China based on Singaporean statistics in Table 4.16; Taiwan's trade with China based on Table 3.03.

All these data, as well as Singapore's China-bound investment that is to be reviewed later, show that Singapore's economic relationship with China is closer than Taiwan's economic relationship with China. If one says that one wants to do business with China because one is ethnically, linguistically, and culturally close to those on the mainland, then both the business communities in Singapore and Taiwan should have an equal degree of enthusiasm for doing business with China and have a business volume

proportionate to their sizes.<sup>17</sup> We may even expect Singapore to have *lesser* ties with China owing to its long distance from China. Furthermore, Taiwan is culturally closer to the mainland than Singapore is. About 25 percent of the Singaporean population is not Chinese. In comparing Singapore and Taiwan, the ethnic and cultural variables for explaining economic ties can be held constant. The geographic factor favors Taiwan. What remains as a variable accounting for the lesser trade ties between Taipei and Beijing and the closer trade ties between Singapore and China can only be political. We have already seen a lot of the regulations and restrictions used by the Taiwanese government to control cross-Strait trade and investment.

Owing to the political conflict between the two sides of the Strait, Taipei wishes to avoid excessive dependence on China, because such dependence gives Beijing an additional tool to coerce Taiwan into accepting political arrangements on Beijing's terms. Chen Shui-bian says that the major threat to Taiwan comes from China.<sup>18</sup> Taiwan's 2002 defense white paper, a biennial publication by the Ministry of National Defense, sees China's electronic and information warfare as Taiwan's biggest threat.<sup>19</sup> Taipei does not see such threats from Japan and the United States; it even calls for military cooperation and free trade agreements with these two countries.

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<sup>17</sup> The idea that cultural, linguistic, and ethnic closeness facilitates business development is vividly represented by the concept of bamboo network, which includes Chinese entrepreneurs from Taiwan, Hong Kong, and Southeast Asia. Lee Kuan Yew: "We are ethnic Chinese. We share certain characteristics through common ancestry and culture... People feel a natural empathy for those who share their physical attributes. This sense of closeness is reinforced when they also share a basis for culture and language. It makes for easy rapport and trust, which is the foundation for all business relations." Quoted in Samuel Huntington, 1996, p. 170. See also Murray L. Weidenbaum, *The Bamboo Network* (New York: Martin Kessler Books, 1996).

<sup>18</sup> "Chen Shui-bian Says Threat to Taiwan Comes from Mainland," *Ming Pao*, June 26, 2002. For content and context, see Chapter 5.

<sup>19</sup> Brian Hsu, "Menace of Tech Warfare Looms: Paper," *Taipei Times*, July 24, 2002.

Using the COPDAB scale (see Chapter 1) to measure Taiwan's relations with the United States and Japan on the one hand, and with China on the other, it can be seen that most of the time Taiwan's relations with the United States and Japan show cooperativeness, and its relations with China is characterized by dispute. COPDAB has 15 event categories, of which category 1 to 7 represents cooperation, category 8 represents neutral act, and category 9 to 15 denotes conflict. In this 15-point scale, category 1 represents the most cooperative behavior, and category 15, the most serious conflict.<sup>20</sup> Taiwan is seeking military and economic cooperation with the United States and Japan (event category 3), and the United States is giving Taiwan such support, including arms sales to Taiwan. Bush's remarks that the United States will do "what it takes" to help Taiwan defend itself are tantamount to official verbal support (event category 6). Taiwan's desire for a free trade agreement with the United States and Japan may lead to nonmilitary economic, technological, and industrial agreements (event category 4). The meetings of senior Taiwanese and U.S. military officials (see Chapter 5) are not simply minor official exchanges (event category 7). On the contrary, Beijing's hostile remarks on Taipei's plan to issue passports with a new look, Premier Zhu's warning that the Chinese will shed blood to stop Taiwan's independence, and the intermittent threat on use of force, all belong to strong verbal expression displaying hostility (event category 10). Beijing's efforts to block Taipei's participation in international organizations belong to diplomatic or economic hostile actions (event

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<sup>20</sup> The categories of dyadic interactions range from cooperative event categories: (1) voluntary unification into one country, (2) major strategic alliance, (3) military and economic support, (4) nonmilitary economic, technological, and industrial agreements, (5) cultural and scientific agreements, (6) official verbal support, (7) minor official exchanges, (8) neutral or insignificant acts, to conflict event categories: (9) mild verbal expression displaying discord, (10) strong verbal expression displaying hostility, (11) diplomatic or economic hostile actions, (12) political actions, (13) small-scale military actions, (14) limited war acts, and (15) extensive war acts, causing death, dislocation, and high strategic costs.

category 11), and its military exercises and firing of missiles in 1995-96 are obviously small-scale military actions (event category 13). In short, between Taiwan and the United States, and Japan too, many events fall into the cooperative event categories (i.e., categories 1 to 7). On the contrary, between Beijing and Taipei, many events fall into the conflict event categories (i.e., categories 9 to 15). This shows that the serious political conflict that exists between Taiwan and China does not exist between Taiwan and the United States, or between Taiwan and Japan. This conflict affects economic ties.

In the past four decades, Taiwan traded more with the United States and Japan than with China. Taiwan bought more goods from these two countries than from China. At present, the United States and Japan are Taiwan's largest trade partners. In light of these two countries' importance in Taiwan's foreign trade, it is necessary to take a closer look at their trade ties with Taiwan. Table 4.19 traces Taiwan's trade ties with the United States to 1983; that is, five years before Taipei approved indirect cross-Straits trade. It shows that from 1983 to 2000, Taiwan's trade with the United States ranged from 20.79 percent to 38.40 percent of Taiwan's foreign trade. During the same period, Taiwan's trade with China never exceeds 12 percent of Taiwan's foreign trade. Comparing Table 4.19 with Table 4.05, it becomes clear that Taiwan not only bought more goods from the United States than from China, but also shipped more goods to the United States than to China.

During the same period, Taiwan's trade with Japan ranged from 16.88 percent to 21.39 percent of Taiwan's foreign trade (see Table 4.20). Most of the time Taiwan imported approximately 30 percent of the goods it needed from Japan, and imported only 2 or 3 percent of the goods it needed from China. Comparing Table 4.19 with Table

4.20, it can be seen that Taiwan even bought more from Japan than from the United States.

Table 4.19. Taiwan's Trade Dependence on the United States, 1983-2000  
(value in US\$millions; dependence rates in percent)

|      | Exports | Imports | Total Foreign Trade | Exports to US | Imports from US | Total Trade with US | As Share of Total Exports (%) | As Share of Total Imports (%) | As Share of Foreign Trade (%) |
|------|---------|---------|---------------------|---------------|-----------------|---------------------|-------------------------------|-------------------------------|-------------------------------|
| 1983 | 25,123  | 20,287  | 45,410              | 11,334        | 4,646           | 15,980              | 45.11                         | 22.90                         | 35.19                         |
| 1984 | 30,456  | 21,959  | 52,415              | 14,868        | 5,042           | 19,910              | 48.82                         | 22.96                         | 37.99                         |
| 1985 | 30,726  | 20,102  | 50,828              | 14,773        | 4,746           | 19,519              | 48.08                         | 23.61                         | 38.40                         |
| 1986 | 39,862  | 24,181  | 64,043              | 19,014        | 5,433           | 24,447              | 47.70                         | 22.47                         | 38.17                         |
| 1987 | 53,679  | 34,983  | 88,662              | 23,685        | 7,648           | 31,333              | 44.12                         | 21.86                         | 35.34                         |
| 1988 | 60,667  | 49,673  | 110,340             | 23,467        | 13,007          | 36,474              | 38.68                         | 26.19                         | 33.06                         |
| 1989 | 66,304  | 52,265  | 118,569             | 24,036        | 12,003          | 36,039              | 36.25                         | 22.97                         | 30.39                         |
| 1990 | 67,214  | 54,716  | 121,930             | 21,746        | 12,612          | 34,358              | 32.35                         | 23.05                         | 28.18                         |
| 1991 | 76,178  | 62,861  | 139,039             | 22,321        | 14,114          | 36,435              | 29.30                         | 22.45                         | 26.20                         |
| 1992 | 81,470  | 72,007  | 153,477             | 23,572        | 15,771          | 39,343              | 28.93                         | 21.90                         | 25.63                         |
| 1993 | 85,091  | 77,061  | 162,152             | 23,587        | 16,723          | 40,310              | 27.72                         | 21.70                         | 24.86                         |
| 1994 | 93,049  | 85,349  | 178,398             | 24,337        | 18,043          | 42,380              | 26.16                         | 21.14                         | 23.76                         |
| 1995 | 111,659 | 103,550 | 215,209             | 26,407        | 20,771          | 47,178              | 23.65                         | 20.06                         | 21.92                         |
| 1996 | 115,942 | 102,370 | 218,312             | 26,866        | 19,972          | 46,838              | 23.17                         | 19.51                         | 21.45                         |
| 1997 | 122,081 | 114,425 | 236,506             | 29,552        | 23,234          | 52,786              | 24.21                         | 20.31                         | 22.32                         |
| 1998 | 110,582 | 104,665 | 215,247             | 29,376        | 19,679          | 49,055              | 26.56                         | 18.80                         | 22.79                         |
| 1999 | 121,591 | 110,690 | 232,281             | 30,902        | 19,693          | 50,595              | 25.41                         | 17.79                         | 21.78                         |
| 2000 | 148,321 | 140,011 | 288,332             | 34,815        | 25,126          | 59,941              | 23.47                         | 17.95                         | 20.79                         |

Source: Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 2001* (New York: Oxford University Press, 2001), 364-365. Percentages are the author's own calculations.

Table 4.20. Taiwan's Trade Dependence on Japan, 1983-2000  
(value in US\$millions; dependence rates in percent)

|      | Exports | Imports | Total Foreign Trade | Exports to Japan | Imports from Japan | Total Trade with Japan | As Share of Total Exports (%) | As Share of Total Imports (%) | As Share of Foreign Trade (%) |
|------|---------|---------|---------------------|------------------|--------------------|------------------------|-------------------------------|-------------------------------|-------------------------------|
| 1983 | 25,123  | 20,287  | 45,410              | 2,477            | 5,587              | 8,064                  | 9.86                          | 27.54                         | 17.76                         |
| 1984 | 30,456  | 21,959  | 52,415              | 3,187            | 6,442              | 9,629                  | 10.46                         | 29.34                         | 18.37                         |
| 1985 | 30,726  | 20,102  | 50,828              | 3,461            | 5,549              | 9,010                  | 11.26                         | 27.60                         | 17.73                         |
| 1986 | 39,862  | 24,181  | 64,043              | 4,560            | 8,255              | 12,815                 | 11.44                         | 34.14                         | 20.01                         |
| 1987 | 53,679  | 34,983  | 88,662              | 6,986            | 11,841             | 18,827                 | 13.01                         | 33.85                         | 21.23                         |
| 1988 | 60,667  | 49,673  | 110,340             | 8,772            | 14,825             | 23,597                 | 14.46                         | 29.85                         | 21.39                         |
| 1989 | 66,304  | 52,265  | 118,569             | 9,065            | 16,031             | 25,096                 | 13.67                         | 30.67                         | 21.17                         |
| 1990 | 67,214  | 54,716  | 121,930             | 8,338            | 15,998             | 24,336                 | 12.41                         | 29.24                         | 19.96                         |
| 1991 | 76,178  | 62,861  | 139,039             | 9,189            | 18,858             | 28,047                 | 12.06                         | 30.00                         | 20.17                         |
| 1992 | 81,470  | 72,007  | 153,477             | 8,894            | 21,767             | 30,661                 | 10.92                         | 30.23                         | 19.98                         |
| 1993 | 85,091  | 77,061  | 162,152             | 8,977            | 23,186             | 32,163                 | 10.55                         | 30.09                         | 19.84                         |
| 1994 | 93,049  | 85,349  | 178,398             | 10,221           | 24,786             | 35,007                 | 10.98                         | 29.04                         | 19.62                         |
| 1995 | 111,659 | 103,550 | 215,209             | 13,157           | 30,266             | 43,423                 | 11.78                         | 29.23                         | 20.18                         |
| 1996 | 115,942 | 102,370 | 218,312             | 13,659           | 27,493             | 41,152                 | 11.78                         | 26.86                         | 18.85                         |
| 1997 | 122,081 | 114,425 | 236,506             | 11,691           | 29,022             | 40,713                 | 9.58                          | 25.36                         | 17.21                         |
| 1998 | 110,582 | 104,665 | 215,247             | 9,324            | 27,001             | 36,325                 | 8.43                          | 25.80                         | 16.88                         |
| 1999 | 121,591 | 110,690 | 232,281             | 11,900           | 30,591             | 42,491                 | 9.79                          | 27.64                         | 18.29                         |
| 2000 | 148,321 | 140,011 | 288,332             | 16,599           | 38,558             | 55,157                 | 11.19                         | 27.54                         | 19.13                         |

Source: Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 2001* (New York: Oxford University Press, 2001), pp. 364-365. Percentages are the author's own calculations.

The research now has enough data to compare Taiwan's trade with the United States and Japan on the one hand, and with cross-Straits trade on the other. Table 4.21 serves this purpose. It shows that defined as a share of foreign trade and as a share of

GNP, Taiwan's trade with the United States and with Japan were always larger than its trade with China.

Table 4.21. Taiwan's Trade with the United States and Japan Compared with Taiwan's Trade with China, 1990-2000 (in percent)

|      | As a Share of Foreign Trade |       |       | As a Share of GNP |       |       |
|------|-----------------------------|-------|-------|-------------------|-------|-------|
|      | US                          | Japan | China | US                | Japan | China |
| 1990 | 28.18                       | 19.96 | 4.23  | 20.94             | 14.83 | 3.14  |
| 1991 | 26.20                       | 20.17 | 6.20  | 19.83             | 15.26 | 4.69  |
| 1992 | 25.63                       | 19.98 | 7.60  | 18.13             | 14.13 | 5.37  |
| 1993 | 24.86                       | 19.84 | 9.32  | 17.64             | 14.07 | 6.60  |
| 1994 | 23.76                       | 19.62 | 10.02 | 17.07             | 14.10 | 7.20  |
| 1995 | 21.92                       | 20.18 | 10.46 | 17.53             | 16.13 | 8.36  |
| 1996 | 21.45                       | 18.85 | 10.95 | 16.52             | 14.51 | 8.38  |
| 1997 | 22.32                       | 17.21 | 11.15 | 18.00             | 13.88 | 8.99  |
| 1998 | 22.79                       | 16.88 | 11.13 | 18.22             | 13.49 | 8.89  |
| 1999 | 21.78                       | 18.29 | 11.12 | 17.41             | 14.62 | 8.89  |
| 2000 | 20.79                       | 19.13 | 10.84 | 19.06             | 17.54 | 9.93  |

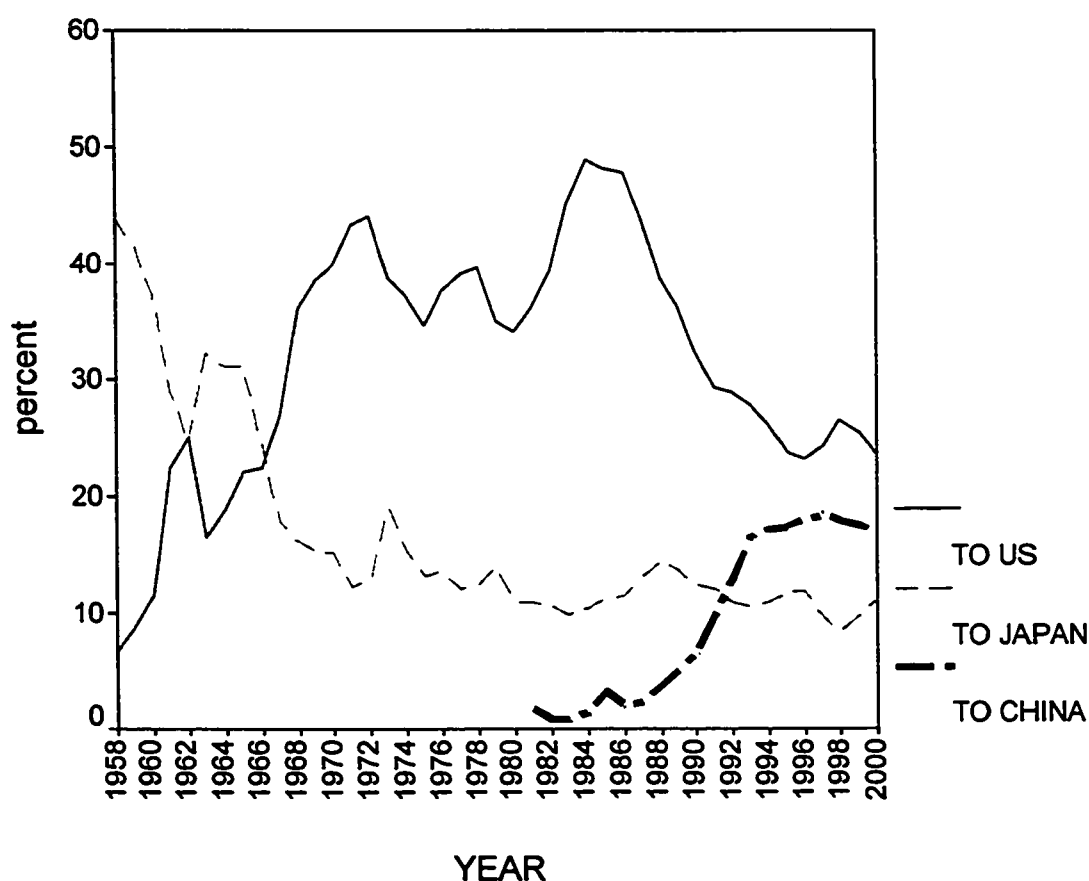
Based on Tables 4.05, 4.06, 4.19, and 4.20.

There are marked shifts in the flow of Taiwan's exports over the past five decades. In the 1950s and the 1960s, Taiwan reoriented toward Japan, which became its largest export market. The United States took over from Japan in 1967, and has been Taiwan's largest export market ever since. Since the rapid decrease in the Japan-bound exports as a share of Taiwan's total exports during the 1960s, Japan has been buying around 10-15 percent of Taiwan's total exports, and this figure has remained steady since the 1970s (see Table 4.02). Meanwhile, the United States took approximately 40 percent of Taiwan's total exports in the 1970s and the 1980s. But in 1988, the percentage began



to fall, and by 2000 the United States took 24 percent of Taiwan's total exports. A noteworthy phenomenon is that after 1988, Taiwan's exports to China began to acquire momentum, and by 2000 China took 17 percent of Taiwan's total exports. This suggests that the decrease in Taiwan's exports to the United States corresponded to the increase in Taiwan's exports to China. In other words, China took over from the United States some of the function of being Taiwan's export market. Figure 4.3 shows the shifts in export flows in the past four decades.

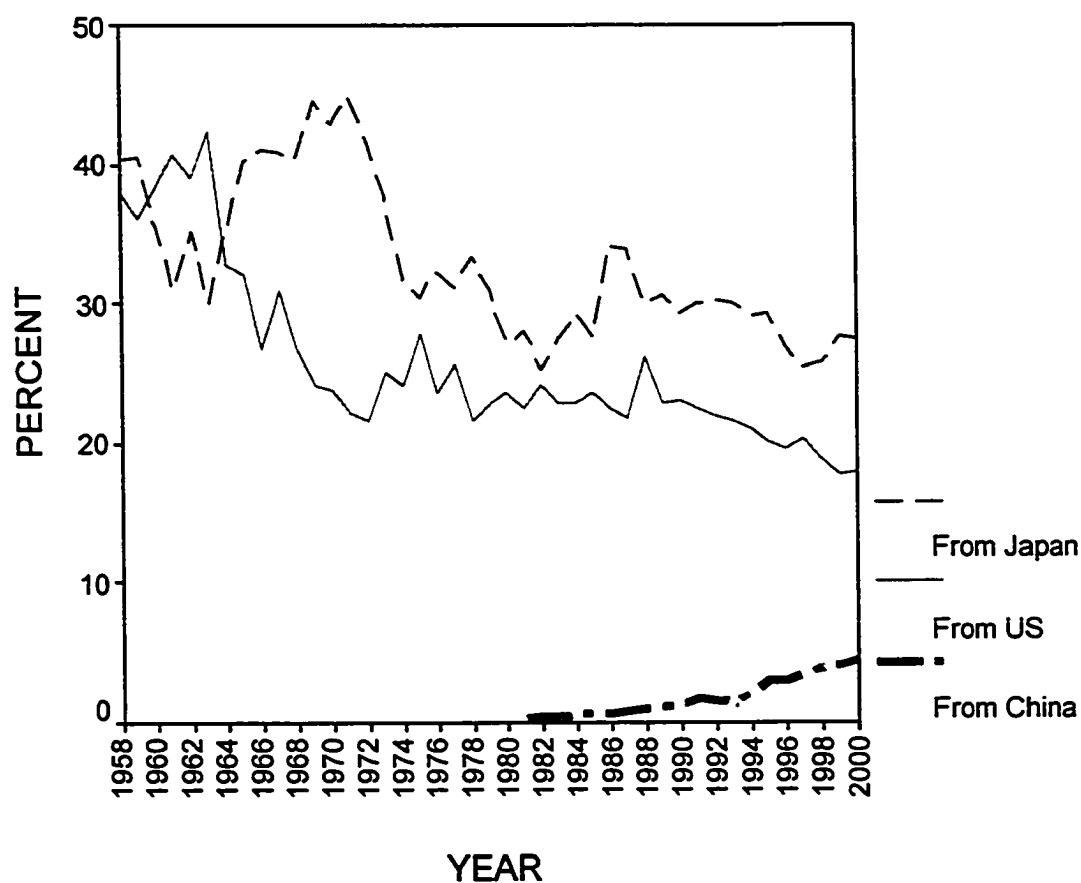
Figure 4.3. Taiwan's Exports to the US, Japan, and China as Percentage of Taiwan's Total Exports, 1958-2000



Source: Based on Tables 4.02, 4.05, 4.19, and 4.20.

However, Taiwan's imports from China were very small. Figure 4.4, based on information from Table 4.22 below, and on Tables 4.19 and 4.20 above, shows Taiwan's imports from Japan, the United States, and China in the past four decades. It shows that Japan was the leading supplier of goods to Taiwan, that the United States was second to Japan, and that China was unimportant as a goods supplier to Taiwan.

Figure 4.4. Taiwan's imports from Japan, the United States, and China as Percentage of Taiwan's Total Imports, 1958-2000



Source: Based on Tables 4.19, 4.20, and 4.22

Table 4.22. Taiwan's Imports from Japan, the United States, and China, 1958-82  
(value in millions of U.S. dollar; share in percent)

|      | Total imports | From Japan | From US | From China | From Japan as % of total imports | From US as % of total imports | From China as % of total imports |
|------|---------------|------------|---------|------------|----------------------------------|-------------------------------|----------------------------------|
| 1958 | 222.4         | 89.5       | 84.4    | ....       | 40.24                            | 37.95                         | ....                             |
| 1959 | 231.1         | 93.4       | 83.5    | ....       | 40.42                            | 36.13                         | ....                             |
| 1960 | 295.7         | 104.8      | 113.1   | ....       | 35.44                            | 38.25                         | ....                             |
| 1961 | 321.2         | 99.7       | 130.8   | ....       | 31.04                            | 40.72                         | ....                             |
| 1962 | 295.9         | 103.9      | 115.2   | ....       | 35.11                            | 38.93                         | ....                             |
| 1963 | 356.1         | 107.1      | 150.5   | ....       | 30.08                            | 42.26                         | ....                             |
| 1964 | 425.0         | 149.0      | 139.1   | ....       | 35.06                            | 32.73                         | ....                             |
| 1965 | 556.7         | 223.8      | 178.9   | ....       | 40.20                            | 32.14                         | ....                             |
| 1966 | 619.5         | 254.1      | 165.2   | ....       | 41.02                            | 26.67                         | ....                             |
| 1967 | 801.6         | 326.9      | 248.4   | ....       | 40.78                            | 30.99                         | ....                             |
| 1968 | 895.4         | 361.6      | 239.3   | ....       | 40.38                            | 26.73                         | ....                             |
| 1969 | 1,206.1       | 535.8      | 291.8   | ....       | 44.42                            | 24.19                         | ....                             |
| 1970 | 1,524.0       | 652.8      | 364.0   | ....       | 42.83                            | 23.88                         | ....                             |
| 1971 | 1,843.4       | 827.1      | 408.3   | ....       | 44.87                            | 22.15                         | ....                             |
| 1972 | 2,523.8       | 1,049.3    | 545.4   | ....       | 41.58                            | 21.61                         | ....                             |
| 1973 | 3,796.1       | 1,429.9    | 954.0   | ....       | 37.67                            | 25.13                         | ....                             |
| 1974 | 6,984.3       | 2,221.2    | 1,685.1 | ....       | 31.80                            | 24.13                         | ....                             |
| 1975 | 5,959.5       | 1,814.9    | 1,654.8 | ....       | 30.45                            | 27.77                         | ....                             |
| 1976 | 7,608.6       | 2,454.9    | 1,800.6 | ....       | 32.26                            | 23.67                         | ....                             |
| 1977 | 8,522.0       | 2,647.8    | 2,188.4 | ....       | 31.07                            | 25.68                         | ....                             |
| 1978 | 11,050.0      | 3,686.0    | 2,383.0 | ....       | 33.36                            | 21.57                         | ....                             |
| 1979 | 14,774.0      | 4,561.0    | 3,381.0 | ....       | 30.87                            | 22.88                         | ....                             |
| 1980 | 19,733.0      | 5,353.0    | 4,673.0 | ....       | 27.13                            | 23.68                         | ....                             |
| 1981 | 21,200.0      | 5,929.0    | 4,766.0 | 75.2       | 27.97                            | 22.48                         | 0.35                             |
| 1982 | 18,888.0      | 4,780.0    | 4,563.0 | 84.0       | 25.31                            | 24.16                         | 0.44                             |

Source: Data for 1958-62 from the International Monetary Fund (IMF) and International Bank for Reconstruction and Development, *Direction of Trade 1958-62*, p. 337; data for 1963-65 from IMF, *Direction of Trade 1961-65*, p. 98; data for 1966-68 from IMF, *Direction of Trade 1964-68*, p. 153; data for 1969-75 from IMF, *Direction of Trade 1969-75*, p. 93; data for 1976-77 from IMF, *Direction of Trade 1971-77*, p. 100; data for 1978 from IMF, *Direction of Trade Statistics Yearbook 1979*, p. 100; data for 1979 from the Asian Development Bank (ADB), *Key Indicators of Developing Asian and Pacific Countries 1997*, p. 324; data for 1980-82 from ADB, *Key Indicators 1998*, p. 330; data on Taiwan's imports from China taken from Table 3.03.

Whether the disruption of trade between two countries will hurt one or both of them depends on (1) the degree to which a country depends on trade for income, and (2) the importance of the bilateral trade to its foreign trade. For a country whose GNP consists of little income from trading, a disruption will not matter. For a country whose foreign trade is larger than its GNP, a disruption may prove important, but still it depends on the proportion of the disrupted trade to foreign trade. Different economies have different external trade dependence rates, as illustrated in Table 4.23, which shows that Singapore has the highest and China the lowest rate among the four selected economies.

Table 4.23. External Trade Dependence of Singapore, Taiwan, China, Korea, Defined as a Share of GNP, 2000 (value in US\$billions; rates in percent)

|                           | Singapore | Taiwan | Korea | China |
|---------------------------|-----------|--------|-------|-------|
| Foreign Trade             | 271       | 288    | 333   | 474   |
| GNP                       | 98        | 314    | 406   | 1,065 |
| External Trade Dependence | 276%      | 91%    | 82%   | 44%   |

Source: Based on various tables presented above.

Taiwan's external trade dependence rate is 91 percent. To determine how much Taiwan would lose if a complete disruption of its foreign trade occurs as result of an embargo by China or a war in the Strait, we need to find out how much Taiwan's foreign trade contributes to Taiwan's GNP, which among other things includes exports of goods and services minus imports of goods and services. Suppose Taiwan continues to trade with the rest of the world while cross-Strait trade stopped, the loss to Taiwan can be calculated by subtracting Taiwan's trade surplus with China from Taiwan's GNP. In 2000, Taiwan's trade surplus with China is US\$18.8 billion and Taiwan's GNP is

US\$314 billion. A removal of cross-Strait trade would cut Taiwan's income to US\$295 billion, or a 5.98 percent decrease.

In their book, *Globalization in Question*, Paul Hirst and Grahame Thompson found that the trade-to-GDP (gross domestic product) ratios among the major powers in 1913 were higher when compared with 1973.<sup>21</sup> This implies that the world economy was more open in 1913 than in 1973, because a larger trade flow across national boundaries indicates a higher degree of economic interdependence. When trade openness is measured as merchandise exports plus imports as a percentage of GDP, the industrial countries in North America and Europe—including Japan—experienced a slow increase in openness after 1950, while East Asia witnessed a faster increase in openness which resulted in a higher degree of openness.<sup>22</sup> A piece of evidence in East Asia that supports their observation regarding the higher degree of trade openness in 1913 comes from Japan's trade with China. Surprisingly, Japan's trade dependence on China in the nineteenth century was higher than Taiwan's trade dependence on China in the twenty-first century. Given the fact that transportation in the old days was less modern, and Japan still had more trade with China under that condition than Taiwan has today, Taiwan's alleged trade dependence on China is obviously exaggerated. Table 4.24 shows Japan's export and import dependencies on China from 1880 to 1924.

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<sup>21</sup> Paul Hirst and Grahame Thompson, *Globalization in Question* (Cambridge, MA: Blackwell Publishers, 1996), 27.

<sup>22</sup> *Ibid*, 28.

Table 4.24. Japan's Trade with China, Including Guangdong and Hong Kong, 1880-1924

| Year                                             | 1880 | 1902 | 1913 | 1921 | 1922 | 1923 | 1924 |
|--------------------------------------------------|------|------|------|------|------|------|------|
| Exports to China as % of Japan's total exports   | 22.0 | 28.1 | 34.4 | 33.8 | 28.3 | 25.2 | 26.9 |
| Imports from China as % of Japan's total imports | 15.0 | 15.8 | 12.8 | 18.8 | 16.7 | 18.6 | 16.7 |

Source: Shigeru Uyehara, *The Industry and Trade of Japan* (London: P.S. King & Son, 1926), 72, 74, 75.

From Table 4.24 it can be seen that Japan's volume of exports to China in 1880 was 22 percent of Japan's total exports for that year. In 1913 and 1921, China absorbed more than one-third of Japan's total exports. Even shortly before the Sino-Japanese War that erupted in 1937, China took 26.9 percent of Japan's total exports. During the same period, Japan imported 12.8 to 18.8 percent of the goods she needed from China. In other words, Japan's export and import dependencies on China in the late nineteenth and the early twentieth century were higher than Taiwan's export and import dependencies on China today. To sum up, when compared with the past and current trade dependence rates among different countries in the region, Taiwan's economic dependence on China is not high.

#### IV. Analyzing Investment and Cooperation: Approach 3

Taiwan's investment in China was described in Chapter 3. As shown in Table 3.07, China had utilized US\$26 billion of Taiwanese capital by 2000. In the past few years, China was the largest recipient of Taiwan's outward investment, and Table 3.10

shows that Taiwanese investment in China in 2000 was larger than the combined total of Taiwanese investment in a group of selected countries. But the fact that China is the largest recipient of Taiwanese investment neither means that Taiwanese investment is the most important source of foreign investment in China, nor automatically implies economic interdependence. On the mainland side, there is a huge economy that would dwarf a huge amount of foreign investment. Data show that Taiwan's investment in China was US\$2.61 billion in 2000, while China's GNP for that year was US\$1,065 billion.<sup>23</sup> On the other hand, Taiwan's investment in Southeast Asian countries, even moderate by comparison with its investment in China, may occupy an important position in those countries. "By 1997, Taiwan was not only the largest foreign investor in Vietnam...but also the second largest in Cambodia and Thailand."<sup>24</sup> The actual significance of Taiwanese investment in China can only be revealed by a comparison of different sources of investments in China. Table 4.25 serves this purpose.

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<sup>23</sup> China's GDP at purchasing power parity was even larger, equaling US\$4.5 trillion in 2000. See *World Factbook 2001* (Washington, DC: Central Intelligence Agency), 105.

<sup>24</sup> Bruce Cheesman, "Taiwan Targets Cambodia in South-Bound Investment Policy," *Business Times*, February 14, 1997, and Woranuj Maneerungsee, "Investment in Thailand Still Attractive to Taiwanese Companies: Willing to Endure 'Transitional Period,'" *Bangkok Post*, July 24, 1997; quoted in Lynn White III, "Taiwan and Globalization," in *East Asia and Globalization*, ed. Samuel Kim (Lanham, MD: Rowman & Littlefield, 2000), 174.

Table 4.25. Actually Used FDI and Other Investments in China by Selected Countries  
(Territory) 1991-2001

US\$10,000; numbers in parentheses are percentages of total

|       | National<br>total   | Hong Kong            | United<br>States   | Japan              | Taiwan             | Singapore          |
|-------|---------------------|----------------------|--------------------|--------------------|--------------------|--------------------|
| 1991  | 466,661<br>(100)    | 257,911<br>(55.2)    | 33,066<br>(7.0)    | 60,952<br>(13.0)   | 47,189<br>(10.1)   | 5,821<br>(1.2)     |
| 1992  | 1,129,162<br>(100)  | 770,612<br>(68.2)    | 51,944<br>(4.6)    | 74,827<br>(6.6)    | 105,335<br>(9.3)   | 12,593<br>(1.1)    |
| 1993  | 2,777,087<br>(100)  | 1,744,493<br>(62.8)  | 206,785<br>(7.4)   | 136,137<br>(4.9)   | 313,913<br>(11.3)  | 49,180<br>(1.7)    |
| 1994  | 3,394,584<br>(100)  | 1,982,268<br>(58.4)  | 249,082<br>(7.3)   | 208,616<br>(6.1)   | 339,134<br>(9.9)   | 117,961<br>(3.4)   |
| 1995  | 3,780,569<br>(100)  | 2,018,511<br>(53.3)  | 308,373<br>(8.1)   | 321,247<br>(8.5)   | 316,516<br>(8.3)   | 186,061<br>(4.9)   |
| 1996  | 4,213,516<br>(100)  | 2,085,160<br>(49.4)  | 344,417<br>(8.1)   | 369,214<br>(8.7)   | 348,202<br>(8.2)   | 224,716<br>(5.8)   |
| 1997  | 5,238,734<br>(100)  | 2,155,111<br>(41.1)  | 346,117<br>(6.6)   | 439,037<br>(8.3)   | 334,234<br>(6.3)   | 260,696<br>(4.9)   |
| 1998  | 4,755,749<br>(100)  | 1,939,983<br>(40.7)  | 417,355<br>(8.7)   | 344,407<br>(7.2)   | 305,123<br>(6.4)   | 340,397<br>(7.1)   |
| 1999  | 4,244,696<br>(100)  | 1,740,233<br>(40.9)  | 422,255<br>(9.9)   | 306,358<br>(7.2)   | 275,857<br>(6.4)   | 264,252<br>(6.2)   |
| 2000  | 4,935,627<br>(100)  | 1,672,933<br>(33.8)  | 438,452<br>(8.8)   | 306,117<br>(6.2)   | 253,702<br>(5.1)   | 217,261<br>(4.4)   |
| 2001  | 4,967,212<br>(100)  | 1,793,509<br>(36.1)  | 454,222<br>(9.1)   | 450,921<br>(9.0)   | 337,209<br>(6.7)   | 214,524<br>(4.3)   |
| Total | 39,903,597<br>(100) | 18,160,724<br>(45.5) | 3,272,068<br>(8.2) | 3,017,833<br>(7.6) | 2,976,414<br>(7.4) | 1,893,462<br>(4.7) |

Source: *China Statistical Yearbook* (Beijing: National Bureau of Statistics). Data for 1991 from the 1993 issue, pp. 648-49; for 1992-93, from the 1994 issue, pp. 528-29; for 1994-95, from the 1996 issue, pp. 598-99; for 1996-97, from the 1998 issue, pp. 639-41; for 1998-99, from the 2000 issue, pp. 606-08; for 2000, from the 2001 issue, pp. 604-06; for 2001, from the 2002 issue, pp. 630-32. Percentages are the author's calculations.



Table 4.25 identifies the major sources of the actually used foreign direct investment (FDI) and other investments in China for the period of 1991-2001. Prior to 1998, the National Bureau of Statistics lumped the “actually used FDI and other investments” together with “foreign loans,” and called them “actually used foreign capital.” This research delineates these two categories for analysis and does not include foreign loans. Table 4.25 shows that, in terms of actually used FDI plus other investments, Hong Kong was the most important source of foreign investment in China throughout the 1990s. Hong Kong contributed almost half of all the foreign investment in China for many years during the decade. Up to this point Hong Kong has been left out in the research on China’s foreign trade, because Hong Kong mainly serves as an entrepot between China and the world rather than directly trading with China itself. Data would show a huge volume of trade between China and Hong Kong, and if these data were taken at face value, Hong Kong would be one of China’s most important trade partners (see Appendix Table I). This research does not include Hong Kong for comparison in the section on trade, but will now include Hong Kong for a comparison of major investors in China. Because Hong Kong possesses great financial strength, is on China’s doorstep, and does not feel threatened by China, it becomes the natural leader in investing in China.<sup>25</sup>

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<sup>25</sup> Before 1997, Hong Kong was not part of China, and its investment in China was considered as FDI by China. After 1997, China continues to regard Hong Kong’s investment as FDI, and this is shown in *China Statistical Yearbook*, which after 1997 continues to list Hong Kong’s investment as foreign investment. This measure is similar to the measure that flights departing for Hong Kong at Chinese airports are considered international flights, and passengers depart from the international gates. Table 4.25, which records major sources of FDI flows to China from 1991 to 2000, simply follows the Chinese government’s classification. Hong Kong is a separate customs territory and its government declares: “Transactions and assets and liabilities vis-à-vis the mainland of China are treated as international transactions...Examples of international transactions are trade in goods, trade in services, and external factor income flows.”

Table 4.25 shows that, in terms of the total amount of actually used foreign investment in China for the period of 1991-2001, the United States is the second most important investor in China, Japan is the third, and Taiwan is in the fourth position, although it does not really lag far behind. But there is a big gap between Taiwan and Hong Kong. For example, in 2001 Hong Kong contributed 36.1 percent of the actually used—i.e., not contracted—foreign investment in China, Taiwan's share was only 7.4 percent. From 1991 to 2001, Hong Kong accounted for 45.5 percent of the realized amount of foreign investment in China; Taiwan contributed only 7.4 percent. Hong Kong's share was six times that of Taiwan. But in 2001 Hong Kong's population was only 6.5 million while Taiwan's population was 23 million, or three times larger than that of Hong Kong's. This means that Hong Kong's per capita investment in China was about 20 times that of Taiwan.<sup>26</sup>

FDI aside, from 1991 to 1997 China received US\$14.4 billion of foreign loans from Japan, US\$3.6 billion from the United States, US\$2.7 billion from Hong Kong, and US\$407 million from Singapore. This made up about one-third of China's foreign loans for that period. During the same period, Beijing received no foreign loans from Taipei.

The comparison between Singapore and Taiwan is revealing. In 2001 Singapore's population was merely 4 million but its investment in China equaled 64 percent of Taiwan's investment in China for the same year. In 1999, Singapore and

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<sup>26</sup> According to a World Bank report, some "Chinese enterprises established affiliates in Hong Kong so that they could invest in China as foreign firms, thereby taking advantages of tax and other incentives." See World Bank, *China Engaged: Integration with the Global Economy* (Washington, DC: World Bank, 1997), 26. It is difficult to know how many Chinese firms have done this, as well as the magnitude of such a problem. Given that this problem does exist, the Chinese government could have overstated Hong Kong's investment in China, because some of this investment was Chinese in origin. Taiwanese firms do not have to pretend to be Hong Kong firms because they have already enjoyed benefits for foreign firms. It is also not known how many Hong Kong and Taiwanese firms have invested in China through the British Virgin Islands, a tax haven.

Taiwan made almost the same amounts of investment in China; and in 1998 Singapore's share was even larger Taiwan's. In per capita terms, from 1991 to 2001, Singapore's investment in China was much larger than that from Taiwan. Other than the ratio, a researcher must bear in mind that Singapore is in Southeast Asia and far away from China, and Taiwan is in East Asia and much closer to China. Although in most cases distance does not matter for portfolio investment, it does make a difference for FDI because factories must be set up, managers must be sent, and supplies must be shipped. Freight cost and travel time matter in the calculation. Of course, multinationals from economic superpowers invest in almost every corner of the world. But regional actors tend to invest in nearby regions, as the example of Vietnam below reveals.

While Taiwan was a distant fourth behind Hong Kong in investing in China, its investment in Southeast Asia, as noted above, occupied a prominent position. One example is Vietnam. According to Vietnamese statistics, from 1988 to 1999, Singapore contributed the largest accumulated amount of foreign investment in Vietnam, and Taiwan brought in the second largest amount. The importance of Taiwanese investment to Vietnam can be seen from the fact that Taiwan was *not* a distant second to Singapore; it was just slightly behind Singapore (see Table 4.26). In 1999, Taiwan was just behind France—Vietnam's former colonial master—and Korea in investing in Vietnam (see Table 4.27). The importance of Taiwanese investment to the economy of Vietnam can only be greater, not smaller, than the importance of Taiwanese investment in China. If we have to use the term economic interdependence or economic dependence, it seems that Vietnam is more dependent on Taiwanese investment than China is.

Table 4.26. Foreign Direct Investment Projects Licensed in Vietnam,  
1988-1999: Top 10 Investors

|                        | Number of Projects | Total Registered Capital<br>(US\$millions) |
|------------------------|--------------------|--------------------------------------------|
| Total                  | 2,800              | 37,088.4                                   |
| Singapore              | 238                | 5,867.4                                    |
| Taiwan                 | 458                | 4,592.2                                    |
| Hong Kong              | 306                | 3,612.5                                    |
| Japan                  | 270                | 3,360.6                                    |
| Korea                  | 266                | 3,149.3                                    |
| France                 | 149                | 2,136.2                                    |
| British Virgin Islands | 87                 | 1,737.8                                    |
| Russia                 | 62                 | 1,519.1                                    |
| US                     | 108                | 1,308.9                                    |
| UK                     | 38                 | 1,179.0                                    |

Source: Adopted from General Statistical Office, Socialist Republic of Vietnam, *Nien Giam Thong Ke 1999 (Statistical Yearbook 1999)* (Hanoi[?]: Statistical Publishing House, 1999), table 140 on pp. 248-249.

Table 4.27. Foreign Direct Investment Licensed in Vietnam, 1999  
Selected Countries (Territory)

|                     | Number of Projects | Total Registered Capital<br>(US\$millions) |
|---------------------|--------------------|--------------------------------------------|
| Total               | 312                | 1,568.3                                    |
| France              | 13                 | 303.4                                      |
| Korea               | 31                 | 176.3                                      |
| Taiwan              | 93                 | 171.6                                      |
| Malaysia            | 7                  | 161.9                                      |
| Singapore           | 15                 | 151.6                                      |
| British West Indies | 1                  | 143.5                                      |
| US                  | 17                 | 119.2                                      |
| Japan               | 14                 | 62.1                                       |
| Hong Kong           | 17                 | 41.6                                       |
| China               | 24                 | 29.8                                       |

Source: Adopted from General Statistical Office, Socialist Republic of Vietnam, *Nien Giam Thong Ke 1999 (Statistical Yearbook 1999)* (Hanoi[?]: Statistical Publishing House, 1999), table 143 on pp. 253-254.

Note: Taiwan's MOEA data showed that Taiwan approved an amount of US\$110.07 million of investment for Vietnam in 1998, and another amount of US\$34.56 million in 1999.

Trade and investment aside, Beijing and Taipei do not seem to have much cooperation in such areas as scientific and technological research, contracted construction projects, or labor service—these are indicators of the qualitative aspect of economic interdependence. Based on available data, Table 4.28 selected five economies for a comparison.

Table 4.28. China's Five Cooperation Partners, 1998-2001 (value in US\$1,000)

|      |                     | Hong Kong | Singapore | Macao  | Korea  | Taiwan |
|------|---------------------|-----------|-----------|--------|--------|--------|
| 2001 | Total               | 188,254   | 117,984   | 20,244 | 22,709 | 12,503 |
|      | Contracted Projects | 169,976   | 51,104    | 6,411  | 527    | 239    |
|      | Labor Cooperation   | 18,133    | 66,878    | 13,797 | 22,032 | 12,258 |
|      | Design Consultation | 144       | 2         | 36     | 150    | 6      |
| 2000 | Total               | 225,006   | 120,818   | 22,128 | 21,633 | 12,353 |
|      | Contracted Projects | 202,782   | 65,421    | 9,789  | 37     | 446    |
|      | Labor Cooperation   | 22,099    | 55,344    | 12,329 | 21,552 | 11,875 |
|      | Design Consultation | 125       | 53        | 10     | 44     | 32     |
| 1999 | Total               | 219,212   | 101,864   | 24,932 | 16,740 | 14,112 |
|      | Contracted Projects | 196,653   | 53,085    | 11,824 | 148    | 2      |
|      | Labor Cooperation   | 22,468    | 48,732    | 13,084 | 16,582 | 13,978 |
|      | Design Consultation | 91        | 47        | 24     | 10     | 132    |
| 1998 | Total               | 201,726   | 92,446    | 26,584 | 10,391 | 11,379 |
|      | Contracted Projects | 182,677   | 58,916    | 13,033 | 53     | 465    |
|      | Labor Cooperation   | 18,773    | 33,526    | 13,379 | 10,324 | 10,834 |
|      | Design Consultation | 276       | 4         | 172    | 14     | 80     |

Source: *China Statistical Yearbook* (Beijing: National Bureau of Statistics, 2000-2002), pp. 614-615 in 2000 issue; pp. 612-613 in 2001 issue; and pp. 638-639 in 2002 issue.

Of the five selected economies, four are Chinese societies, and all but Singapore are in the East Asian region. The reason for selecting these economies is that ethnic and cultural variables can be held constant; and that Korea, which is not a Chinese society, is added in order to serve as a hard case. Geographical proximity as a variable can largely be held constant except for Singapore, which is in Southeast Asia, but Singapore's distance makes it a hard case. The numbers in Table 4.28 represent China's earnings from these partners. Contracted project refers to contracts won by China to build projects in these economies or for these economies. "Service [labor] cooperation with foreign countries refers to the activities of providing technology and labor service to employers or contractors in the form of receiving salaries and wages."<sup>27</sup> "Overseas design and consultation refers to projects with charges for technical services from overseas operations. It includes geographic and topographic mapping, geological resources prospecting and survey, planning of construction areas, provision of design documents and blueprints...as well as engineering, technical and economic consultation, and feasibility study, research and evaluation of projects."<sup>28</sup> A closer look at Table 4.28 discovers that (1) Taiwan ranked last among the five cooperation partners in terms of the money involved in this area of cooperation, (2) Hong Kong, Singapore, and Macau have a great deal of cooperation with China in the area of contracted projects, and in labor cooperation, and (3) Taiwan has very little cooperation with China in the area of contracted project, and has concentrated in the area of labor cooperation.

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<sup>27</sup> *China Statistical Yearbook 2001* (Beijing: National Bureau of Statistics, 2001), 618.

<sup>28</sup> *Ibid.*, 619.

A major reason for the small number of contracted projects to be built by mainland companies in Taiwan, or for Taiwan, is because Taiwan has restricted migrant workers from the mainland.<sup>29</sup> In Hong Kong, it is not an uncommon scene to see huge Chinese engineering firms building infrastructure projects such as roads and land reclamation. But Taiwan has yet to welcome these firms to the island. The small number of contracted projects China had with Taiwan is likely to be the projects China built for Taiwanese employers and contractors on the mainland or elsewhere. Again, Singapore's economic cooperation with China apart from trade and investment is 10 times that of Taiwan. From 1999 to 2001, even Korea, a culturally and ethnically different state, had more economic cooperation with China in areas other than trade and investment as classified by China.

Currently, 310,000 foreign workers are employed in Taiwan. As of June 2000, approximately 59 percent of these workers were employed in manufacturing, and 13 percent were working in construction. The majority—about 140,000—were from Thailand. About 80,000 foreign workers, mostly from Indonesia and the Philippines, were employed in the nursing and care-taking sectors. Another 70,000 foreign maids, mostly from the Philippines, were employed as domestic helpers.<sup>30</sup> However, few of these migrant workers are from China (see Table 4.29).

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<sup>29</sup> Some mainland fishermen wait for jobs from Taiwanese bosses on “floating hotels,” that is, boats off Taiwan's coast. They work as helpers for Taiwanese fishermen. The floating hotels are subject to hazards such as typhoons, fire, and congestion.

<sup>30</sup> *Republic of China Yearbook 2001* (Taipei: Government Information Office), 342.

Table 4.29. Foreign Workers in Taiwan, 2000

| Country              | Percent |
|----------------------|---------|
| Indonesia            | 18      |
| Philippines          | 35      |
| Thailand             | 45      |
| Vietnam and Malaysia | 2       |

Source: Council of Labor Affairs, June 2000; quoted in *Republic of China Yearbook 2001* (Taipei: Government Information Office, 2001), 343.

Apart from the flows of goods and capital, a flow of personnel including managers, engineers, and workers should also be in place if two economies are really interdependent. But in the past decade, owing to Taiwan's restrictions on travelers from the mainland, Taiwan received more foreign visitors from other countries than from China (see Table 4.30). During the period from 1987 to 2000, the total number of arrivals in Taiwan from the tiny city-state of Singapore was larger than those from the Chinese mainland. Nationals from the large countries such as Japan and the United States, and from the middle powers such as Indonesia, Thailand, and the Philippines in the region made more trips to Taiwan than PRC citizens did. Mainland tourists are not allowed into Taiwan up to this moment. Taipei began to allow PRC citizens who have permanent residency in a third country or are studying abroad, to visit the island in 2002, provided that they come in a group of five or more and stay for not more than 10 days.<sup>31</sup>

<sup>31</sup> "Removal of Travel Restrictions to Foster Good Will," *Taipei Journal*, November 30, 2001, p. 6.



Table 4.30. Foreign and Mainland Visitors to Taiwan, 1987-2000, by Selected Countries  
(number of arrivals)

|       | Mainland | Japan      | US        | Thailand  | Singapore | Philippines | Indonesia |
|-------|----------|------------|-----------|-----------|-----------|-------------|-----------|
| 1987  | 28       | 794,537    | 215,884   | 27,252    | 56,347    | 32,856      | 26,183    |
| 1988  | 381      | 909,044    | 214,581   | 23,624    | 61,302    | 34,152      | 26,395    |
| 1989  | 4,838    | 962,545    | 219,046   | 21,350    | 59,573    | 28,981      | 26,361    |
| 1990  | 7,520    | 914,750    | 221,201   | 21,266    | 59,207    | 29,564      | 25,764    |
| 1991  | 11,074   | 825,420    | 224,182   | 23,739    | 61,962    | 26,863      | 22,780    |
| 1992  | 13,134   | 794,237    | 243,022   | 33,416    | 63,739    | 28,709      | 22,247    |
| 1993  | 18,343   | 696,431    | 248,942   | 88,985    | 59,810    | 52,981      | 33,984    |
| 1994  | 23,562   | 816,665    | 266,115   | 114,613   | 69,259    | 69,468      | 38,489    |
| 1995  | 42,634   | 907,338    | 273,606   | 146,632   | 69,665    | 89,490      | 45,857    |
| 1996  | 58,010   | 911,777    | 277,236   | 120,089   | 77,642    | 104,525     | 50,505    |
| 1997  | 72,346   | 900,714    | 293,681   | 121,534   | 81,356    | 112,844     | 54,092    |
| 1998  | 90,626   | 822,817    | 300,753   | 127,987   | 86,695    | 120,543     | 47,415    |
| 1999  | 106,699  | 823,799    | 311,995   | 137,664   | 85,569    | 120,319     | 76,424    |
| 2000  | 117,125  | 914,884    | 356,535   | 132,998   | 94,691    | 83,137      | 106,787   |
| total | 566,320  | 11,994,958 | 3,666,779 | 1,141,149 | 986,817   | 934,432     | 603,283   |

Source: Figures for Mainland from *Cross-Strait Economic Statistics Monthly* (Taipei: MAC), no. 101, January 2001, p. 36; figures for all other countries from the *Statistical Yearbook of the Republic of China 2001* (Taipei: Directorate-General of Budget, Accounting and Statistics, 2001), pp. 230-231.

## V. Conclusion

In the past few years, some Taiwanese scholars have carried out research on Taiwan's "high" economic dependence on China amid the government's claim that a worry looms large for Taiwan because its trade dependence on the mainland is rising.<sup>32</sup> But what is high and what is low? One thousand dollars can be a large amount and at the same time a small amount of money. It is true that in recent years, Taiwan shipped 17 percent of its total exports to China and one-third of its outward investment flowed to China. However, as shown above, these are parts of the indicators that do not tell the whole story. Absolute figures can be misleading if they are not put into a comparative perspective. By comparison, Taiwan depends on Japan and the United States for trade more than it depends on China; Taiwan buys more goods from Japan and the United States than it buys from China; Taiwan sells more goods to the United States than to China; and, as far as the "realized" amount of investment is concerned, Taiwan lags behind Hong Kong, the United States, Japan, and sometimes Singapore as an investor in China. However, the implications of trading with China have captured the imagination of government officials and scholars alike, and questions have been raised on what is the acceptable level of trade with China.<sup>33</sup> Talks on the "rising" trade dependence rate with

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<sup>32</sup> See, for instance, Tse-kang Leng, "A Political Analysis of Taiwan's Economic Dependence on Mainland China," *Issues & Studies* 34, no. 8 (August 1998): 132-154. Leng tends to think that China's embargo against Taiwan would not work. The government's claim can be found in the *Republic of China Yearbook*, various issues; see, for example, p. 168 of the 1999 issue.

<sup>33</sup> Suisheng Zhao reported discussions on what was the acceptable level of economic interdependence from *Zhongyang Yibao* (Central Daily News, Taipei), June 3, 1994, p. 7; and *Taiwan Shibao* (Taiwan Times), September 2, 1994, p. 1. See Zhao, "Economic Interdependence and Political Divergence," in *Across the Taiwan Strait*, ed. Suisheng Zhao (New York: Routledge, 1999), p. 39 (footnote 25).

China and its political implications have led to the impression that such a rate is alarmingly high, when in fact it is low.

What kind of economic ties between Beijing and Taipei can be considered close? There are two answers to this question, one from the mainland and one from Taiwan. The mainland side has never expressed worry over trade dependence on Taiwan, and the mainland is unlikely to see any level of cross-Strait trade and investment as exceedingly high. Because China's GNP and trade figures are quite large and rapidly increasing, its economic transactions with Taiwan defined in terms of proportion to these figures will always remain low. The answer to the question will be more meaningful if it is sought from the Taiwan side because it is Taipei that has expressed worry over trade dependence on China. It seems that any criterion by Taipei to judge the level of cross-Strait economic cooperation—such as the 10 percent “warning line” for export dependence—can only be nominal and depends on the situation of cross-Strait relations. Because the Taiwanese government has vigorously regulated the island's economic transactions with China according to its perception of risk and its judgment of cross-Strait ties, trade and investment across the Strait have been hindered by politics and have not reached a level they should reach under normal conditions.

What should that level be under normal conditions? As mentioned earlier, in the three-year period of 1946–48, Taiwan exported 90 percent of its goods to the mainland and imported 90 percent of the goods it needed from there. But Taiwan is now a mature economy with global business activities, so it is unrealistic to expect such dependence rates. Also, one should not at this moment expect the level to resemble the close trading ties between Canada and the United States or between Mexico and the United States

because a free trade area does not exist between Taiwan and China. But there is no reason to believe that cross-Strait trade cannot come close to that between Canada and the United States once a similar free trade area is created. True, Taiwan is a modern economy, but so is Canada. At present, it seems fair to suggest that cross-Strait trade should come close to that between Singapore and Malaysia to call it economic interdependence. It also seems fair to suggest that Taiwan's trade dependence on China reaches the level Japan had with China in the nineteenth century to call it some sort of economic dependence. To call it economic interdependence, trade defined as a percentage of GNP should come close to 15 percent of the GNPs on both sides—or at least on the Taiwan side—of the Taiwan Strait (i.e., Waltz's suggestion, which of course is nominal). To be fair, if Taiwan cannot rival Hong Kong as an economic partner of China, at least it should not be outperformed by Singapore in trade, investment, and other areas of cooperation with China if cross-Strait ties are to be described as economically interdependent.

A question remains to be answered. Would it not be possible that business disputes have limited cross-Strait trade? In other words, the independent variable could be business disputes rather than political conflict. For example, if there is no business dispute between Singapore and China but a lot of business disputes between Taiwan and China, one may expect these disputes to affect trade flows and investment, thus the lack of business dispute between Singapore and China explains their closer commercial ties.

But there is no evidence to suggest that the level of business dispute is higher between Beijing and Taipei. In fact, Singapore has a lot of grievances about its investment in the Suzhou Industrial Park (SIP), a flagship project in Sino-Singaporean

economic cooperation. Eager to help China to modernize itself, Singapore signed an ambitious agreement with China in 1994 to build a 70 square kilometer township in Suzhou near Shanghai. The agreement promised support for Singapore in building the park and would allow Singapore to pass on its experiences in the running of a modern town and management of an industrial area to Suzhou, which would relay the experiences to the rest of China. However, “major problems cropped up when there was a tug-of-war for investment between SIP and a rival park, the Suzhou New District (SND) promoted by the Suzhou municipal authorities.”<sup>34</sup> Singapore tried to persuade the Chinese side to freeze the SND for five years, so that both sides could devote attention to the SIP. “The Chinese demurred.” Eventually, a disappointed Singapore signed a Memorandum of Understanding with Beijing significantly to scale down its commitments to the SIP, and to cut Singapore’s stake in the park from 65 to 35 percent by 2001, while China would increase its stake from 35 to 65 percent. Singapore would build an eight square kilometer section of the park, which would then serve as a reference model for the 70 square kilometer site. “Singapore was unhappy because it was not getting the kind of attention which it thought it was assured. What it got was considered to be unfair tactics.”<sup>35</sup> Singapore’s Senior Minister Lee Kuan Yew even “voiced his frustrations publicly” in December 1997, and Chinese President Jiang Zemin promised that the SIP would receive priority over other projects, but, as Professor Lee Lai To at the National University of Singapore observed, there are “lessons to be drawn” from this unhappy cooperation.<sup>36</sup>

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<sup>34</sup> Lee Lai To, “The Lion and the Dragon: A View on Singapore-China Relations,” *Journal of Contemporary China*, vol. 10, no. 28 (2001), 421.

<sup>35</sup> Ibid.

<sup>36</sup> Ibid.

Thus, there is no reason to believe that the level of business dispute is lower between Singapore and China. Business disputes cannot be the independent variable explaining the level of cross-Strait economic ties, because they exist between China and Singapore, and between China and Taiwan. One can even argue that Singapore has more unhappy experiences than Taiwan in investing in China because one seldom hears about similar complains from Taiwanese investors. What does not exist between Singapore and China is a similar political conflict, which affects cross-Strait economic cooperation.

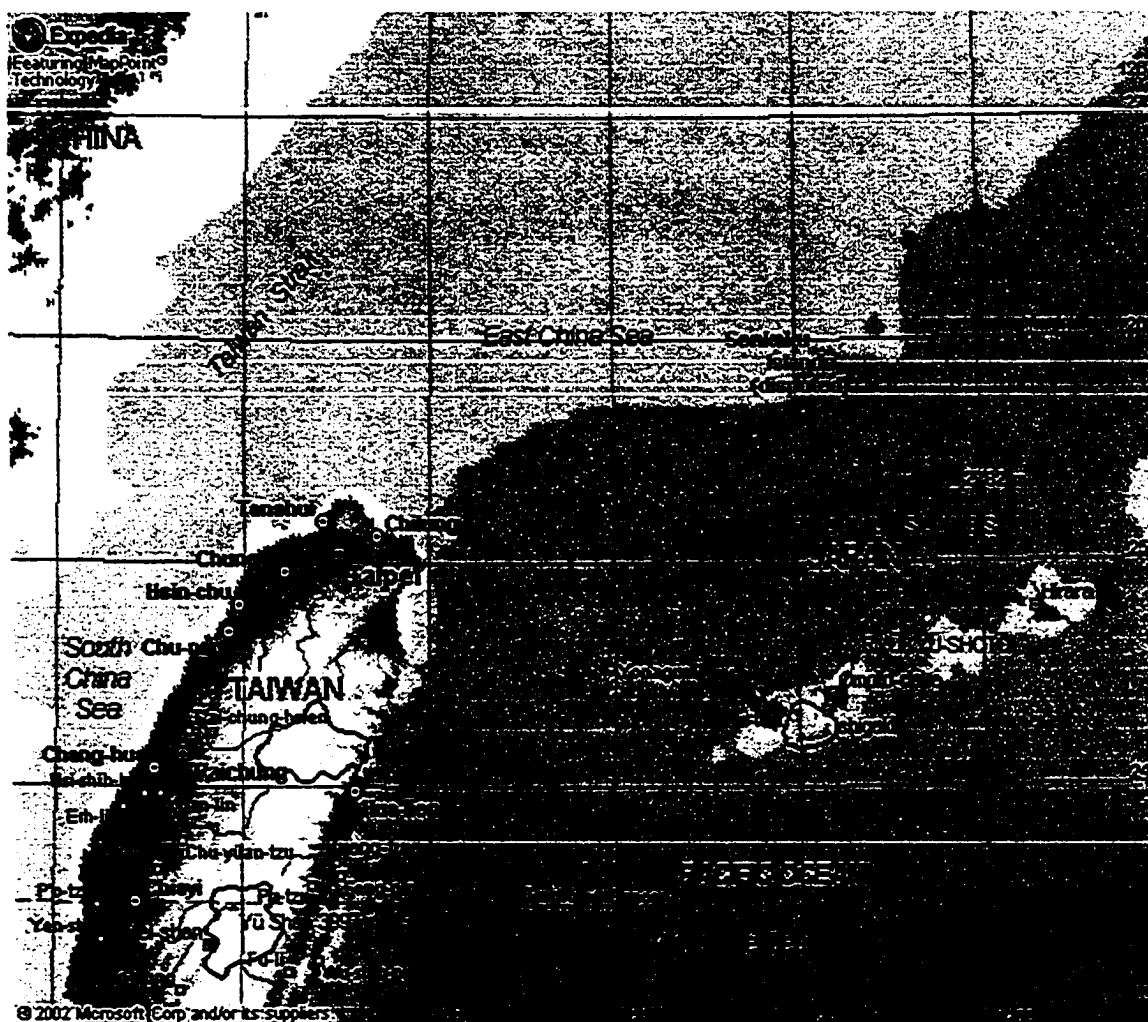
There can be no doubt that politics have gotten into the way of business. Without looking at a map to locate the Japanese island of Ishigaki, a researcher cannot imagine how ridiculous the indirect route of cross-Strait travel can be (see Map 4.1). Shanghai is perpendicularly to the north of Keelung. To go there from Keelung via Ishigaki, a foreign-registered cargo ship must first sail around the north tip of Taiwan, head south and then east for more than 150 miles, then turn back to Shanghai, which is now further in the north and in the northwest. Despite the inconvenience, Taipei refused to back off, hoping that the mainland would bend first and accept some of its political demands in return for direct shipping links. More than 100,000 Taiwanese visit Fujian province's Meizhou island (about 150 miles to the west of Taipei) each year to pay tribute to Mazu, at a century-old temple. The peak season for such pilgrimages is in March. As pressure mounted in January 2000, an official from the Ministry of Transportation and Communications insisted that pilgrims would be allowed to take foreign-registered ships across the Strait, but these ships must "leave from Kaohsiung to go to Fujian province via Hong Kong, or they can also depart from Keelung and sail via Ishigaki Island in Japan."<sup>37</sup>

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<sup>37</sup> "Pilgrims to China can escape ban on direct shipping," *Taipei times*, January 8, 2000.

Those unwilling to go this zigzag way can either travel illegally on fishing boats or spend a day flying to Meizhou via Hong Kong or Macau. The loss of time and money again testifies to the effects of politics on economics.

Map 4.1. Taiwan and Ishigaki



Source: Expedia Map of Taiwan.

Note: Chilung is Keelung. Also, the Chinese call “Senkaku Islands” Diaoyu Tai, which they consider as Chinese territory.

Macau is more convenient than Hong Kong because passengers from Taiwan can continue their flight to other destinations on the mainland in the same plane, provided that the aircraft lands in Macau and the flight number is changed.<sup>38</sup> Passengers can sit or walk inside the terminal when their aircraft prepares for the flight onto the mainland. In a trial of strength between the two sides of the Strait, aircraft keep landing and taking off when they should not, consuming a lot of fuel for political reasons. In September 2002, among the foreign visitors to Macau, 127,097 were Taiwanese and 15,648 were Japanese.<sup>39</sup> Given Japan's economic strength, large population, and reputation as an important source of tourists, there is no way the Japanese can be outnumbered by the Taiwanese. The only possible explanation for the much larger number of Taiwanese is that many of these Taiwanese are not tourists but transit passengers who used Macau to enter the mainland. The reason is because (1) Macau is the most convenient place for Taiwanese to enter China, for it has more connecting flights to various destinations on the mainland, in addition to the flexible arrangement just mentioned; and (2) it is on the doorstep of the Pearl River Delta region, where many Taiwan-funded factories are located, and Taiwanese business people can walk across the Macau-mainland border to board a bus or taxi to their factories.

In the early 1990s, because there was no direct telecommunication across the Strait, indirect telecommunication was made mostly via the AT&T exchange network on

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<sup>38</sup> Hong Kong Trade Development Council, "Implications for Hong Kong: If There Are Direct Links between the Chinese Mainland and Taiwan," Economic Forum paper, July 2000, at <http://www.tdctrade.com/econforum/tdc/000701.htm> (accessed November 13, 2002).

<sup>39</sup> See Macau government's Web site at [www.macautourism.gov.mo/index\\_cn.htm](http://www.macautourism.gov.mo/index_cn.htm) (accessed November 13, 2002). The accumulated total of Taiwanese visitors to Macau from January to September 2002 was 1,180,596; that of Japanese was 122,616.



the West Coast of the United States.<sup>40</sup> This arrangement cost Taiwan and China some US\$20 million each in fees to third parties.<sup>41</sup> In 1996, the director-general of telecommunications in Taiwan proposed laying a fiber-optic cable across the Strait, and Ralph Clough expressed support for the idea during a meeting with Lee Teng-hui, pointing out that such a cable would save money and would be the least risky way to create a symbolic link between Taiwan and China. “Lee’s response was that indirect telecommunication didn’t cost much.”<sup>42</sup>

Given all these restrictions and the lack of direct transportation links, it would be surprising if a high degree of cross-Strait economic interdependence really existed. Between Beijing and Taipei, economic cooperation takes place amid political competition, leading to a lot of waste. The price of a bad political relationship is a far-from-ideal economic relationship. There is good reason to believe that, removing the concrete embodiments of the conflict, such as the lack of direct transportation links and Taipei’s restrictions on mainland goods, and putting in their places the arrangements that are characteristics of a good political relationship, such as an investment protection agreement, would greatly increase the level of cross-Strait economic cooperation.

To conclude, hypothesis 1 is tested and proved to be correct. The hypothesis is restated as follows: *A zero-sum political conflict exists between Beijing and Taipei, and it has seriously affected their positive-sum economic cooperation.*

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<sup>40</sup> Zhan, 2.

<sup>41</sup> Clough 1999, p. 45.

<sup>42</sup> Ibid.

## Chapter 5

### The Effects of Economics on Politics

How can the authorities in Taiwan be called the Chinese Government? They can't. Nothing could be more reasonable than the "one country, two systems" arrangement.

— Deng Xiaoping told Kuok Hock Nien, owner of the Malaysian conglomerate Kuok Brothers, September 1990

We absolutely cannot accept Beijing's unilateral imposition of its "one China" principle or "one country, two systems" formula. It is regrettable that China insists on this ideology as a precondition and then time and again boycotts the formal resumption of cross-strait consultation.

— Chen Shui-bian told Harvey Sicherman, president of Foreign Policy Research Institute, circa January 2003

Imagine how fierce the war would be once it erupts in Taiwan, which is only 36,000 square kilometers in size and has a concentration of the world's most advanced weapons.

— Luo Yuan, Academy of Military Sciences, April 2001

This chapter answers an important question: Have trade and investment muted the conflict? If economic exchanges have pacifying effects, a closer political relationship between Beijing and Taipei should have emerged as a result of a decade and a half of such exchanges. This closer political relationship can be seen if Taipei and Beijing cooperate more and argue less. In concrete terms, Beijing and Taipei are judged to have

a closer political relationship if they can carry out a sustained dialogue leading to the settlement of differences at higher levels, if they can compromise on subsidiary principles that are derived from broad political principles, if they can agree on some form of political association, if their external policies become compatible, if their security policies become less hostile, if the exchanges narrow the social gap between the two societies, and if current political events no longer block economic cooperation.

To determine if Beijing and Taipei have developed a closer political relationship as a result of their economic ties, the research compares current events with the events in 1987, the year when Taiwan approved indirect trade with China. The purpose of the comparison is to see if there is any improvement in their political relations. Some specific aspects of the political relationship are needed for the comparison, and they are selected on the basis of their comparability. Political negotiation, for example, is one aspect. If the comparison finds that there is an impasse in political negotiation now as it was 15 years ago, no improvement of political ties can be deduced from this aspect. Seven specific aspects of the Beijing-Taipei political relationship are selected for a comparison: (1) progress in political negotiation, (2) willingness on both sides to bend rules, (3) the ability to agree on future politico-economic association, (4) compatibility in external policies, (5) the degree of hostility in security policies, (6) social and perceptual gaps, and (7) the effects of current political events on economic cooperation. As mentioned in Chapter 1, seven empirical questions will be posed and the answers to which serve as indicators of relations. The seven empirical questions are:

1. Can both sides carry out a political negotiation?
2. Have both sides compromised on matters of principle?
3. Can they agree on any form of political and economic integration?
4. Are their policies becoming more compatible in the international arena?
5. Is there an arms buildup on either side?
6. Are the social and perceptual gaps between the two societies narrowing?
7. Do current political events affect development of economic ties?

Based on the empirical evidence presented below, this chapter argues that the economic cooperation between the two sides of the Taiwan Strait has not softened the position of either side. In other words, it has not helped to resolve their conflict. The reasons are two: (1) the political conflict is difficult to resolve, and (2) the level of economic interdependence is too low to have an effect. Regarding the second point, I do not want to speculate on what is the effective level of economic interdependence for muting the conflict, but I do want to illustrate that politics, *defined as the process by which both sides try to outmaneuver the other in the conflict*, is the dominating factor in cross-Strait ties. If economics were the dominating factor in cross-Strait ties, it would have led to a reduction of the conflict.

The theoretical assumption of liberalism about the pacifying effects of trade has already been noted in Chapter 1. To examine this assumption, this chapter treats cross-Strait economic cooperation as the independent variable, and the conflict between the two sides as the dependent variable. The purpose is to detect the muting effects of trade and investment. The economic variable is conceptualized as cross-Strait trade and investment

since the late 1980s. Table 5.1 sums up this variable. The current state of political relations between Taipei and Beijing, which is the subject matter of this chapter, is examined against the background of this variable.

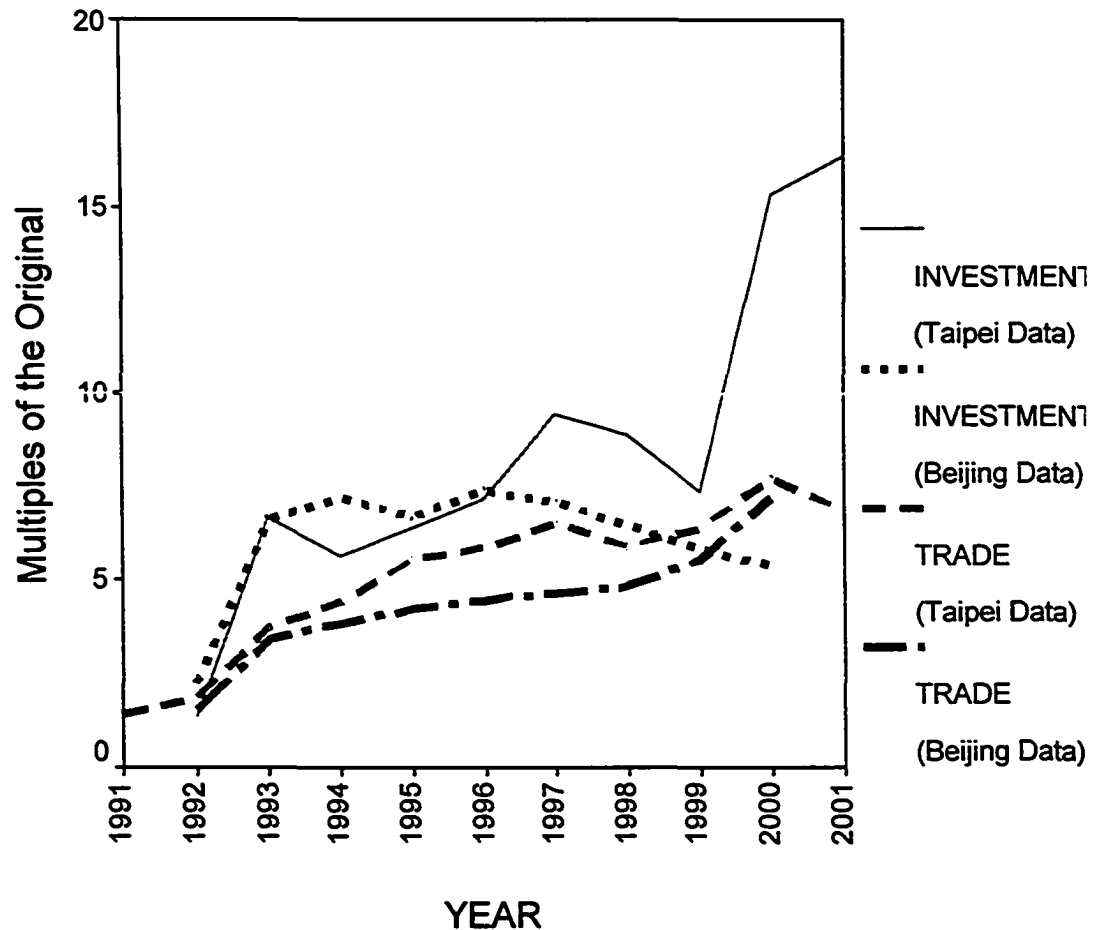
Table 5.1. Cross-Strait Trade and Investment, 1990-2001 (US\$billions)

|      | Trade        |               | Taiwanese Investment in China  |                                 | Chinese Investment in Taiwan |
|------|--------------|---------------|--------------------------------|---------------------------------|------------------------------|
|      | China's Data | Taiwan's Data | China's Data (utilized amount) | Taiwan's Data (approved amount) |                              |
| 1990 | ...          | 4.04          | ...                            | ...                             | Negligible                   |
| 1991 | 4.23         | 5.79          | 0.47                           | 0.17                            | -----                        |
| 1992 | 6.55         | 7.40          | 1.05                           | 0.24                            | -----                        |
| 1993 | 14.39        | 15.09         | 3.13                           | 1.14                            | -----                        |
| 1994 | 16.32        | 17.88         | 3.39                           | 0.96                            | -----                        |
| 1995 | 17.88        | 22.52         | 3.16                           | 1.09                            | -----                        |
| 1996 | 18.98        | 23.78         | 3.48                           | 1.22                            | -----                        |
| 1997 | 19.83        | 26.37         | 3.34                           | 1.61                            | -----                        |
| 1998 | 20.49        | 23.95         | 3.05                           | 1.51                            | -----                        |
| 1999 | 23.47        | 25.83         | 2.75                           | 1.25                            | -----                        |
| 2000 | 30.53        | 31.25         | 2.53                           | 2.60                            | -----                        |
| 2001 | ...          | 27.84         | ...                            | 2.78                            | -----                        |

Source: Data for 1990-2000 from Appendix Table I, Appendix Table II, Table 3.07, and Table 4.25; data for 2001 from *Cross-Strait Economic Statistics Monthly* (Taipei: Mainland Affairs Council), no. 113, January 2002.

Table 5.1 shows that cross-Strait trade increased by approximately seven times from 1990 to 2001. Regarding investment, Taiwan's data show that the approved amount of China-bound investment in 2001 was 16 times the amount in 1991 (the large increase is related to a zero starting point). China's data show that the utilized amount of Taiwanese investment in 2000 was more than five times the figure in 1991 (see Figure 5.1). Has the increase in trade and investment improved political relations? The answers to the seven empirical questions will show the degree of correlation between economic exchanges and political relations.

Figure 5.1. Growth of Cross-Strait Trade and Taiwan's Investment in China, 1991-2001



### I. Can Both Sides Carry Out a Political Negotiation?

Despite the increase in trade and investment, both sides have failed to engage in a political negotiation, and there is also an absence of political dialogue, which can be conceptualized as a lower level of talks. There was no political negotiation in 1987 when Taiwan tacitly approved indirect trade with China, because Taipei wanted “no contact, no negotiation, no compromise” with Beijing—the “three nos” policy, and the “period of

mobilization for quelling Communist rebellion” was not ended. Similarly, there is no political negotiation in 2002; that is, 15 years after the indirect trade began.

While Beijing insisted on party-to-party talks and Taipei refused such talks before it received the recognition of an equal government on Taiwan, official talks between the two sides were impossible. On March 19, 1991, Taipei established an unofficial dialogue body, the Straits [sic] Exchange Foundation (SEF), to negotiate with the mainland on various issues arising from growing commercial contacts. The SEF receives private donations and government funds; since its founding, it has been headed by Koo Chen-fu, a billionaire and once a Central Committee member of the Kuomintang (KMT). The SEF is supervised by the cabinet-level Mainland Affairs Council (MAC), which deliberates, makes, and oversees mainland policy. So far, the SEF remains the only unofficial body that is authorized by the government to negotiate with its counterpart from the mainland. Koo Chen-fu is assisted by a group of negotiators; among them is Shi Hwei-yow, the toughest SEF negotiator who had served as a district court judge in various parts of Taiwan before becoming the secretary-general of the Foundation.

On the mainland side, Beijing established the Association for Relations Across the Taiwan Strait (ARATS) on December 16, 1991, as a corresponding organization to negotiate with the SEF. ARATS is also an unofficial body and Wang Daohan, a former Shanghai mayor who was Jiang Zemin’s mentor before Jiang rose to power, heads it. Wang was assisted by a group of negotiators including Tang Shubei, the ARATS vice chairman who recently resigned. Although ARATS is Beijing-based, Wang prefers to stay in Shanghai.

From March 1991 to March 2003, SEF and ARATS held a total of 22 meetings, which included the 1993 Singapore meeting between SEF chairman Koo Chen-fu and ARATS chairman Wang Daohan, seven rounds of administrative talks and three rounds of secretary-general-level talks. However, owing to the substantial difference in positions on both sides, nothing substantive has come out of these meetings. The Singapore meeting resulted in four agreements dealing with matters such as document authentication, compensation for loss of registered mail, and provisions for consultations between SEF and ARATS officials. The seven rounds of administrative talks and the three rounds of secretary-general-level talks focused on technical matters such as repatriation of hijackers, illegal migrants, and fishing disputes. In May 1995, a meeting preparing for a second round of Wang-Koo talks decided that the two men should meet in Beijing on July 20, 1995. But Beijing postponed the meeting in June 1995 and fired missiles to waters near Taiwan in response to Taiwanese President Lee Teng-hui's visit to the United States. Meetings between the two organizations were halted for three years from May 1995 to April 1998. Taipei repeatedly called for dialogue, and Beijing agreed to resume talks in February 1998; two months later, an SEF deputy secretary-general traveled to Beijing to meet with ARATS officials.

In October 1998, Koo Chen-fu departed for Shanghai and Beijing for an "ice-breaking" trip. It was Koo's first visit to the mainland since the SEF was founded in 1991, and in the words of the Taipei government, "Koo became the highest-ranking negotiator from Taiwan to visit the mainland since the Chinese civil war divided the two sides of the Taiwan Strait in 1949." While in Shanghai, Koo met Wang Daohan, who agreed to visit Taiwan at an appropriate time. It was agreed during the meeting that the



two dialogue bodies would resume contacts and negotiations, and the two organizations should provide more assistance on matters concerning protection of the property and personal safety of visitors from both sides.<sup>1</sup> However, no significant breakthroughs were made on other difficult issues, and “nothing substantial has come out of that meeting, as Taiwan and the mainland have remained at a standoff over each other’s perception of the ‘one China’ concept.”<sup>2</sup>

Wang Daohan never made his trip to Taiwan, because in 1999 Leng Teng-hui told Deutsche Welle (a German radio station) that cross-Strait relations should be regarded as “state-to-state relations,” causing a strong response from Beijing. Beijing said that the foundation for talks was destroyed by Lee’s remarks, which were termed the “two states theory” and which contradicted the one-China principle. The mainland press also accused the SEF of endorsing Lee’s position. Hence, talks and contacts between the two dialogue bodies were suspended and had not been resumed as of March 2003.

In the words of a government publication in Taipei, “Eight years has gone by since that breakthrough [1993] meeting between Koo and the ARATS’s Wang Daohan, but the two sides of the strait are still in disagreement over fundamental issues,” and “Koo acknowledged that a lack of trust between the two sides remains a major obstacle to improved ties.”<sup>3</sup> In other words, trade and investment have not built trust between the two sides. At a Spring Festival party in 2002, Koo used a couplet to describe cross-Strait relations. It can be roughly translated as “warmth will come with spring, but the chill of

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<sup>1</sup> For a description of the SEF-ARATS interactions, see *Republic of China Yearbook 2002*, pp. 103-05, and the SEF’s website at [www.sef.org.tw](http://www.sef.org.tw).

<sup>2</sup> Myra Lu, “Koo Urges Mutual Understanding,” *Taipei Journal*, May 4, 2001, p. 1.

<sup>3</sup> Ibid.

winter remains.”<sup>4</sup> Koo said that the spring season for cross-Straits relations has not yet arrived, and he called for interactions between the SEF and ARATS to usher in that season. In April 2002, on the ninth anniversary of the first Wang-Koo meeting, Koo again urged Beijing to resume dialogue with Taipei. “The SEF chairman alluded to a phrase favored in Beijing, that politics should not interfere in cross-Straits economic affairs.”<sup>5</sup>

For some period in the early 1990s, the SEF was very much in the limelight. SEF officials frequently traveled across the Taiwan Strait for talks on technical matters, and for arranging several meetings with ARATS officials in Taipei. But the situation has changed since Beijing refused to talk in 1999. As Taipei’s *China Times* reported in December 2001: “Over the past three years, the SEF and ARATS have both gradually turned into nominal entities no one pays attention to. With relations between the two semi-official associations in limbo, as if reflecting the current state of cross-strait relations in general, the two bodies are filled with more utterances than interaction, and more guessing than goodwill.”<sup>6</sup> And as *Taipei Times* reported in February 2002, “It has been argued in some quarters that the two agencies have rendered themselves useless in the three years since they last held talks, although the range of exchanges between the two sides, and the numbers of people involved in such activities, continue to grow.”<sup>7</sup>

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<sup>4</sup> “Koo Chen-fu: Spring of Cross-Straits Relations Has Not Yet Arrived,” *Ming Pao*, February 20, 2002.

<sup>5</sup> Myra Lu, “SEF Chairman Koo Calls Beijing to Table,” *Taipei Journal*, May 3, 2002, p. 1.

<sup>6</sup> Don’t Waste ARATS, SEF,” *China Times* (Taipei), December 17, 2001, at [www.taiwanheadlines.gov.tw/20011217/20011217o1.html](http://www.taiwanheadlines.gov.tw/20011217/20011217o1.html).

<sup>7</sup> Lin Miao-jung, “Taipei Unimpressed after ARATS Opens an Office in Macau,” *Taipei Times*, February 5, 2002.

After Chen Shui-bian was elected president, Beijing repeatedly told Chen that cross-Straits dialogue could reopen as long as he recognizes the one-China principle, which says Taiwan is an inalienable part of Chinese territory.<sup>8</sup> Such an assurance from Chen is particularly important because Chen's party, the Democratic Progressive Party (DPP), has a political platform calling for Taiwan's independence. Chen has refused to accept the one-China principle as a precondition for talks, insisting that talks should be free of preconditions. Chen said that he is willing to discuss the "one China" issue but cannot accept the one-China principle as a prerequisite for talks.<sup>9</sup> This position is unacceptable to Beijing, for it implies that the status of Taiwan as a part of China is still unsettled.<sup>10</sup> Beijing wants to discuss the form of political association between the two sides, not the problem of whether Taiwan is a part of China or not.

Beijing urges the Chen administration to do two things before talks can begin: (1) recognize the "1992 consensus" and (2) accept the one-China principle. Actually, these two things are just one requirement, because the "1992 consensus" is a consensus that holds that both sides of the Taiwan Strait belong to one nation. Beijing insists that, during a Hong Kong meeting between ARATS and SEF in November 1992, the two sides reached a verbal consensus saying that both sides of the Taiwan Strait are parts of one China, while allowing each side to interpret what that China means (in such a situation, the mainland would say that China is the PRC, and Taiwan would say that China is the

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<sup>8</sup> "China Playing Waiting Game with Taiwan's Chen," AFP, April 4, 2000; Daniel Kwan, "Mainland Urges Chen to Declare Allegiance," *South China Morning Post*, April 11, 2000.

<sup>9</sup> "Taiwan President-elect Repeats Offer to Talk with China," AFP, May 5, 2000.

<sup>10</sup> At a forum on cross-Straits relations, held in Xiamen on May 10, 2000, ARATS Vice-Chairman Tang Shubian criticized Chen Shui-bian's suggestion that "one China is a topic for discussion." Tang said that "this implies that Taiwan's status is unsettled, and will thus create a new and big problem." Duowei news at <http://chinesenewsnet.com>, May 11, 2000.

ROC). Beijing said that because of this consensus, the 1993 Wang-Koo meeting was possible; that this consensus also provided a foundation for subsequent talks; and that denying the consensus meant destroying the foundation for talks.

After taking office, Chen denied the existence of the “1992 consensus.” Chen said that Shi Hwei-yow, secretary-general of the SEF, told him that the term was “invented” by a former member of the KMT government. Commentators believe that the official he referred to was Su Chi, a former MAC chairman. Chen said that since the “1992 consensus” did not exist, it would “impose a difficult task on” him if he were forced to admit its existence. Chen said he would admit the existence of cross-strait talks in 1992, but nothing more.<sup>11</sup>

Chen won the election on March 18, 2000, and took office on May 20, 2000. During this period, Su Chi “said Chen could suggest that both sides should adhere to the ‘1992 consensus.’”<sup>12</sup> Su made the suggestion in a speech he delivered on April 28, 2000, at a seminar jointly sponsored by the Chinese Europe-Asia Educational Foundation and the National Sun Yat-Sen University.<sup>13</sup> In that speech, titled “The Development of Taiwan and Cross-Strait Relations in the Twenty-first Century,” Su said that the “one China, with each side free to express its interpretation” formula was once the best way in dealing with the “one China” issue.<sup>14</sup> This formula “was agreed between Taipei’s Straits Exchange Foundation and Beijing’s Association for Relations Across the Taiwan Strait in

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<sup>11</sup> “Chen Expects Obstruction from China,” *Taipei Times*, November 11, 2001.

<sup>12</sup> “MAC Offers Proposal to End Cross-Strait Stalemate,” Central News Agency (Taipei), April 28, 2000.

<sup>13</sup> Ibid.

<sup>14</sup> Ibid.

1992's groundbreaking cross-strait talks."<sup>15</sup> However, Su "also noted that the formula has now been denied and dismissed by Beijing as simply Taipei's interpretation of the consensus, not Beijing's understanding of it."<sup>16</sup>

Huang Kun-huei, another former chairman of the MAC, also said shortly before Chen took office that the consensus reached in 1992—that there is "one China, with each side free to express their [sic] interpretation" of what that means—is a better way to handle cross-Straits relations. Huang explained to the press how the 1992 consensus was reached. He recalled that the Beijing delegation had been called back to the mainland due to differences in the definition of "one China" between the two sides, which were revealed at the Hong Kong conference. Meanwhile, the Taipei delegation was still waiting in Hong Kong for a response. Eventually, ARATS told SEF that the mainland had agreed on the "one China, free separate interpretations" formula, which was the only format acceptable to both sides. Huang suggested that Chen's government adopts this formula.<sup>17</sup>

It is difficult for an outsider to ascertain whether the "1992 consensus" really existed. The problem comes from the fact that the consensus, if it really existed, was verbal and not written down. Given the remarks by two former chairmen of the MAC, it seems that some form of common understanding did exist.<sup>18</sup> Of course, both Su and

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<sup>15</sup> Ibid.

<sup>16</sup> Ibid.

<sup>17</sup> "One China, Free Interpretation Formula Seen as a Better Way," Central News Agency, May 2, 2000.

<sup>18</sup> Former MAC vice chairman Lin Chong-ping also made remarks suggesting the existence of the "1992 consensus." On February 25, 2000, Lin said that Taiwan still agrees with Beijing that there is "one China," but the two sides should have the freedom to have different views about what that China is. See "Taipei Prepares Response to Beijing Threat," *South China Morning Post*, February 25, 2000.

Huang served under the KMT government, but that does not discredit their remarks. Nevertheless, the issue has now become an important and sticky one between the two sides. In retrospect, it seems unlikely that Beijing would agree if Taipei were to interpret China as the ROC, and thus Su's remark that Beijing once denied and dismissed the formula after giving its blessing could be true. But Beijing's denial and dismissal could also be taken to mean that it allows Taipei to interpret China its own way but denies and dismisses that interpretation—i.e., each side is free to interpret and at the same time free to dismiss the other side's interpretation. It could also be true that as Taiwan moved away from the "one China" position, Beijing became wary and would rather acquiesce to Taipei's interpretation than seeing Taiwan breaking off from that position.

Chinese Foreign Minister Tang Jiaxuan has scorned Chen, saying that he looks down on Chen because he "tells lies." Speaking to the Chinese-language media after delivering a speech to the United Nations General Assembly in November 2001, Tang was asked to comment on Chen's denial of the "1992 consensus," and was overheard by Taiwan's official Central News Agency as saying, "I very much despise him, because he cannot tell the truth; all his words are lies." Taiwan's foreign ministry was quick to respond, saying that Tang was "rude, unreasonable, and crude."<sup>19</sup>

Chinese Premier Zhu Rongji said that he "is not interested in Taiwan" if Chen does not change his cross-Strait policy.<sup>20</sup> Zhu made the remark during a visit to Indonesia in November 2001, and was implying that although both sides would join the

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<sup>19</sup> "I Look Down on Liar Chen, Says Tang," *HK-iMail*, November 14, 2001, at [www.hk-imail.com](http://www.hk-imail.com); and "Tang Jiaxuan Despises Chen Shui-bian Because He Lies," *Ming Pao*, November 13, 2001.

<sup>20</sup> "Zhu Rongji: Three Links Not Implied by WTO Membership for Both Sides," *Ming Pao*, November 10, 2001.

World Trade Organization (WTO) soon, talks on direct transportation links and other matters cannot be held if Chen does not accept the one-China principle.

In December 2001, Taiwan Affairs Office spokesman Zhang Mingqing on the mainland expressed hope of resuming cross-Straits talks at an early date, but insisted that acceptance of the one-China principle be a prerequisite. Zhang said that “the possibility of resuming dialogue is always there” and “we can talk at any time, but the key matter is that the Taiwan authorities refuse to accept the one-China principle.”<sup>21</sup> Earlier that month, the DPP won a major victory in Taiwan’s legislative elections, obtaining the largest number of seats in the Legislative Yuan and thus a strengthened mandate. Chen Shui-bian said that ultimately Beijing would have to negotiate with the DPP, not the KMT. But scholars in China generally predicted “the deadlock in negotiations across the Taiwan Strait to continue for at least another two years.”<sup>22</sup> That is, until Chen finishes his term. Fan Xizhou, director of Taiwan Research Institute at Xiamen University, said, “It is not realistic to expect there will be a great leap forward in cross-Straits economic exchanges until the two sides solve their political differences.”<sup>23</sup> Fan’s observation is different from the popular claims on rapidly expanding economic ties between the two sides, and is a major theme that this research will support.

In order to induce Taiwan to accept the one-China principle, Beijing has relaxed the definition of “one China” which read: There is but one China in the world; both the *mainland* and Taiwan belong to one China; and China’s sovereignty as well as territorial

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<sup>21</sup> Hu Qihua, “Taiwan Urged to Adhere to One-China Principle,” *China Daily*, December 27, 2001, p. 1.

<sup>22</sup> Pamela Pun, “No Great Leap for Cross-Straits Ties, Analysts Warn,” *HK-iMail*, December 5, 2001.

<sup>23</sup> *Ibid.*

integrity cannot be split. This definition was given by Vice-Premier Qian Qichen and came close to Taiwan's definition of one China during the KMT rule.<sup>24</sup> The definition is different from the previous one that says that there is only one China in the world, Taiwan is a part of China, and the PRC government is the sole legitimate government representing the whole of China. Major-General Wang Zaixi, deputy director of the State Council's Taiwan Affairs Office, said during a trip to Singapore in September 2001 that Beijing is even willing to discuss with Taipei such sensitive matters as the name, the national anthem and flag of the country after reunification.<sup>25</sup> Taipei, however, has not responded favorably; it complains that the PRC is saying one thing to Taiwan (i.e., the new definition) and another to the international community (i.e., the old definition).<sup>26</sup> Apparently, the effort to substitute geographic names (the mainland and Taiwan) for political ones (the PRC and the ROC) does not make the issue easier to resolve.

At a party to mark the ninetieth anniversary of the 1911 revolution, held in Beijing in October 2001, President Jiang Zemin once again urged Taipei to accept the one-China principle. Reiterating that the principle is the foundation for developing cross-Strait ties and realizing peaceful reunification, Jiang said the principle *could not be evaded or be ambiguous*.<sup>27</sup> At a tea party to usher in the New Year of 2002, Jiang called for more cross-Strait exchanges and said, "We will, on the basis of the *one-China*

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<sup>24</sup> William Philpott, "China Details Taiwan Unification Offer," *South China Morning Post*, September 10, 2001.

<sup>25</sup> Pamela Pun, "Timetable Needed for Reunification: Beijing," *HK-iMail*, September 1, 2001; Wang made the remarks to Singapore's Chinese-language newspaper, *Lianhe Zaobao* (United Morning Post).

<sup>26</sup> Deng Xiaoping said explicitly during a conversation with Dr. Winston Yang in 1983: "Only the People's Republic of China is entitled to represent China in the international arena."

<sup>27</sup> "Jiang Zemin Again Urges Taiwan to Accept 'One China' Principle," *Ming Pao*, October 10, 2001.



*principle*, continue to work towards an improvement of cross-Strait relations, and enhance the liaison and exchange of visits between people of the mainland and Taiwan.”<sup>28</sup> (emphasis added)

From Beijing’s perspective, talks on direct “three links” are welcome because more economic exchanges between the two sides will help to tie Taiwan’s economy to that of the mainland. But Beijing also wants Taipei to adhere to the one-China principle. An anonymous PRC official said in August 2001 that because Taiwan earns US\$20 billion a year in trade with the mainland, Taiwan needs the “three links” more than the mainland does, especially when the island is trying to find a way out of its economic downturn.<sup>29</sup> The official said that Beijing welcomes the “three links” but does not think it is an urgent matter, and that such links will benefit Taiwan more than they benefit the mainland. In Beijing, Taiwan Affairs Office spokesman Zhang Mingqing said in November 2002 that although the mainland sees some urgency for the “three links,” these links “bring absolutely greater benefit to Taiwan than to the mainland.”<sup>30</sup> The cancellation of the 1996 “no haste, be patient” policy by Taipei in August 2001 is, from Beijing’s perspective, to help Taiwanese businesses and economy rather than the mainland’s economy. Beijing sees cancellation of the policy as a sign that the Taiwanese government is under pressure from the business community and economic reality. Beijing thinks that, given more time, cracks will show under the feet of the policymakers

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<sup>28</sup> “Beijing Urges More Exchanges,” *China Daily*, January 2, 2002, p. 1.

<sup>29</sup> “Beijing Welcomes the Three Links But Sees No Urgency,” *World Journal*, August 25, 2001.

<sup>30</sup> *Oriental Daily News* (Hong Kong, in Chinese), November 28, 2002. Zhang made the remarks when commenting on Taipei’s insistence that chartered flights across the Taiwan Strait during the 2003 Chinese New Year holidays must stop by Hong Kong or Macau.

in Taipei, and they would be forced to accept the one-China principle as a precondition for talks on cross-Straits economic cooperation. Huang Jiashu, a professor with the Renmin University in Beijing, thoroughly deliberated such a view in a long newspaper column.<sup>31</sup> In January 2001, that is, eight months before Taipei abandoned its “go slow, be patient” policy, Huang had accurately sensed some changes. Huang observed that Taiwanese President Chen Shui-bian had a new explanation of the “go slow, be patient” policy. According to Huang, Chen started to claim that in the past the government had followed that policy because there was the need to do so, but in the future the government would see things from a new perspective, namely, “active opening and effective management.” Huang wrote:

Chen said: “Taiwan’s economic prosperity will face another round of difficult tests,” and “the government and the public must still have the best preparation for the worst possibility.” This pointed to the pressure exerted on him from the economic realm and from the industrial and business circles.<sup>32</sup>

Because Chen was under pressure, Huang reasoned that “to the Taiwanese authorities, the overall trend is clear: They have to recognize ‘one China’ sooner or later, and they may have more room to maneuver and obtain more gains if they do so sooner rather than later.”<sup>33</sup>

Of course, such a line of reasoning is valid if Taipei wants to talk. But if Taipei wants to keep Beijing at arm’s length, talks are not always welcome, and Chen’s

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<sup>31</sup> Huang Jiashu, “Dilemma for Chen: Cracks Showing Under the Feet of Taiwan’s Leader,” *China Daily (Hong Kong Edition)*, January 5, 2001, p. 9.

<sup>32</sup> *Ibid.*

<sup>33</sup> *Ibid.*

“difficulty” in recognizing the “1992 consensus” and the one-China principle provides an excuse to delay talks. What are the purposes of talks if Taipei wants to maintain the status quo or if the DPP intends to creep toward independence? Beijing’s insistence on the “1992 consensus” and the one-China principle may have given the shrewd politicians in Taipei a pretext to limit contacts. Steven Goldstein observes, “Indeed, one might argue that the specific intent of Taiwan’s pursuit of trade and contacts with the mainland has been to assure that it not lead to any broader relationship. Taipei has intended that such contacts maintain the illusion of forward motion in order to satisfy an expansive business community and keep the mainland at bay until such time as conditions improve.”<sup>34</sup> If this observation is correct, Beijing’s insistence on the one-China principle actually helped Taipei’s procrastination effort. Having said that, a researcher may ask if there is any way Beijing can back down.

Lee Teng-hui came to power in 1988 and Taipei began to adjust its policy of “no contact, no negotiation, no compromise” with Beijing. The SEF was created for unofficial contacts with the mainland because official contacts were not possible. Thereafter, Taipei proposed “two equal political entities” on both sides of the Strait as a preparation for negotiations on an equal footing. Some scholars interpreted Lee Teng-hui’s 1999 suggestion that cross-Strait ties are “state-to-state relations” as an effort to put Taipei on a par with Beijing for negotiations. Signs show that Taipei wanted to discard the policy of no negotiation. Taipei wanted talks if (1) these talks are conducted on an equal footing, (2) if Beijing renounces the use of forces against Taiwan, and (3) if Beijing

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<sup>34</sup> Steven M. Goldstein, *Taiwan Faces the Twenty-first Century: Continuing the ‘Miracle’* (New York: Foreign Policy Association, 1997), 72.

allows Taipei to have larger international space. These demands are unacceptable to Beijing, although it also wanted talks. The controversy arising from the one-China principle since Chen took office has complicated the issue and made it harder to arrange talks.

Comparing 2002 with 1987, an analyst would find that there is no political negotiation now as there was no political negotiation then. Despite the optimistic predictions by some scholars that trade and investment would bring the two opponents to the negotiation table and lay a foundation for political cooperation, this has yet to happen, and is unlikely to happen in the near future. The 1993 Wang-Koo meeting in Singapore was symbolic; the 1998 Koo-Wang meeting in Shanghai was perfunctory. Now, the controversy on the one-China principle is obstructing political talks. So far, cross-Strait trade and investment have not enabled them to begin a serious political consultation, which is not only an indicator of a closer political relationship, but is also an opportunity for compromises and breakthroughs that would result in a closer relationship.

## **II. Have Both Sides Compromised on Matters of Principle?**

On matters on political principle, neither side has shown flexibility or yielded to the other side. Beijing and Taipei have some broad political principles and some derivative, or subsidiary, principles to guide their dealings and association with each other, and these principles are identifiable and incompatible. On the mainland side, the broad political principles include:

1. Taiwan is a part of China, not a state.

2. There is only one China in the world.
3. The PRC government is the sole legal government of China.

The derivative principles corresponding to these broad principles are:

- 1a. Taiwan will become a Special Administration Region of the PRC.
- 2a. Cross-Strait affairs are domestic affairs (viewing them as international affairs would mean two Chinas)
- 3a. Talks to proceed on a party-to-party basis (talks on a government-to-government basis would imply two legal governments of China).

On the Taiwan side, the broad political principles include:

1. Taiwan (or the ROC on Taiwan) is independent and sovereign.<sup>35</sup>
2. China is a divided nation.
3. The ROC government is a separate and legitimate government.

The derivative principles corresponding to these broad principles are:

- 1a. Taiwan (or the ROC on Taiwan) cannot be a part of the PRC.
- 2a. Cross-Strait affairs are not simply domestic affairs.

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<sup>35</sup> Taiwan and the ROC have been interchangeably used by Taipei today. For example, when President Chen Shui-bian's wife Wu Sue-jen departed for a visit to the United States in September 2002, the government-run *Taipei Journal* reported: "Wu stressed that she would not bring up the subject of *Taiwan's* sovereignty dispute with China. However, if asked directly by U.S. reporters, she would state her conviction that *Taiwan* [note: not the ROC] is a sovereign nation. 'I don't need to keep repeating this. It's just like I don't have to keep emphasizing that I'm a woman,' Wu was quoted as saying." See "First Lady of the ROC Embarks on U.S. Visit," *Taipei Journal*, September 20, 2002, p. 1.

### 3a. Talks to proceed on a government-to-government basis.

Other subsidiary principles that are derived from one or more of the broad principles included: Beijing's refusal to renounce the use of force because it says the use of force is an internal matter on which it makes no promise to anyone; Taipei's insistence that any dealings with Beijing must not jeopardize its *de facto* if not *de jure* sovereignty; Beijing's idea of using the "one country, two systems" model to reunify the country; and Taipei's suggestion on forming a confederation that would consist of two equal states.

Although it would be an exceptionally stringent test to expect both sides of the Taiwan Strait to yield on broad political principles, it would still be reasonable to expect some flexibility at the technical level. Surprisingly, even the derivative principles are firmly held and there is no sign of wavering as a result of cross-Strait economic exchanges. The research examines two clashes of subsidiary principles in the economic realm to illustrate the deadlock.

First, Beijing's principle that Taiwan is a part of China represented by the PRC, and thus cross-Strait transactions are domestic affairs between a central and local government, clashes with Taipei's principle that the ROC is sovereign and equal. Economic ties do not soften these principles, which are embodied in the conflicting ideas for arranging direct shipping and air links. Before the DPP came to power, Beijing had said that it would talk with Taipei on a party-to-party basis; that is, the Communist Party of China (CPC) would talk with the KMT. But since the DPP came to power, this formula has not been workable, because Beijing refuses to talk to a party whose political platform enshrines independence. To get around the obstacle, Beijing suggests that direct

transportation links can be negotiated on a people-to-people, business-to-business, and company-to-company basis. This formula is copied from the agreement on aviation between Hong Kong and Taiwan—an agreement that was negotiated mainly between Hong Kong’s Cathay Pacific Airways and Taiwan’s China Airlines, with government officials acting as advisers. It is also modeled from the agreement on Hong Kong-Taiwan shipping links, in which Hong Kong ships entering Taiwan’s harbors fly the bauhinia flag (i.e., Hong Kong flag), and Taiwanese ships entering Hong Kong waters fly no flag. Taipei, however, prefers cross-Strait shipping and air links under WTO if not international rules.<sup>36</sup> It resents any arrangements that would dwarf its status as an independent, sovereign state or hint at the inapplicability of its governmental authority. The MAC in Taipei holds that agreements on important matters such as shipping and air links cannot be negotiated by private companies and should be negotiated through official channels or by the organizations authorized by the government, such as the SEF. But Wang Zaixi, deputy director of the Taiwan Affairs Office, said, “It is impossible for the two sides of the Taiwan Straits to conduct political negotiation on a government-to-government basis.”<sup>37</sup> The principle of no political negotiation on a government-to-government basis extends to no business negotiation on a government-to-government basis, the reason is because Taipei does not see itself as a local government, while talks between two central governments resemble state-to-state talks, which would contradict the one-China principle.

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<sup>36</sup> MAC chairwoman Tsai Ing-wen said on November 9, 2001: “We hope to negotiate the ‘three links’ issue with China under the WTO structure.” President Chen Shui-bian said on the same day that, “I hope both sides can use the WTO for cross-Strait economic exchanges and dialogue.” See Tsai Ting-I, “WTO Ideal for Talks on Links: Tsai,” *Taipei Times*, November 10, 2001.

<sup>37</sup> Wu Gang, “State-to-State Talks Not Suitable for Taiwan Question,” *China Daily*, September 14, 2001.

Regarding the use of the WTO framework to regulate cross-Straits ties, Taiwan Affairs Office spokesman Zhang Mingqing on the mainland explained that when both sides join the WTO, an opportunity arises for direct “three links,” but the WTO would not become the arena for discussions between Beijing and Taipei on the opening of these links, because these links belong to “internal affairs” across the Taiwan Strait, and thus it is impossible for the two sides to discuss these issues in the WTO framework.<sup>38</sup>

Second, economic benefits do not silence the political disputes that spread to the economic realm. The Asia-Pacific Economic Cooperation (APEC) forum belongs to the economic realm and deals with finance, wealth, and prosperity. Both sides of the Strait joined the APEC in 1991. China insists that Taiwan cannot join the international organizations that require statehood to join, but it does not oppose Taiwan’s participation in economic cooperation organizations such as the Asian Development Bank (ADB), the APEC, and the WTO, for reasons that will be analyzed in Chapter 6. The problem of Taiwan’s participation in APEC was solved when it was agreed—Taipei denied it had agreed—that Taiwan would send an economic official, not a political official, to attend the APEC summit. Under such an arrangement, Taiwan has sent its minister of economic affairs or chairman of the cabinet-level Council for Economic Planning and Development to the APEC summit, and Chinese President Jiang Zemin has met them and spoken to them. Despite his pragmatism, President Lee Teng-hui was displeased by being banned from APEC summits, and he called for a “natural meeting” of leaders from Beijing and Taipei “on international occasion.” Beijing turned a deaf ear to him, believing that

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<sup>38</sup> Wu Zhong, “Three Links ‘Outside WTO,’” *HK-iMail*, December 7, 2001; and “Mainland Accuses Chen of Creating New Conflicts,” *Ming Pao*, November 1, 2001.



admitting Lee Teng-hui to an APEC summit and including him for a photo-taking session with President Jiang Zemin would create an impression of two Chinas. Beijing says Chinese affairs should be handled by the Chinese themselves and there is no need to rely on international occasions. Furthermore, the APEC is an occasion for economic cooperation, not for political negotiation. Taipei tolerated the arrangement until 2001.

Chen Shui-bian took power in 2000; China became the host country for APEC in 2001; and Chen demanded participation in the APEC in Shanghai, which could hardly be an “international” venue for a meeting of the leaders from both sides of the Strait. When Beijing turned down Chen’s request, Chen wanted to send Li Yuan-tsu, a senior presidential advisor and former vice president, to Shanghai. Beijing was upset and refused to let Li Yuan-tsu attend the APEC forum. In Taipei’s own words, “Beijing claimed that this was an infraction of a tacit understanding dating back to 1991, which holds that high-level political officials may not represent the ROC at the meetings. According to this agreement, only officials with a background in economics can attend. Beijing cited Li’s lack of an economic background as their reason for withholding the invitation.”<sup>39</sup>

Insisting that Li should attend the APEC meeting, Chen said that Li, a former vice president under Lee Teng-hui, had retired for many years and could not create any political problem. Taipei was looking into the possibility of commissioning Li as a member of the Council for Economic Planning and Development, thus giving him the status of an economic official. Beijing, however, had made up its mind to ban Li,

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<sup>39</sup> Catherine Hsieh, “Taiwan Blocked from Informal APEC Meeting,” *Taipei Journal*, October 26, 2001, p. 1.

whatever economic portfolio he might hastily acquire. Thus, the APEC meeting began in Shanghai on October 20, 2001, without Taiwan's participation for the first time since 1991. In a flare-up at a preparatory APEC news conference moderated by Chinese Foreign Minister Tang Jiaxuan, Taiwanese Economic Affairs Minister Lin Hsin-I tried to explain Taipei's choice of Li Yuan-tsu but was cut short by Tang, who said it was "unnecessary to waste everyone's time" to discuss the issue. Tang's demeanor stunned many in Taiwan, who became furious and said Tang was rude and discourteous. But Tang blamed Taiwan for the problem. "The issue should not have become a problem. The fact that it has become a problem makes one wonder whether there is some political conspiracy involved" on the part of Taiwan.<sup>40</sup> Thus, for the first time that an APEC meeting was held on Chinese soil, Beijing and Taipei quickly turned the economic cooperation forum into a tug-of-war.

Chen Shui-bian said the mainland had no right to refuse Li Yuan-tsu. He refuted the rumors that if Li Yuan-tsu could go this time, Lee Teng-hui could go next time, and even he himself could go eventually, saying that such reasoning was ungrounded, excessive, and simplistic.<sup>41</sup> Noting that all the previous host countries had sent a special envoy to Taiwan to present an invitation letter, and Taiwan had sent a representative to attend the meeting, Chen said the mainland had breached the protocol by not sending any special envoy to Taiwan and not presenting any invitation letter.

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<sup>40</sup> Monique Chu and Lin Chieh-yu, "Cross-Strait Bickering at APEC Reaches Climax," *Taipei Times*, October 19, 2001.

<sup>41</sup> "Ah Bian: Mainland Has no Right to Refuse Li Yuan-tsu," *Ming Pao*, October 27, 2001.

With each side clinging to its principle, a compromise was not made even on a technical matter, that is, Taipei's representation at the APEC. Taipei preferred non-participation to heeding China's demand of sending another person—a surprising move that deviated from Lee Teng-hui's pragmatic diplomacy. Again, Beijing's principle that Taiwan is a part of China, not a sovereign state, clashed with Taipei's principle that as a sovereign state the ROC decides for itself. From Taipei's perspective, Beijing's inability to coerce Taiwan into doing a simple thing proves exactly that Taiwan is not subordinate to the PRC. Political principles clash, even in the realm of economic cooperation, rather than being melted by the promises of economic welfare.

Taipei refused to play by Beijing's rule in 2002. President Chen Shui-bian sent Lee Yuan Tseh, head of Academia Sinica, to the APEC meeting in Mexico. Lee was a Nobel laureate in chemistry in 1986 and had been a professor with the University of California at Berkeley before returning to Taiwan in 1994. Lee publicly endorsed Chen Shui-bian at the crucial moment of the presidential election in 2000, winning a lot of votes for Chen. Since then, Lee and Chen have been known to be close political allies. However, Lee has no economic background, and the sending of a chemist without economic portfolio to the APEC meeting in Mexico indicates that Taipei does not abide by the so-called tacit consensus, and that Taipei cares about its self-determination as much as it cares about economic cooperation. Beijing did not object Taipei's choice, but little warmth was seen between Jiang Zemin and Lee Yuan Tseh.

Of course, it is unimaginable that the economic benefits from cross-Strait commerce will someday result in Beijing's consent for Taiwanese independence. In the words of Chinese Premier Zhu Rongji, "We will by no means allow Taiwan to separate

from China,” and “that is an issue of principle, and we will never give in an inch in matters of principle.”<sup>42</sup> Chen Qimao, president emeritus of Shanghai Institute for International Studies, which is reported to have advised the Shanghai-based ARATS chairman Wang Daohan, explains why Taiwan must come back to China’s fold:

Taiwan was recovered from Japan only after China fought an eight-year war in which China sacrificed the lives of more than 20 million people and lost a tremendous amount of wealth. If Taiwan were allowed to achieve independence, then this would amount to the cession of China’s territory once again, which the Chinese people would never tolerate.<sup>43</sup>

Professor Chen also explains why the Beijing leadership cannot back down on the Taiwan issue or allow Taiwan to separate from China:

Any leader who is perceived to be soft on this issue and to have failed to protect sovereignty and territorial integrity would be regarded as “Li Hongzhang” [the Qing Dynasty official who in 1895 signed the Treaty of Shimonoseki which ceded Taiwan to Japan] and would be discarded by the people. From the perspective of the Chinese leadership and people, since October 1971 the international community has reached a consensus that there is only one China, that Taiwan is part of China, and the PRC is the only legitimate representative of China. Accordingly, the one-China formula has been established in international relations and this consensus and framework have been reinforced by the three Sino-American communiqués. The Chinese people regard these international frameworks as important achievements of the first- and second-generation PRC leadership. How could the third-generation leadership retreat from this position?<sup>44</sup>

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<sup>42</sup> Zhu made the remarks to Singaporean Prime Minister Goh Chok Tong when they met in Beijing in April 2000. See Daniel Kwan, “Mainland Urges Chen to Declare Allegiance,” *South China Morning Post*, April 11, 2000.

<sup>43</sup> Chen, 142. Chen framed the issue in a way as if China fought the war specifically to liberate Taiwan, not to passively resist Japanese aggression.

<sup>44</sup> Ibid.

Accordingly, Professor Chen's conclusion was that "the 1.2 billion Chinese people will never tolerate Taiwan's permanent separation from the motherland and will spare no blood to keep Taiwan a part of China."<sup>45</sup> However, on the other side of the Taiwan Strait, the profits from cross-Strait trade will not silence the voices of the advocates of Taiwanese independence. In March 2002, the World Taiwanese Congress, a pro-independence group serving as an umbrella organization for overseas Taiwanese, held an annual meeting in Taipei. President Chen Shui-bian, DPP chairman Frank Hsieh, and Lee Ying-yuan, secretary-general of the presidential office, attended the meeting, during which participants chanted "Republic of Taiwan."<sup>46</sup> Chen has tried to pose himself as a centrist since taking office, but his party refuses to amend its pro-independence platform. In short, the profits from trade do not seem to have an effect on firmly held principles.

But then, what are the imaginable effects of economics on the subsidiary principles? One may imagine that both sides would refrain from arguing about small matters, such as Taipei's representative at the APEC meeting, that do not really affect the broad principles. Taipei might open cross-Strait links as domestic links while seeing itself as the central government of the ROC that nominally encompasses the mainland. Beijing might open government-to-government dialogue with Taipei but still regard itself as the only central government of China. However, because the broad political principles are conflicting and zero-sum in nature (e.g., if Taiwan becomes a part of the PRC, Taipei's principle that the ROC is a sovereign state cannot be upheld; if Beijing accepts "phased two Chinas," its one-China principle must be amended as a goal and not as

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<sup>45</sup> Ibid., 151.

<sup>46</sup> "Chen Shui-bian Attends Meeting of Pro-Independence Group with Political Heavyweights," *Ming Pao*, March 18, 2002.

reflecting the reality), it would be difficult for cross-Strait economic cooperation to have a significant effect on them.

### **III. Can Both Sides Agree on Any Form of Politico-economic Integration?**

Beijing and Taipei cannot agree on any form of political integration resulting from their economic interactions. Beijing insists that “one country, two systems” is the only way to go ahead; Taipei objects and has proposed a cross-Strait confederation. In the economic area, the two sides have argued about the nature of cross-Strait transportation links, differing in opinions as to whether these links should be domestic, international, or special. Taipei wants an agreement to protect Taiwanese investments; Beijing says a domestic law is protecting them. Taipei boasts of the jobs and wealth generated by Taiwanese firms on the mainland; Beijing frowns at the relocation of “sunset industries” to the mainland—that is, the labor-intensive industries that cannot survive anymore in Taiwan—and prefers high-tech industries that do not cause environmental pollution.

The fact that economic interactions across the Strait do not bring about a closer political relationship between the two sides can be seen from the conflicting ideas for future association between the two sides. As noted earlier, Beijing formulated the “one country, two systems” policy almost two decades ago and is still upholding it. Taipei has refused to accept it, for it means a subordinate position for Taiwan. Lee Teng-hui has argued that the “one country, two systems” model that was initially formulated for Hong Kong, could not be applied to Taiwan, because “Hong Kong is a colony, but Taiwan is

where the Republic of China exists.”<sup>47</sup> Jia Qingguo, who teaches at Peking University, has written an article to explain the model’s applicability to Taiwan. Professor Jia wrote:

In theory, the solution offered in “one country, two systems” represents a win-win option for all. If it works well in Hong Kong there may be no reason why the parties involved will not accept it as a solution to the Taiwan problem...The only workable option to deal with this problem appears to be the concept of “one country, two systems.”...If the concept of “one country, two systems” works well in Hong Kong, views of the skeptics may well change.<sup>48</sup>

Professor Jia then explained why the model would work well in Hong Kong. He said that it is an all-win concept that caters to all parties’ interests, that Beijing has good reasons to honor its promise to stick to its policy of “one country, two systems,” and that if the policy fails, every major party will lose. Professor Jia listed the advantages of the model, which gives Taiwanese the security they want and at the same time allows them to keep their way of life. Apparently, Professor Jia’s view on the applicability of the model does not include a consideration for the absence of willingness on the part of Taiwan to take it. Research shows that only a small number of people in Taiwan think the model is applicable to the island. The MAC has commissioned several research agencies to conduct opinion polls, in which the respondents were asked: Is the “one country, two systems” formula applicable to solving the problems across the Straits? The results are presented in Table 5.2, which shows a consistently unfavorable view of the formula in Taiwan.

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<sup>47</sup> Quoted in Qingguo Jia, “Cross-Strait Relations after the Return of Hong Kong to Chinese Sovereignty,” in *Uncertain Future: Taiwan-Hong Kong-China Relations after Hong Kong’s Return to Chinese Sovereignty*, ed. C.L. Chou and Leong H. Liew (Brookfield, VT: Ashgate, 2000), 141.

<sup>48</sup> *Ibid.*, 146-147.

**Table 5.2. Taiwan Opinion Polls: Is the “One Country, Two Systems” Formula Applicable to Solving the Problems Across the Straits?**

| No (%) | Yes (%) | Date  | Number of Respondents | Survey conducted by |
|--------|---------|-------|-----------------------|---------------------|
| 74.1   | 7.7     | 01/91 | 1,067                 | C                   |
| 68.5   | 4.4     | 06/92 | 3,118                 | A                   |
| 78.9   | 9.1     | 01/93 | 1,067                 | C                   |
| 80.3   | 5.2     | 08/93 | 1,067                 | B                   |
| 78.8   | 4.7     | 10/93 | 1,067                 | C                   |
| 73.8   | 4.1     | 02/94 | 1,600                 | A                   |
| 84.5   | 7.8     | 03/95 | 1,067                 | C                   |
| 77.7   | 3.5     | 07/95 | 1,621                 | A                   |
| 76.0   | 6.5     | 02/97 | 1,610                 | A                   |
| 81.2   | 8.5     | 04/98 | 1,067                 | B                   |
| 76.7   | 9.9     | 05/98 | 1,122                 | D                   |
| 73.0   | 6.3     | 09/98 | 1,078                 | E                   |
| 76.4   | 8.7     | 10/98 | 1,107                 | E                   |
| 72.9   | 9.1     | 04/99 | 1,112                 | E                   |
| 87.2   | 10.4    | 08/99 | 1,067                 | C                   |
| 75.0   | 8.5     | 10/99 | 1,119                 | E                   |
| 78.8   | 9.8     | 02/00 | 1,067                 | B                   |
| 74.3   | 9.3     | 04/00 | 1,085                 | A                   |
| 83.7   | 12.2    | 05/00 | 1,067                 | C                   |
| 73.9   | 16.1    | 03/01 | 1,077                 | D                   |
| 70.4   | 13.3    | 07/01 | 1,100                 | E                   |
| 70.7   | 9.4     | 02/02 | 1,081                 | A                   |
| 69.9   | 10.4    | 04/02 | 1,091                 | A                   |

A=Election Study Center, National Chengchi University, Taipei

B=Burke Marketing Research Ltd., Taipei

C=China Credit Information Service, Ltd., Taipei

D=Center for Public Opinion and Election Studies, National Sun Yat-sen University, Kaohsiung

E=Survey and Opinion Research Group, Department of Political Science, National Chung-cheng University, Chiayi

**Respondents:** Taiwanese adults aged 20-69 accessible to telephone interviewers

**Source:** Mainland Affairs Council at <http://www.mac.gov.tw> (data prior to 2001 can also be found in *Republic of China Yearbook 2001*, p. 118)



On the issue of future political association with the mainland, Taipei does not have a model with the clarity and consistency coming close to Beijing's "one country, two systems." But it has suggested its own ideas, one of which is confederation, a system implying equal political status for both sides.

Shortly after being elected president, Chen Shui-bian expressed interest in a cross-Strait confederation. Chen said, "A confederation system (for China and Taiwan) is a breakthrough option. There is plenty of room for discussions—whether it is feasible or whether a consensus can be reached by the people here."<sup>49</sup> Vice-President-elect Annette Lu said when referring to Chen's comments on confederation that, "We have to think creatively, imaginatively and constructively."<sup>50</sup> But Beijing quickly rejected the idea, for it violates the one-China principle. A confederation is a system of loose political association that contains two or more sovereign states, neither of which is subordinate to the other. It is even looser than a federal system, which is characterized by a central government. It was reported that Jiang Zemin "specifically ruled out such an approach [i.e., a loose federal framework] in talks with Shen Junshan, the president of (Taiwan) Ching-hua University."<sup>51</sup> Beijing cannot accept federation, let alone confederation. However, that was the only time that Chen showed interest in the confederation idea, which has not been mentioned since he took office. Although Chen promised a "future one China" in his inauguration speech, the possible form of association between the two sides has not been deliberated, not by Chen and not by his party, the DPP.

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<sup>49</sup> "Taiwan President-elect Chen Open for Talks on Confederation with China," AFP, April 21, 2000.

<sup>50</sup> Ibid.

<sup>51</sup> Waldron, 337.

Since becoming the opposition party in 2000, the KMT has shown some interest in the confederation idea. Lee Teng-hui stepped down as KMT chairman after the KMT was defeated by the DPP in the 2000 presidential election, and Lien Chan became the chairman. In the early months of 2001, Lien, who holds a doctorate in political science from the University of Chicago, raised the confederation idea in his new book, *New Blueprint, New Dynamic*. In June, KMT members began considering the possibility of including the idea in the party's platform. National Policy Foundation (NPF), a KMT think tank, released a policy paper on cross-Straits confederation in July 2001, stressing that the model would be transitional as Taiwan and the mainland peacefully pursue eventual unification.<sup>52</sup> According to Su Chi, KMT heavyweight and NPF researcher, "the fact that members of a confederation traditionally retain their rights to exercise diplomacy and national defense, with each entitled to govern its internal affairs, makes the political grouping a good potential model for handling cross-Straits development."<sup>53</sup> Su explained that a confederation is neither a commonwealth nor a federation, and that "even though the two sides of the strait live under one roof as if it were, neither is a subordinate entity to the other."<sup>54</sup> The policy paper, to be submitted to the Sixteenth National Congress of the KMT in July 2001, stressed that the confederation idea would not lead to Taiwanese independence or a hurried unification. Meanwhile, the People First Party (PFP) "agreed with the KMT's phased approach to the confederation goal, maintaining that this integration model is only one of several options for cross-strait

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<sup>52</sup> Myra Lu, "Cross-Straits Confederation Idea Stirs Debate," *Taipei Journal*, July 13, 2001, p. 2.

<sup>53</sup> Ibid.

<sup>54</sup> Ibid.

development. The PFP remains open to unification into single nation or based on a European Union model, a federation or even a commonwealth.”<sup>55</sup> DPP Secretary-general Wu Nei-jen, however, warned that any policy that intends to change the status quo must have the consent of Taiwan’s people, and this applies to the KMT’s confederation policy.

Although Beijing has been courting the KMT since it became the opposition party, it flatly rejected the confederation idea, as well as other suggestions such as those by the PFP. Chinese Foreign Ministry spokeswoman Zhang Qiyue told reporters at a news conference on July 10, 2001, that “we do not approve of the so-called confederation model.”<sup>56</sup> Zhang said China would continue to insist on the “one country, two systems” formula it applied to Hong Kong when it resumed exercise of sovereignty over the territory in 1997, because that formula “fully protects national sovereignty and takes into account Taiwan’s history and current reality with a high degree of flexibility.”<sup>57</sup> Zhang said, “under the principle of one China, we are willing to hold a full exchange of views with political parties and individuals from Taiwan.” However, after pouring cold water on the idea, Beijing gave consolation to the KMT by noting that the idea marks a departure from the “two states theory” declared by Lee Teng-hui. Seeing that the confederation idea had not received a favorable response from Beijing, the KMT shelved the idea and did not include the policy paper in the Sixteenth National Congress agenda. A few months later, Vice-Premier Qian Qichen, China’s top Taiwan policy official, reiterated that “one country, two systems” was the only acceptable model for

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<sup>55</sup> Ibid.

<sup>56</sup> “Beijing Vetoes KMT Confederation Idea,” *China Daily (Hong Kong Edition)*, July 11, 2001.

<sup>57</sup> Ibid.

reunification.<sup>58</sup> The reason for Beijing to reject confederation is quite clear: It is essentially a “two countries, one system” model.<sup>59</sup> The two countries refer to the PRC and the ROC, and the one system refers to the confederation system. This contradicts the one-China principle. “No formula is better than peaceful reunification and one country, two systems,” and “nothing threatens peace and stability in the Taiwan Strait more than Taiwan independence,” Jiang Zemin told his audience which included former U.S. President George Bush and Chinese basketball player Yao Ming, in the George Bush Presidential Library at Texas A&M University during a visit in October 2002.<sup>60</sup>

In Taipei, the DPP has used its victory in the December 2001 legislative elections to argue that the people of Taiwan reject “one country, two systems.” *Taipei Journal*, published by the Government Information Office, carried an editorial to laud “the DPP’s impressive gains in the Legislature, where it now has the largest number of seats” and to explain that “the DPP victory and the devastating setback to some candidates was a big blow not only to the pro-unification camp but also to Beijing’s efforts to promote its ‘one country, two systems’ formula on the island.”<sup>61</sup> Commenting on the electoral results for different parties, DPP chairman Frank Hsieh said that while the DPP has become the largest party in the parliament, the New Party did not obtain 5 percent of the votes; and that because the New Party has advocated “one country, two systems,” it has failed to

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<sup>58</sup> William Philpott, “China Details Taiwan Unification Offer,” *South China Morning Post*, September 10, 2001.

<sup>59</sup> A term coined by this author.

<sup>60</sup> Gao Anming, “Jiang: Nation ‘Force for Good,’” *China Daily*, October 25, 2002, p. 1.

<sup>61</sup> “A Rebuff to Beijing’s ‘One Country, Two Systems,’” *Taipei Journal*, December 14, 2001, p. 6; see also “Voters Rejects ‘One Country, Two Systems’ Formula,” *Taipei Journal*, December 7, 2001, pp. 1-2.

win the hearts and minds of the people, who have therefore discarded it.<sup>62</sup> The defeat of the New Party was thus interpreted solely in terms of its mainland policy, which echoed Beijing's "one country, two systems."

Chen Shui-bian told visiting U.S. congressman Doug Ose in January 2002 that Taiwan's people would not accept "one country, two systems." Citing an article from the *Washington Post* on December 23, 2001, Chen compared Taiwan's December 2001 legislative elections with the election of the Chief Executive in Hong Kong that would take place in March 2002. The article said that just 16 percent of Hong Kong's seven million people support Hong Kong Chief Executive Tung Chee-hwa's decision, but only 800 people hand-picked by Beijing could vote, and that since Beijing has already announced that Tung "deserves another term," Hong Kong people have no say in the choice of their leader. Chen said that by comparing these two elections, it is clear that while Taiwan's people can choose their own leaders and legislators through the ballot box, Hong Kong people cannot, and that is why the people in Taiwan cannot accept the "one country, two systems" model as practiced in Hong Kong.<sup>63</sup>

Although it insists that the Taiwan issue be solved peacefully, the United States has rarely expressed its opinion on the form of future political association between the two sides. However, U.S. Secretary of Defense William Cohen said during a visit to Hong Kong that Hong Kong's status as an autonomous region of China is not necessarily a model for China to bring Taiwan back into its fold. Cohen said: "Hong Kong is a

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<sup>62</sup> "DPP becomes the largest party in the Legislative Yuan," *Ming Pao*, December 2, 2001.

<sup>63</sup> "Chen Shui-bian Uses Hong Kong as an Example to Refuse One Country, Two Systems," *Ming Pao*, January 10, 2002. See also "Two Elections," *Washington Post*, December 23, 2001, p. B6.

unique situation.” When further asked by reporters how Taiwan might be reunited with China, Cohen said, “I think the way in which Hong Kong has functioned under its relationship with China—the ‘one country, two systems’—is unique to it, and I don’t think it could be used as any kind of model for any other country.”<sup>64</sup> The Hong Kong government has a different view. Stephen Lam, the chief spokesman for Tung Chee-hwa, said that Hong Kong has had a positive experience in the three years since it returned to Chinese control. Lam said, “We hope this will be a model for our compatriots in Taiwan,” and “we would genuinely like to invite our compatriots in Taiwan to look at the situation in Hong Kong with an open mind.”<sup>65</sup>

None of the major parties in Taiwan has accepted Beijing’s “one country, two systems” model. Beijing, on the other hand, is not willing to consider other models. It is surprising to see that little flexibility has been shown on the issue of the possible form of political association between the two sides of the Strait. The economic ties between the two sides have not made it easier for them to agree on simple political matters, let alone political integration. As economic transactions grow, each side stands firm on its own political position.

It has been noted that Taipei and Beijing also differ in their views on cross-Strait economic integration. Their argument centers on the nature of their economic links. From Beijing’s perspective, those links are domestic; from Taipei’s perspective, they are neither domestic nor international, but special. Jeff Yang, deputy director of the department of legal affairs of the MAC, said that the government sees the relations across

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<sup>64</sup> “SAR Model Not Relevant to Taiwan, Says Cohen,” *South China Morning Post*, March 11, 2000.

<sup>65</sup> *Ibid.*

the Taiwan Strait as neither internal nor international—implying a special and ambiguous relationship that corresponds to the ambiguous interaction between the governments of the two sides.<sup>66</sup> Taipei has suggested that cross-Strait economic transactions be conducted under the WTO framework, but since the WTO framework is an international framework, Beijing opposes the idea.

Although Beijing does not want to define cross-Strait links as international, it has used the WTO framework to pressure Taiwan to open the “three links.” Foreign Trade Minister Shi Guangsheng once warned a Taiwanese business delegation that China would file a WTO complaint against Taiwan for failure to open the “three links.”<sup>67</sup> Taipei’s response was that WTO regulations do not explicitly cover shipping, air services, or postal transactions. However, Taipei opened the “mini three links” between Kinmen and Xiamen, and between Matsu and Fuzhou in January 2001. It could be a preemptive move, for Taipei could now argue that there are indeed direct links between the territories of the two sides. It turned out that only residents of the outlying islands and other authorized persons can go to the mainland from Kinmen and Matsu, which are not to be used as transit points for Taiwanese business people from Taiwan proper. In addition, “to protect national security,” Taipei adopted a quota system for mainland residents entering Kinmen and Matsu. Each day, a maximum of 700 mainland residents will be allowed to enter Kinmen and 100 to Matsu for commercial activities.

Beijing and Taipei did not have much coordination when the “mini three links” were opened. Both sides were talking to the other through the media. Beijing insists that

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<sup>66</sup> Lin Miao-jung, “Cross-Strait Relations Law to be Updated: MAC,” *Taipei Times*, June 26, 2002.

<sup>67</sup> “Editorial: WTO and ‘Three Links’ Not Linked,” *Taipei Times*, June 30, 2000.

the “three links” across the Taiwan Strait should proceed “under the one-China principle,” be “direct and two-way,” and be “mutually beneficial.” As ships from Kinmen and Matsu sailed into mainland harbors in their maiden voyages, even the top mainland news agencies in Hong Kong did not know whether mainland ships could sail to Kinmen and Matsu, and busily called Beijing’s ARATS for confirmation. The confirmation was given a few weeks later when a Xiamen ship sailed to Kinmen.

Finally, the fact that Taipei and Beijing disagree on the way to economic integration can be seen from Taipei’s repeated request for an agreement on protection of Taiwanese investments, and Beijing’s refusal by saying that there is already a domestic law to protect Taiwanese investments and therefore such an agreement is not necessary. Beijing also argues that if a cross-Strait agreement on investment protection was to be signed, it should be two-way, but since there is no mainland investment in Taiwan, there is no way to sign such an agreement. Beijing says that the State Council promulgated the “Regulations on Encouraging Investments from Taiwanese Compatriots” in 1988, a document that contains language on protection of Taiwanese investment. Regarding protection of Taiwanese investment, Article 8 of the document says: “The state does not nationalize the investments made by Taiwanese investors, as well as their assets.” Article 9 stipulates: “When the state, acting upon the need of public interest, takes over Taiwanese enterprises for use, equivalent compensation will be made according to law.” Article 10 states: “The legal profits and incomes obtained by Taiwanese investors, as well as their capital after settlement of account, can be remitted out of the mainland.” Article 15 guarantees that Taiwanese investors can run their businesses at their own



discretions. Article 20 says that when business disputes arise, either mainland or Hong Kong arbitrator can be invited to arbitrate.

To give the document legal status, the National People's Congress (NPC) Standing Committee approved and adopted the "Law on Protecting Investments by Taiwanese Compatriots" in 1994. This law is actually copied from the State Council's directive and serves to give the document greater legal importance. In 1999, the State Council promulgated the "Implementation Procedure for Protecting Investments by Taiwanese Compatriots." This document has 31 articles and reaffirms all the rights and privileges granted to Taiwan's investors in the previous two documents. In addition, Article 20 of the 1999 document reiterates that the assets of Taiwanese investors, their business ownerships and the profits they made from their investments can be transferred and inherited. Article 23 states that no organization is allowed to illegally appropriate money or manpower from Taiwan-funded enterprises, inspect Taiwan-funded enterprises, impose fines on Taiwan-funded enterprises, or compel Taiwan-funded enterprises to participate in training and assessment activities that are not required by law. Article 25 says that the state protects the freedom of person, as well as personal safety, of Taiwanese investors on the mainland. Article 29 says that other than mainland and Hong Kong arbitrators, Taiwanese arbitrators may be invited to arbitrate business disputes.<sup>68</sup> Beijing says that since these documents adequately protect Taiwanese investments, a bilateral agreement on protection of Taiwanese investment is not needed. From Beijing's perspective, since Taiwan is a province, there is no way such an agreement can be signed,

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<sup>68</sup> The Editorial Board of China's White Paper on Foreign Trade and Economic Cooperation, Ministry of Foreign Trade and Economic Cooperation, *zhong guo dui wai jing ji mao yi bai pi shu* (China's White Paper on Foreign Trade and Economic Cooperation 2000) (Beijing: Social Science Press House, 2000), 652-56.

as if to be signed by two signatories of equal governmental status, or be treated as an international agreement on protection of foreign investment.<sup>69</sup>

Fifteen years have passed since 1987, and Beijing and Taipei have no agreement on their future political association—not on technical aspects and not on broad principles. The two sides also haggle on the way in which cross-Strait economic integration should take place—should it be domestic, international, WTO, or special? Despite the development of economic ties, few compromises have been made, no agreement on future political integration has been reached, and no sign indicates that they can reach such an agreement in the near future.

#### **IV. Are Their Policies Becoming Compatible in the International Arena?**

Beijing and Taipei continue to fight each other in the international arena; their policies do not converge as a result of their economic ties. This can be seen in two major areas: (1) the two sides struggle in their efforts to persuade other countries to switch diplomatic recognition, and (2) Taiwan's attempt to join international organizations as a way to upgrade its international standing, and Beijing's objections. These two phenomena are briefly reviewed below, with a focus on recent events.<sup>70</sup>

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<sup>69</sup> Actually, Jiang Zemin mentioned in his 1995 eight-point proposal that, "on the premise of reciprocity and mutual benefits," both sides should negotiate and sign an unofficial agreement to protect Taiwanese investment. It is a hint that such an agreement is possible on condition that Taipei meets a series of Beijing's demands, such as allowing mainland investment in Taiwan.

<sup>70</sup> For a good account of Taiwan's diplomatic struggle in the early 1990s, see Murray Rubinstein, "Political Taiwanization and Pragmatic Diplomacy: the Eras of Chiang Ching-kuo and Lee Teng-hui, 1971-1994, in *Taiwan: A New History*, ed. Murray Rubinstein (Armonk, NY: M.E. Sharpe, 1999), especially pp. 462-65.

There was a sense of bitterness in Taipei when South Korea and South Africa switched their diplomatic recognition to Beijing in the 1990s. Taiwan was particularly angry at South Korea because it felt it was betrayed by South Korea, which switched diplomatic recognition to Beijing in 1992 without much warning. Taiwan and South Korea halted air links in 1992; since then, South Korea has been trying to persuade Taiwan to resume those links. But the sense of bitterness in Taiwan has prevented negotiations from reopening the air links. In the words of Lo Chih-cheng, executive director of the Taipei-based Institute for National Policy Research, “South Korea has deliberately downgraded official contacts with Taiwan and the status of official negotiators. It has been fussy about the wording of contracts (disallowing words relating to territory and sovereignty) and has been generally wary about China’s reaction as far as every aspect of Taiwan-South Korea relations is concerned.” Lo wrote, “On the one hand it [South Korea] exploits commercial benefits to the hilt, but in its diplomatic interactions, it stubbornly refuses to compromise. If negotiations are a ‘give and take’ exercise, then South Korea’s ‘take everything and give nothing’ attitude shows a bad-natured desire to have the whole pie.” Lo held that “aviation rights...are an extension of sovereignty to begin with,” and “if South Korea therefore believes, or simply pretends, that Taiwan’s sovereignty does not exist, then there is no possibility for the resumption of air links.”<sup>71</sup> South Korea complains that it is not getting a fair treatment because other countries, such as Japan, have no diplomatic relations with Taiwan but have air links.

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<sup>71</sup> Lo Chih-cheng, “South Korea Ignores the Facts in Air Links Issue,” *Taipei Times*, May 24, 2002. Lo’s article was translated by Scudder Smith and Francis Huang.

South Africa learned a lesson from South Korea's abrupt move. South African President Nelson Mandela announced in November 1996 that his country would establish diplomatic relations with Beijing in early 1998, and stressed the desire to keep close ties with Taipei. Mandela's announcement allowed a long period of adjustment for both Taipei and Pretoria. In such a transition period, Taipei could gradually come to terms with the reality, while arrangements for commerce and unofficial contacts after the switch of diplomatic recognition could be worked out.<sup>72</sup> In 1998, South Africa, the Central African Republic, Guinea Bissau, and Tonga established diplomatic relations with the PRC; and only the Marshall Islands, a microstate in the South Pacific, established official links with Taipei.<sup>73</sup>

Beijing was caught by surprise when Taipei successfully persuaded Macedonia—with promise of US\$1 billion of aid—to switch diplomatic recognition to Taipei in 1999. In retaliation, Beijing closed its embassy in Skopje and vetoed a UN plan to extend the mandate of a peacekeeping force on the Kosovo-Macedonia border—an arrangement Macedonia badly needed at that time.<sup>74</sup> Eventually, China proved too big to ignore, and Macedonia reportedly received only US\$20 million in direct investment and only US\$150 million in loans and technical assistance from Taiwan. In June 2001, Macedonia announced it would resume diplomatic relations with Beijing, causing a major diplomatic

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<sup>72</sup> Tun-jen Cheng cited Taipei's *Free China Review* (September 6, 1996) in complaining that South Africa's decision came only "three months after Vice-Premier Hsu Li-teh had led a delegation that finalized huge economic cooperation projects and obtained President Mandela's assurance not to abandon old friends while making new ones." Thus, there was still a sense of bitterness. See Tun-jen Cheng, "Taiwan in 1996: From Euphoria to Melodrama," *Asian Survey*, vol. 37, no. 1 (January 1997), 48.

<sup>73</sup> Jean-Pierre Cabestan, "Taiwan in 1998: an Auspicious Year for the KMT," *Asian Survey*, vol. 39, no. 1 (January/February 1999), 144.

<sup>74</sup> Beijing's reason was that funds should be spent on peacekeeping operations in Africa, where attention was urgently required.

setback for the Chen administration. Taiwanese Foreign Ministry spokeswoman Chang Siao-yue announced a split with Macedonia and accused Beijing of “coercing” Skopje. In response, Chinese Foreign Ministry spokeswoman Zhang Qiyue said that “the normalization has once again demonstrated that China’s sovereignty and territorial integrity is inalienable” and “any attempt and practice to split China will work to no avail.” Thus, in the mini-war of diplomatic recognition between the two sides, Taipei was once again defeated, left with egg on its face, and wasted US\$150 million.

On the same day that Chen Shui-bian assumed DPP chairmanship, Beijing dealt another blow to Taipei by announcing establishment of diplomatic relations with Nauru, which had had diplomatic ties with Taipei for 22 years. On July 21, 2002, Nauru’s President Rene Harris signed a joint communiqué with Chinese Deputy Foreign Minister Zhou Wenzhong in Hong Kong, saying Nauru recognized the PRC as the sole legitimate government of China and that Taiwan was part of China. Taiwanese Foreign Minister Eugene Chien was furious and accused Beijing of having promised around US\$140 million to Nauru in exchange for its switch of diplomatic recognition to Beijing. Chien said, “China played the cash game by offering over 100 million Chinese Yuan to a country 21 km in diameter, which is less than half the size of the Pudong International Airport in Shanghai and with a population as small as 10,000.”<sup>75</sup> Chien condemned China’s practice of what he termed “money diplomacy,” and asked: “While there are so many jobless people in China, doesn’t such an approach disregard the wellbeing of its people?” He said he found it unreasonable that China would spend such a huge sum of money to secure diplomatic ties with Nauru while it remains an aid recipient from

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<sup>75</sup> Monique Chu, “Nauru Faces Ultimatum on Relations,” *Taipei Times*, July 23, 2002.

countries such as Japan. Chien raised his voice when he said Taipei would not be dissuaded by Beijing's efforts to corner it. "We will never withdraw. We will advance vigorously. The Republic of China is a rose that cannot be flattened by pressure," Chien said, waving his hands as he made his remarks. When asked if what he meant was that Taipei was determined to add a new diplomatic ally in Nauru's place, Chien replied: "The public and the outside world will have to watch what we do."<sup>76</sup> Chien said he doubted the utility of the two sides engaging in this tug-of-war, although Taipei would not cease its efforts in the struggle. Beijing's willingness to use a huge sum of money to win over a tiny state in the South Pacific is a sign of determination and seriousness; it will isolate Taiwan when chances arise and means become available. At present, 27 states recognize the ROC, after Nauru is subtracted from the list.<sup>77</sup>

On August 3, 2002, that is, two weeks after Nauru cut ties with Taipei, Chen Shui-bian hit back with the remarks that there was "one country on each side" of the Taiwan Strait, and that holding a referendum on Taiwan's independence was a "basic human right."<sup>78</sup> Chen's move was apparently a protest and at the same time a warning to Beijing that it must not go too far in isolating Taiwan internationally, to the extent of depriving it of its diplomatic ties with an inconsequential country that would only have symbolic significance.

Beijing found it difficult to frame Chen's "one country on each side" of the Taiwan Strait as it had framed Lee Teng-hui's "two states theory" for an assault. Was it a

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<sup>76</sup> Ibid.

<sup>77</sup> For a list of these states, visit the Ministry of Foreign Affairs at <http://www.mofa.gov.tw>.

<sup>78</sup> Craig Smith, "A Distracted China Issues Censure of Taiwan Chief's Remark," *New York Times*, August 6, 2002, p. A4.

“one state theory” and if it was, should not Beijing welcome it after lashing out at the “two states theory”? Initially, Beijing seemed to take it as a protest rather than a major plot. A spokesman for the Taiwan Affairs Office of the State Council issued a statement denouncing Chen’s comments, saying that the comments would have ramifications for Taiwan’s economy. But on August 12, 2002, Shanghai tested its air raid defenses, making it clear that the potential adversary was Taiwan and warning that a move toward independence by the island would mean war.<sup>79</sup> It was Shanghai’s first air raid drill in the middle of the city since 1949, in which more than 1,000 people and 37 rescue teams took part.<sup>80</sup> The drill was conducted in Changling District, where many Taiwanese business people live and work. During the drill, the commander of Nanjing Military Region, which encompasses Shanghai, warned that Taiwan’s declaration of independence would mean war.

On another front, Beijing fiercely opposes any bid by Taiwan to join the international organizations that require statehood for membership. When President Clinton declared in Shanghai in 1998 that the United States would *not* support (1) independence for Taiwan; (2) “two Chinas” or “one China, one Taiwan”; and (3) membership for Taiwan in the international organizations that require statehood to join, Beijing hailed Clinton’s visit as a great success, and Taipei was dismayed. Some scholars interpreted Lee Teng-hui’s “two states theory” as a response to Clinton’s

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<sup>79</sup> “Shanghai Holds Air Raid Drill with Taiwan in Mind,” *South China Morning Post*, August 13, 2002.

<sup>80</sup> “Shanghai Holds Large-Scale Civil Defense Exercise,” *Ming Pao*, August 13, 2002.

remarks, and a measure to put Taiwan on an equal footing with China for any future negotiation.<sup>81</sup>

Judged from Taipei's recent diplomatic maneuvers, its policy is to walk into the limelight on the international stage, make the world aware of Taiwan's existence, and achieve a higher profile in world affairs through participation in four organizations: the WTO, the APEC, the World Health Organization (WHO), and the United Nations (UN). The disputes arising from Taiwan's manipulation of its WTO and APEC membership have already been noted. The tussle between the two sides resulting from Taiwan's bid to join the UN and the WHO will be reviewed below.

The ROC was a founding member of the UN, but it left the UN in 1971 when its membership was given to the PRC. Adhering to the one-China position, the KMT government initially refused to launch any effort to rejoin the UN, but the self-isolation resulting from that position was politically costly, because it reduced the legitimacy of the KMT government in the eyes of the people at home and abroad. The DPP had long advocated UN membership for Taiwan. Eventually, the two political parties reached a consensus on breaking out of international isolation, and Taiwan began its effort to join (or rejoin) the UN in 1993. Every year, Taipei would ask its diplomatic allies to urge the world body's secretariat to set up a working group to examine its case. China would strongly oppose, saying that such a move violates the one-China principle and is a plot to split Chinese territory and sovereignty. Beijing would point out that only sovereign states could join the UN, and Taiwan is not a sovereign state; therefore, the step taken by

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<sup>81</sup> Tien Hung-mao (ROC foreign minister from 2000 to 2001), "Taiwan's Perspective on Cross-Strait Relations and U.S. Policy," *American Foreign Policy Interests*, December 1999, pp. 13-19.



Taiwan's diplomatic allies tramples on the purposes and principles of the UN Charter. Taipei would argue that representation in the UN is the right of more than 20 million people in Taiwan. Drumming up support for Taiwan's 2001 bid to join the UN, Vice-Foreign Minister Wu Tzu-dan said, "the Republic of China on Taiwan is the only country in the world that remains excluded from the United Nations," and "the exclusion of the Republic of China from the United Nations and its related agencies has created major obstacles for the government and people" in Taiwan.<sup>82</sup> However, owing to Beijing's obstruction, the proposal was consistently killed at the Steering Committee discussion and failed to make its way to the General Assembly agenda.

Taiwan was not deterred by the continuous setback. Tien Hung-mao, the first foreign minister in the Chen administration, said that Taiwan would press on with its bid to join the UN although the odds of success in the short term are not in its favor. A former professor of political science at the University of Wisconsin, Tien described himself as a "pragmatist" and said that joining the UN is a long-term goal and "it would be unrealistic" to expect success in a year or two.<sup>83</sup> Again, Taipei was blocked by Beijing in 2000, but it launched another drive in 2001. Vice-Foreign Minister Wu Tzu-dan said Taiwan had a long way to go, but also noted that it had taken Beijing 22 years to return to the UN. Wu said, "We understand this requires prolonged efforts and cannot be achieved overnight," and "we need to persist with constant efforts."<sup>84</sup> Given the words from these officials, it seems that there is no end to this kind of struggle between Taipei

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<sup>82</sup> "Taiwan Tries Again for UN Seat," *HK-iMail*, August 10, 2001.

<sup>83</sup> "Taiwan Clings to UN Hopes," *AFP*, May 16, 2000.

<sup>84</sup> See footnote 67.

and Beijing, regardless of their economic ties. What worries Beijing was Wu's remark that Taipei wanted its own seat and had no intention to challenge China's UN seat, for that means exactly two Chinas in the international community.

Since 1997, Taiwan has opened another front in its campaign to upgrade its international standing through joining international organizations. Taipei wanted to join the WHO, a specialized agency of the UN. Taiwan's reason for joining the WHO is that, in the words of Health Minister Lee Ming-liang, WHO membership is very important to Taiwan because it will enable Taiwan to obtain the latest information on epidemics and other diseases.<sup>85</sup> Lee said Taiwan only wanted to obtain the observer status and had no intention to challenge the one-China principle. In May 2002, at a mobilization rally for WHO membership, Chen Shui-bian explained that WHO membership can provide the best medical care to the 23 million people in Taiwan, and allows Taiwan to give back to the international community what it has received in the past. Chen also noted that although it took Taiwan 12 years to join the WTO (Taiwan became WTO member in January 2002), he believes it will not take as long to join the WHO.<sup>86</sup> Nevertheless, Lee Ming-liang expected Taiwan to fail again in its bid to join the WHO in 2002, but he was optimistic in the long run. Lee said, "I hope to see our hard work eventually bear fruit in the near future."<sup>87</sup> Like the foreign ministry that has a long-term goal of joining the UN, the health department now has a long-term goal of joining the WHO.

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<sup>85</sup> "Lee Ming-liang: Taiwan Has the Right to Join the WHO," *Ming Pao*, February 10, 2002.

<sup>86</sup> Ko Shu-ling, "Chen Makes a Last Push for WHO Seat," *Taipei Times*, May 5, 2002.

<sup>87</sup> *Ibid.*

Taiwan even obtained the support of the United States and Japan shortly before the World Health Assembly (WHA)—the decision-making body of the WHO—met in Geneva in May 2002.<sup>88</sup> However, during the WHA meeting, six countries spoke in favor of Taiwan and 17 countries as well as the Europe Union spoke against it, apparently with Beijing in mind, and Taipei failed again in its bid to join the WHO.

Taipei resents Beijing's obstruction to its participation in international organizations and sees its economic and political interactions with Beijing in the following way: "Peking authorities voraciously absorbed capital and technology from their Taiwanese compatriots, while, at the same time sparing no effort to suppress Taiwan in the international community."<sup>89</sup> It is apparent that the external policies of the two sides have not become agreeable as a result of the development of economic ties. As Taipei continues to seek international recognition and Beijing continues to oppose it, conflict will not subside.

Beijing opposes official contacts between Taiwan and all other countries in the world, because it sees Taiwan as a renegade province, not a sovereign state that is entitled to such contacts. The ROC government in Taiwan sees itself as a central government that has every right to deal with other countries. These two principles clash. For example, after a powerful earthquake struck Taiwan on September 21, 1999, many countries that have no diplomatic relations with Taiwan sent rescue teams to the island. When the rescue work was done, Beijing thanked those countries on Taipei's behalf, and Taipei accused Beijing of "robbery when the house is on fire"—taking the opportunity to assert

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<sup>88</sup> Monique Chu, "U.S. Expresses Support for Observer Bid," *Taipei Times*, May 15, 2002.

<sup>89</sup> *Republic of China Yearbook 2000* (Taipei: Government Information Office, 2000), 163.

representation for Taiwan when Taiwan was in trouble. Beijing, on the other hand, condemned Taipei for engaging in “earthquake diplomacy”—it had used the terms “money bomb diplomacy” and “vacation diplomacy” to condemn Taiwan’s use of money to lure away its diplomatic allies and Lee Teng-hui’s meetings with leaders of Southeast Asian countries on the golf course. A more recent example is Beijing’s protest against the United States when the State Department issued a visa to Taiwanese Defense Minister Tang Yian-min in March 2002. Beijing had protested against previous meetings between U.S. and Taiwanese military personnel, but Tang was the first defense minister to obtain a visa since 1979. The State Department explained that Tang was invited to the United States by private arms suppliers to attend a private meeting. However, Tang met U.S. Deputy Defense Secretary Paul Wolfowitz during the meeting. Chinese Assistant Foreign Minister Zhou Wenzhong summoned U.S. Ambassador Clark Randt to express strong dissatisfaction and resolute objection, pointing out that the U.S. move had violated the three Sino-American communiqués and the one-China principle.<sup>90</sup>

Beijing opposes not only official contacts between Taiwan and other countries, but also “official” contacts between Taiwan and foreign banks. Credit Suisse First Boston (CSFB), an investment bank of the Zurich-based Credit Suisse Group, was cut out of a lucrative underwriting deal by Beijing in 2001, presumably due to sensitivities over Taiwan. CSFB angered Beijing by inviting senior Taiwanese officials to speak at conferences it sponsored earlier that year; it helped Taiwan hold an investment road show in which Taiwanese finance minister took part. Although Beijing tolerates commercial

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<sup>90</sup> “China Summons U.S. Ambassador for Solemn Protest,” *Ming Pao*, March 7, 2002; and “Nation Prompts U.S. to Explain Nuke Report,” *China Daily*, March 13, 2002.

ties between Taiwan and other countries, it dislikes the countries and companies that refer to Taiwanese leaders by their official titles when they are abroad. Taipei subsequently complained that Goldman Sachs and Merrill Lynch had both backed away from helping it hold a promotional investment tour in the United States for fear of upsetting Beijing. The row intensified when U.S. Ambassador to China Clark Randt skipped a dinner in Beijing, reportedly to protest China's blacklisting of CSFB. The press cited unnamed U.S. officials as saying that Randt did not attend the dinner after China withdrew an invitation to CSFB. State Department spokesman Richard Boucher said, "We are concerned with the matter. We have already raised it with the Chinese government." But he said Randt had skipped the dinner simply because "it was not convenient."<sup>91</sup>

These events show that the development of economic ties across the Taiwan Strait has not muted Beijing's objection to the official contacts between Taipei and other countries, or even the commercial contacts conducted in official capacity. Meanwhile, Taipei has continued to seek those contacts. In this regard, the policies on both sides of the Strait have not become compatible.

## V. Is There an Arms Buildup on Either Side?

To create a relaxed atmosphere across the Taiwan Strait, China evacuated its combat troops from the Fujian coast in 1979 and "only a small number of planes are

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<sup>91</sup> "Beijing 'Snubbed for Blacklisting Bank,'" *HK-iMail*, September 8, 2001; "Yen in CSFB Row," *South China Morning Post*, September 6, 2001; "Mainland Affairs Council Accuses Beijing of Blocking Taiwan from Contacts with Foreign Banks," *Ming Pao*, September 8, 2001; Craig Smith, "U.S. Diplomat Said to Protest China Actions on First Boston," *New York Times*, September 6, 2001.

stationed there.”<sup>92</sup> But troops can be redeployed quickly, so can military aircraft. In the places of the evacuated troops, China has deployed missiles, which can do great harm to Taiwan. The deployment of these missiles has alarmed Taipei and Washington and led to some talks on including Taiwan in a U.S.-led Theater Missile Defense (TMD) system. In recent years, both sides of the Strait have modernized their armed forces, with an eye on the other side. It is well-known fact that Taiwan has acquired F-16s from the United States; and China, Su-27s from Russia. It is only necessary to highlight some major aspects of the latest development on both sides, to illustrate that cross-Strait economic ties have little effect on reducing cross-Strait military competition.

As early as 1999, Lieutenant General Hsu Chu-sheng, director of the defense ministry’s military intelligence bureau in Taipei, said, “It is true that China is building new missile bases in its Jiangxi and Fujian provinces. The missiles (M-11s) to be deployed at those bases have a range between 300 and 500 kilometers. It does not need to be explained what the missiles will be aimed [sic] at.”<sup>93</sup> In 2001, the defense ministry in Taipei confirmed a U.S. intelligence report that China is constructing a missile base in Zhangzhou, Fujian province, just opposite Taiwan.<sup>94</sup> By the summer of that year, the number of missiles had increased to approximately 300, and Taipei’s defense ministry expects the number to reach 800 by 2006.<sup>95</sup> Chen Shui-bian explains that China’s deployment of 50 to 70 additional missiles each year requires a TMD system in the

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<sup>92</sup> Zhan, 92.

<sup>93</sup> Brian Hsu, “Military Defiant of New China Missiles,” *Taipei Time*, November 25, 1999.

<sup>94</sup> “PRC Building Advanced Missile Base,” Central News Agency, February 18, 2001.

<sup>95</sup> Brian Hus, “Patriots Put in a Flawless Performance,” *Taipei Times*, June 21, 2001; and “Put ‘Butcher Knife’ Down, Says Chen,” *HK-iMail*, August 16, 2001, using AFP news.

region.<sup>96</sup> A year earlier, Admiral Dennis Blair, commander-in-chief of the U.S. Pacific Command, said that China's missile buildup posed a "long-term danger," that China's growing missile threat against Taiwan could force the United States to arm Taiwan with a state-of-the-art missile system, and that the United States has an obligation under the Taiwan Relations Act (TRA) to provide Taiwan with the means to defend itself and a decision on bringing it within the TMD would take into account of the threat from China, and the "missiles are a big part of that threat."<sup>97</sup> Asked about a report on China's increased deployment of missiles opposite Taiwan, State Department spokesman Richard Boucher said in August 2001, "I would point out what the defense secretary said when he was in China, what other U.S. officials have frequently said that China's deployments obviously have an effect in how we see the balance and stability of the situation there."<sup>98</sup> Deputy Defense Secretary Paul Wolfowitz said that the continuing buildup of short-range missiles opposite Taiwan violates Beijing's pledge to resolve the standoff with the island peacefully, and that, "I also don't believe that that effort at intimidation will ultimately succeed."<sup>99</sup> Former U.S. Defense Secretary William Perry once told China to announce a moratorium on its missile deployment near the Taiwan Strait, for he shared Beijing's concern over a potential arms race, but he believed that the threat arose from China's missile deployment on the Fujian coast rather than from the TMD system Taiwan sought. Perry said, "These developments create a potential for a new crisis...as a result I am more

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<sup>96</sup> For Chen's estimate of the annual increase of the missiles, see Catherine Hsieh, "Chen Calls for Military Ties with U.S., Japan," *Taipei Journal*, August 3, 2001, p. 2.

<sup>97</sup> "U.S. Military Leader Talks about China's Missile Threat," Central News Agency, May 5, 2000.

<sup>98</sup> Bill Gertz, "China Future Superpower, May Be Threat," *Washington Times*, August 29, 2001.

<sup>99</sup> *Ibid.*

pessimistic about China-U.S. relations than I have been in several decades.”<sup>100</sup> China has neither confirmed nor denied the missile buildup, but it seems that there is indeed a buildup, given the words of senior U.S. and Taiwanese officials.

Taiwan’s recent purchase of weapons from the United States included four Kidd-class destroyers, 12 P-3C Orion antisubmarine surveillance planes, and eight diesel-powered submarines. White House officials announced these items on April 24, 2001. The destroyers should be ready by 2003; the delivery date for the diesel-powered submarines, designed to counter blockades and invasions, is not known. Other items on the unofficial list include the Paladin self-propelled artillery system, MH-53E minesweeping helicopters, AAV71A amphibious assault vehicles, MK-48 Mod-4 torpedoes, submarine- and surface-launched Harpoon missiles and the Avenger surface-to-air missile system.<sup>101</sup> Taiwan had already obtained Hawk antiaircraft missiles, advanced radars, Knox-class frigates, C-130 transport planes, and Patriot missiles in addition to the well-publicized F-16s. It also wanted the Aegis-equipped destroyers but was turned down by Washington—the Aegis battle management system can track and take on 100 targets simultaneously in the air. Taiwan’s army is operating the AH-1H Supra Cobra helicopters but is interested in the mighty AH-64 Apache attack helicopters. The island also wanted to purchase some M1-A2, the most sophisticated main battle tanks now serving the U.S. Army. The U.S. government has agreed to sell 200 medium-range AIM-120 air-to-air missiles to Taiwan, on condition that these missiles be kept in the United States and delivered to Taiwan when the need arises. For a time, Saudi Arabia

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<sup>100</sup> Glenn Schloss, “Ex-Defense Secretary Paints Bleak Picture on Ties,” *South China Morning Post*, April 12, 2000.

<sup>101</sup> “ROC Welcomes U.S. Weapons Sale,” *Taipei Journal*, April 27, 2001.



was the world's largest arms importer, followed by Taiwan. However, with interest in every piece of advanced weaponry from abroad, Taiwan became the world's largest arms importer in 1998, spending US\$4.6 billion on weapons.<sup>102</sup> This occurred at a time when arms sales have declined worldwide except for a few countries in Asia and the Middle East. On top of this, Taiwan produces its own weapons, which include the recently test-fired Tien Kung-II (Sky Bow-II) air defense missiles, Tien Chien-II (Sky Sword-II) air-to-air missiles, and Indigenous Defense Fighter (IDF) planes.

In the past 50 years, Taiwan was the top buyer of U.S. arms in East and Southeast Asia, outstripping Japan and South Korea. The U.S. Department of Defense classifies its foreign arms sales into several categories, which include arms sales agreements, actual deliveries, and commercial exports licensed under the Arms Export Control Act. This research looks at the value of weapons actually delivered to Taiwan, and commercial exports licensed under the Arms Export Control Act. The following four tables describe U.S. arms sales to Taiwan, and compare such sales with U.S. arms sales to other East and Southeast Asian countries. Table 5.3 attends to a more recent period, while Table 5.4 traces back to 1950. Table 5.3 shows that from 1992 to 2001, actual deliveries of U.S. arms to Taiwan amounted to US\$12.8 billion, compared with US\$5.8 billion for South Korea and US\$5.5 billion for Japan. This means that Taiwan's figure was 100 percent larger than the figures for Japan and Korea. In addition, Taiwan outstripped Japan and South Korea as the top buyer of U.S. arms from 1950 to 2001. Table 5.4 shows that the total amount of money Taiwan spent on actually delivered U.S. arms during that period

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<sup>102</sup> *United Daily News* (Taiwan) on June 17, 1999 cites the Stockholm Institute of International Peace's annual list of arms importing countries in reporting—seen from *Taiwan Business Bulletin* for the week ending June 23, 1999, at [www.chinaonline.com/features/taiwan\\_wrpt/open/taiwan811c9062421.PDF](http://www.chinaonline.com/features/taiwan_wrpt/open/taiwan811c9062421.PDF). Also, Professor Jia reported that Taiwan was “the world's number one weapons buyer in 1996.” Jia, 147.

was 100 percent larger than the amount spent by Japan and 80 percent larger than the amount spent by South Korea. Taiwan's figure was almost five times larger than Thailand's figure, 18 times larger than the Philippines' figure, and 20 times larger than Malaysia's figure. A noteworthy point is that of the US\$18.3 billion Taiwan spent on U.S. arms in the past 50 years, US\$12.8 billion, or 70 percent of the total, were spent in the most recent decade.

Table 5.3. U.S. Foreign Military Sales Deliveries to Top Buyers in East Asia, 1992-2001  
(value in US\$1,000)

|       | Taiwan     | Korea     | Japan     | Thailand  | Singapore | Malaysia | Philippines |
|-------|------------|-----------|-----------|-----------|-----------|----------|-------------|
| 1992  | 711,405    | 308,932   | 570,923   | 100,281   | 24,245    | 3,199    | 98,257      |
| 1993  | 815,188    | 302,845   | 378,723   | 105,899   | 78,367    | 6,197    | 39,710      |
| 1994  | 844,781    | 379,432   | 779,392   | 150,646   | 86,793    | 11,370   | 45,129      |
| 1995  | 1,334,645  | 441,666   | 692,797   | 355,558   | 58,558    | 9,443    | 57,881      |
| 1996  | 833,050    | 339,844   | 752,869   | 269,823   | 80,240    | 38,722   | 88,765      |
| 1997  | 2,394,148  | 478,029   | 492,054   | 179,508   | 132,710   | 16,814   | 28,492      |
| 1998  | 1,423,954  | 836,461   | 409,416   | 150,005   | 232,099   | 72,405   | 40,056      |
| 1999  | 2,521,905  | 590,183   | 485,171   | 145,082   | 559,508   | 46,349   | 19,492      |
| 2000  | 797,906    | 1,456,763 | 523,628   | 125,779   | 138,925   | 426,224  | 9,913       |
| 2001  | 1,176,151  | 750,006   | 503,414   | 121,094   | 244,524   | 77,346   | 20,124      |
| Total | 12,853,133 | 5,884,161 | 5,588,387 | 1,703,675 | 1,635,969 | 708,069  | 447,819     |

Source: U.S. Department of Defense – Security Cooperation Agency, *Foreign Military Sales, Foreign Military Construction Sales and Military Assistance Facts, as of September 30, 2001* (Washington, DC: Data Management Division, Comptroller, DSAA, 2001), pp. 18-19.

Note: Foreign Military Sales (FMS) Deliveries is defined by the Department of Defense as “total dollar value of defense articles and defense services delivered to a foreign government or international organization in any fiscal year. After implementing an FMS agreement, the responsible military department directs release of material from stocks or procurement or provision of services and training.” See above source, p. iv.

Table 5.4. U.S. Foreign Military Sales Deliveries to Selected Buyers, 1950-2001

(value in US\$1,000)

| Buyer       | Accumulated Total |
|-------------|-------------------|
| Taiwan      | 18,339,051        |
| Korea       | 10,501,669        |
| Japan       | 9,462,524         |
| Thailand    | 4,052,779         |
| Singapore   | 2,593,521         |
| Philippines | 1,043,182         |
| Malaysia    | 879,397           |
| Indonesia   | 709,771           |
| Myanmar     | 8,734             |
| Cambodia    | 4,164             |
| Vietnam     | 1,167             |
| Laos        | 1,078             |

Source: U.S. Department of Defense – Security Cooperation Agency, *Foreign Military Sales, Foreign Military Construction Sales and Military Assistance Facts, as of September 30, 2001* (Washington, DC: Data Management Division, Comptroller, DSAA, 2001), p. 19.

U.S. arms exports to Taiwan under the Arms Export Control Act for the period of 1992-2001 is presented in Table 5.5. The table shows that under this category, Japan spent US\$3 billion on U.S. arms and was the largest U.S. arms purchaser during that period, and Taiwan, having spent US\$1.2 billion, was the second largest. From 1950 to 2001, the accumulated amounts of money spent on U.S. arms under this category by Japan, Korea, and Taiwan were US\$11.5 billion, US\$3.3 billion, and US\$2.9 billion respectively (see Table 5.6). Therefore Japan was the top U.S. arms purchaser under this category. However, when the figures for “foreign arms sales deliveries” and “commercial exports licensed under the Arms Export Control Act” are combined (supposing that nothing in the categories overlaps), Taiwan was still the largest buyer of

U.S. arms in the past five decades. Taiwan had spent US\$21.3 billion; Japan had spent US\$20.9 billion.

Table 5.5. Commercial Exports Licensed Under Arms Export Control Act, from the United States to Top Seven Buyers in East Asia, 1992-2001

(value in US\$1,000)

|       | Japan     | Taiwan    | Korea   | Thailand | Singapore | Malaysia | Indonesia |
|-------|-----------|-----------|---------|----------|-----------|----------|-----------|
| 1992  | 619,327   | 95,610    | 82,441  | 32,457   | 53,593    | 3,100    | 18,134    |
| 1993  | 220,064   | 346,026   | 121,794 | 13,570   | 16,437    | 7,458    | 4,025     |
| 1994  | 379,550   | 261,869   | 88,724  | 20,027   | 14,880    | 6,311    | 9,335     |
| 1995  | 744,937   | 27,760    | 61,574  | 60,277   | 40,038    | 11,813   | 8,185     |
| 1996  | 373,423   | 20,392    | 85,356  | 21,574   | 10,889    | 8,644    | 10,883    |
| 1997  | 249,298   | 261,136   | 47,079  | 18,846   | 12,215    | 34,790   | 4,442     |
| 1998  | 249,498   | 173,055   | 60,105  | 22,666   | 3,087     | 2,900    | 4,349     |
| 1999  | 118,542   | 15,500    | 10,711  | 4,299    | 10,873    | 2,811    | 630       |
| 2000  | 64,663    | 15,392    | 10,946  | 836      | 2,172     | 349      | ....      |
| 2001  | 66,715    | 29,127    | 15,476  | 3,503    | 4,285     | 1,201    | 63        |
| Total | 3,086,017 | 1,245,867 | 584,206 | 198,055  | 168,469   | 79,377   | 60,046    |

Source: U.S. Department of Defense – Security Cooperation Agency, *Foreign Military Sales, Foreign Military Construction Sales and Military Assistance Facts, as of September 30, 2001* (Washington, DC: Data Management Division, Comptroller, DSAA, 2001), pp. 62-63.

Note: Commercial exports licensed under Arms Export Control Act is defined by the Department of Defense as “the total dollar value of deliveries made against purchases of munitions-controlled items by foreign governments directly from U.S. manufacturers. The data are compiled by the Office of Defense Trade Controls (DTC), Department of State, from shippers’ export documents and completed licenses returned to DTC from ports of exit by the U.S. Customs Service.” See the above source, pp. iv-v.

Table 5.6. Commercial Exports Licensed under Arms Export Control Act, from the United States to Selected Asian Buyers, 1950-2001 (value in US\$1,000)

| Buyer       | Accumulated Total |
|-------------|-------------------|
| Japan       | 11,512,762        |
| Korea       | 3,367,995         |
| Taiwan      | 2,963,958         |
| Australia   | 2,716,049         |
| Singapore   | 1,025,053         |
| Thailand    | 751,897           |
| Malaysia    | 608,125           |
| Indonesia   | 287,555           |
| Philippines | 145,139           |
| Brunei      | 82,033            |
| Vietnam     | 80                |
| Cambodia    | 44                |

Source: U.S. Department of Defense – Security Cooperation Agency, *Foreign Military Sales, Foreign Military Construction Sales and Military Assistance Facts, as of September 30, 2001* (Washington, DC: Data Management Division, Comptroller, DSAA, 2001) p. 63.

Before becoming premier in Taiwan, Defense Minister Tang Fei called for a larger defense budget. Tang stressed that Taiwan's defense budget, equivalent to 2.6 percent of the GNP in 2000, was far from sufficient in meeting national security needs. Tang said that even if the budget were raised to 3.5 percent of the GNP in 2001, it would still be too low in terms of beefing up national defenses in the face of the growing military threat from the mainland. According to Tang, China will pose a genuine and serious threat to Taiwan by 2010, when its military modernization program is completed. Tang suggested that, therefore, in addition to continuing to work to improve cross-Straits relations, Taiwan should at the same time upgrade its combat preparedness as well as

surveillance of PRC military movements.<sup>103</sup> Tang's words can be taken to mean that cross-Strait economic relations may develop, but the armed forces must also be strengthened—there is no negative correlation between these two things.

Taiwan's defense budget in the past decade was large compared to those of its neighbors. Although Taiwanese government statistics show that the defense budget as a share of the total national budget sharply decreased from 50.8 percent in 1987 to 16.5 percent in 2002, the absolute amount of the defense budget did not really decrease.<sup>104</sup> Using estimates from a respected research institute, Table 5.7 compares Taiwan's defense budget with those of its neighbors. It shows that Taiwan's defense budget throughout the 1990s was only slightly smaller than that of South Korea, which faced a strong opponent in the north, and is not protected by a buffer strait of 100 miles in width, although it is protected by 37,000 U.S. troops. On the other hand, although Taiwan is not protected by an American military presence, it has the guarantee from the TRA, and the rushing to Taiwanese waters of two U.S. aircraft-led battle groups during the 1996 missile crisis indicated a serious intention on the part of the United States to remain involved. In 2000, Taiwan and Korea had the same defense budget, but Korea's population was 100 percent larger than that of Taiwan. Taiwan's defense budget was approximately 10 times larger than that of the Philippines and Vietnam, which had populations several times larger than Taiwan's. In the same year, Malaysia and Taiwan had similar population figures, but Taiwan's defense budget was eight times larger. In short, Taiwan did not take the

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<sup>103</sup> "Taiwan Defense Minister Asks for Increase in Defense Budget," Central News Agency dispatch as seen from <http://www.chinatopnews.com/> on April 3, 2000.

<sup>104</sup> See the chapter on national defense in *Republic of China Yearbook* (Taipei: Government Information Office, various years) for the year-on-year decreasing share of defense budget in the total national budget.

conflict with Beijing lightly, despite ongoing economic cooperation between the two sides of the Taiwan Strait.

Table 5.7. Defense Budget and Population: Taiwan Compared with its Neighbors  
(defense budget in US\$billions)

|             | 1991  | 1992  | 1993  | 1995  | 1996  | 1997  | 1998  | 1999  | 2000  | Population<br>in 2002 |
|-------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-----------------------|
| Taiwan      | 9.29  | 10.29 | 10.45 | 9.55  | 13.60 | 11.30 | 8.30  | 10.90 | 12.80 | 22,124,000            |
| Korea       | 10.77 | 11.19 | 12.06 | 14.36 | 15.60 | 15.50 | 10.20 | 11.60 | 12.80 | 47,295,000            |
| Philippines | 0.98  | 1.14  | 1.17  | 1.00  | 1.10  | 1.10  | 1.20  | 1.40  | 1.30  | 77,318,000            |
| Vietnam     | 1.87  | 1.75  | ...   | 0.89  | 1.00  | 1.10  | 0.95  | 0.89  | 1.00  | 80,976,000            |
| Malaysia    | 1.72  | 1.96  | 1.96  | 2.41  | 2.40  | 2.50  | 2.10  | 1.80  | 1.60  | 22,092,000            |

Source: *The Military Balance* (London: The International Institute for Strategic Studies), various issues.

Note: Data for 1994 unavailable.

Chen Shui-bian told his military officers at a promotion ceremony that the comprehensive national strength of the PRC has continuously increased in recent years, and its national defense budget has kept growing by a two-digit percentage, plus an active restructuring of the People's Liberation Army (PLA) to improve personnel quality, Taiwan must watch out. Chen said that superficially cross-Strait relations have relaxed in recent years, but the fact is that the mainland has used the media and nongovernmental exchanges to create a false picture of "cross-Strait peace." Chen warned that the armed forces should not lower its guard and should not have any ambiguity because the biggest

threat to Taiwan's security is still the use of force by the mainland, and that the armed forces must study tactics and strategies with the PLA in mind.<sup>105</sup>

Taiwan has a conscription system that is a response to the threat from nowhere but China. Despite growing criticisms from some sectors of the society that accuse the system of interrupting young people's careers, the government stands firm on it. The Military Service Law of the ROC stipulates that all males shall fulfill military service. Article 3 of the law states: "Male persons shall be liable to military service on January 1 of the year immediately following the year during which they reach the age of 18." Originally, these conscripts were required to serve for two years, but the period was shortened to 22 months recently. In short, there is no sign showing that the development of economic ties across the Taiwan Strait has lowered Taipei's guard against Beijing, or softened its determination to defend itself, or brought about a situation that is perceived to be more benign by Taipei.

China has protested against the sales of U.S. weapons to Taiwan. In the 1982 Sino-American communiqué, the United States undertook to "gradually to reduce its sale of arms to Taiwan, leading, over a period of time, to a final solution." However, not only has the United States kept selling arms to Taiwan, but the weapons sold have become increasingly sophisticated. According to Luo Yuan, a researcher with the Beijing-based Academy of Military Sciences, the United States has "crossed the bottom line that no offensive weapons should be sold to Taiwan, as shown by the sale of submarines, which

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<sup>105</sup> "Chen Shui-bian Says Treat to Taiwan Comes from Mainland," *Ming Pao*, June 26, 2002.



are clearly offensive weapons.”<sup>106</sup> If the F-16s are not considered to be offensive weapons, they are at least advanced weapons. The U.S. government has used the word “balance” in the Taiwan Strait to explain its arms sales decisions, instead of arguing about which weapon is defensive and which is offensive and thus cannot be sold. It seems that the pattern has evolved into one in which any military upgrading in China can be interpreted by Washington as upsetting the balance in the Taiwan Strait, and since Taiwan cannot defend itself if the balance is gone, weapons must be sold in order to restore the balance and help Taiwan defend itself.

According to the aforesaid researcher, whose institution is a government-funded military think tank,<sup>107</sup> “the Chinese government will never allow Taiwan’s pro-independence forces to possess the military assets capable of balancing the mainland, let alone allowing them to have superiority in certain aspects. This means that *an arms race is inevitable* (emphasis mine), because when Taiwan buys advanced weapons and equipment from the United States, the mainland will surely develop, produce, and import weapons and equipment that are even more advanced.”<sup>108</sup> This seems to be the case,

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<sup>106</sup> Luo Yuan, “War Threat Grows: U.S. Playing with Fire on Arms Sales to Taiwan,” *China Daily (Hong Kong Edition)*, April 27, 2001, p. 12.

<sup>107</sup> The Academy of Military Sciences (AMS) was founded in 1958 and is the “national center for military studies” as well as the premier military organization in the PLA. According to Bates Gill and James Mulvenon, the AMS is directly subordinate to the Central Military Commission (CMC), but also receives direct tasking from the General Staff Department. The AMS conducts broad, academic research on “national defense, armed forces development and military operations,” consults the CMC and the PLA General Departments, and coordinates academic work throughout the PLA. With about 500 full-time researchers, it is the largest single research organization of the PLA. See Bates Gill and James Mulvenon, “Chinese Military-Related Think Tanks and Research Institutes,” *China Quarterly*, no. 171 (September 2002): 617-24.

<sup>108</sup> See footnote 106.

judging from China's purchase of Su-27 and Su-30 fighter planes and the Sovremenny-class destroyers from Russia.

The first Sovremenny-class destroyer was delivered to China in 2000. As the 7,600-ton warship, escorted by China's East Sea Fleet, sailed through the Taiwan Strait to its destination in the north, it caused some concerns in Taiwan. A defense official in Taiwan said Taiwan's armed forces "have been deployed to monitor closely the progress of the fleet."<sup>109</sup> The Pentagon said the ship's purchase was not unexpected. Pentagon spokesman Rear Admiral Craig Quigley said that, "taken in isolation, this is a good ship, it is a modern ship, but it does not significantly change the balance of power in that part of the world." However, he cautioned that addition of modern warships to the Chinese navy could upset the balance of power between the mainland and Taiwan, although a single ship poses no threat to the U.S. forces in the region.<sup>110</sup>

The Chinese also wanted to upgrade their airborne warning and control system (AWACS). They wanted to buy from Israel the sophisticated Phalcon radar system. Chinese President Jiang Zemin even went to Israel to inspect the first Russian-built plane to be fitted with the advanced Israeli avionics. Israeli officials had hoped Beijing would sign for as many as eight planes, worth at least US\$240 million each. But Washington objected the sale, expressing concerns that the system would give China a dangerous advantage in any confrontation with Taiwan. Israel argued that the system does not contain U.S. technology. As Jiang was flying to Israel to inspect the Ilyushin-50 in April 2000, President Bill Clinton was meeting with Israeli Prime Minister Ehud Barak in the

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<sup>109</sup> "New Destroyer Cruises Through Taiwan Strait," *South China Morning Post*, February 12, 2000.

<sup>110</sup> *Ibid.*

White House, and U.S. officials said the talks between the two leaders would “almost certainly include U.S. concerns” over the sale. At the same time, Sonny Callahan, chairman of the House appropriations subcommittee on foreign operations, threatened to withhold US\$250 million of Israel’s annual US\$2.82 billion in aid if the deal went ahead.<sup>111</sup> Eventually, the deal did not go ahead, and an angry China demanded a huge compensation from Israel for operational and economic damages caused by the cancellation of the sale, but the Israelis explained that the cancellation was a result of U.S. pressure.<sup>112</sup>

Even a casual observer would realize that China’s weapons purchase program was not random; it was executed with the most likely future adversary and warfare in mind. The air force’s modernization drive was launched in order to increase the capability to cover troops when they are being ferried across the Taiwan Strait.<sup>113</sup> The Phalcon radar system can help coordinate combat and transport aircraft in a complex amphibious landing operation. The Sovremenny-class destroyer is equipped with sea-skimming supersonic Sunburn missiles which are said to be able to penetrate U.S. carrier-led battle groups. In November 2002, the *Washington Times* cited U.S. intelligence officials in reporting that China test-fired its own air-to-sea cruise missile that could travel at supersonic speeds, which make it very difficult to intercept, and “this weapon is believed by Pentagon officials to be part of Beijing’s efforts to develop a long-range strike

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<sup>111</sup> “Clinton to Raise Radar Issue,” *South China Morning Post*, April 11, 2000.

<sup>112</sup> News reports hold that China asks for US\$1 billion, but Israel wants to pay only US\$230 million, roughly the value of the basic deal to deliver one plane.

<sup>113</sup> For an evaluation of the Chinese air force’s modernization program, see John Wilson Lewis and Xue Litai, “China’s Search for a Modern Air Force,” *International Security*, vol. 24, no. 1 (Summer 1999): 64–94. These researchers did not speak highly of the modernization program.

capability against U.S. aircraft carriers and ships.”<sup>114</sup> Seemingly, China’s military modernization program is not just aimed at overwhelming Taiwan, but also at deterring the United States from any direct intervention.<sup>115</sup>

In August 2001, the Hong Kong-based, Beijing-funded *Wen Wei Po* newspaper reported that China is capable of monitoring medium-sized warships off its coast with its small reconnaissance satellites, which are capable of tracing and identifying these ships and of closely following the activities of aircraft carriers on the open sea around-the-clock. Beijing seemed to deliver a message, just one day after two U.S. aircraft carriers had finished an unusually large exercise in the South China Sea, that the naval war game had been under close scrutiny. A spokesman for the U.S. Navy’s Seventh Fleet said 14 vessels, at least 130 naval aircraft, more than 20 U.S. Air Force aircraft, and more than 15,000 personnel joined forces in the exercise. The operation, which involved tests of complex air traffic control procedures and ship maneuvering, was conducted amid an ongoing, large-scale Chinese military drill off its southeast coast opposite Taiwan. But the U.S. Navy spokesman denied the drill was intended as a display of force in response to the Chinese war games. “There is no intent to send a specific message to the People’s

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<sup>114</sup> Bill Gertz, “Chinese Missile Has Twice the Range U.S. Anticipated,” *Washington Times*, November 20, 2002.

<sup>115</sup> U.S. defense analysts generally think that China cannot conquer Taiwan in the near future. See, for example, Michael O’Hanlon, “Why China Cannot Conquer Taiwan,” *International Security*, vol. 25, no. 2 (Fall 2000): 51-86. O’Hanlon wrote (on p. 53): “My conclusions suggest strongly, however, that China could not take Taiwan, even if U.S. combat forces did not intervene in a conflict. Nor will China be able to invade Taiwan for at least a decade if not much longer.” Michael Swaine, another analyst, wrote (on p. 52): “At present, the Chinese military lacks the extensive amphibious warfare experience...that would make such an assault [on Taiwan] possible.” See his book, *Taiwan’s National Security, Defense Policy and Weapons Procurement Processes* (Santa Monica, CA: RAND, 1999).

Republic of China.”<sup>116</sup> However, it is not convincing that such a large-scale exercise is not aimed at any country, especially in this part of the world where the United States has many allies and few opponents of comparable strength.

Besides purchasing military hardware, China has carried out landing exercises that are clearly aimed at Taiwan. For example, the choice of Dongshan island off the Fujian coast for landing exercise in August 2001 was a psychological threat to Taiwan. The island is quite large and easily identifiable on a good map; it is close to Taiwan and has similar beach features. According to Taiwan’s military intelligence, a mechanized infantry division and four Army regiments would rapidly land on the island, while the air force and the navy carried out long-range operations to support the landing. The hypothetical plan of the exercise was to attack Taiwan and prevent international forces from coming to its rescue. During the exercise, some newly acquired Su-30 fighter planes reportedly took off from Anhui province to strike at targets on the island.<sup>117</sup>

All these moves, events, and calculations show that the current situation of military competition is not in any way less fierce than the one existing in 1987, the year when indirect cross-Strait trade was opened. Both sides have intensified their efforts to purchase advanced weapons. Although Taipei accuses Beijing of using the economic gains from cross-Strait trade and investment to build its military in order to intimidate Taiwan, Taipei itself has used the trade surplus from China to buy arms. The economic cooperation between the two sides has created a new context for them to argue about

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<sup>116</sup> “Eyes in Sky Watch Coastal War Games,” *HK-iMail*, August 20, 2001; and “U.S. Navy Exercises in South China Sea,” *Taipei Times*, August 19, 2001.

<sup>117</sup> “Dongshan Island Number 6 Exercise to Begin This Week,” *World Journal*, August 20, 2001, p. A7.

what is the proper way to spend the money. In addition to purchasing U.S. arms, Taiwan had also obtained Mirage 2000 fighter planes and Lafayette frigates from France, as well as submarines from the Netherlands. China warned these two countries, ordered the French to close their consulate in Guangzhou, and excluded France from some lucrative business deals on the mainland; since then, the United States remains the only country in the world that dares to sell arms to Taiwan.

Beijing called for an end to the state of hostility in its 1979 “Message to the Taiwan Compatriots,” and Jiang Zemin made the same suggestion in his 1995 eight-point proposal. Taipei called for a mutual renunciation of force. But in 2002, both sides are sparing no effort to prepare for an armed conflict. Despite their economic ties, there are few signs showing that Beijing will ease its military pressure on Taipei, or that Taipei will cease building up its arsenal to deal with Beijing.

## **VI. Social and Perceptual Gaps: Narrowing or Widening?**

If the economic cooperation between the two sides of the Strait can bridge the social and perceptual gaps between the two societies, there is a chance for political reconciliation. If cross-Strait economic ties can narrow the differences in the way of thinking, work style, identity, and values between the two sides, the likelihood of conflict is reduced, social cohesion is increased, and peace can be consolidated. Evidence suggests a multifaceted phenomenon in which some aspects are developing in the gratifying direction while others are not. People from both sides do meet and get to know each other, but also new contexts emerge for them to argue.

Taiwanese scholars, as their government does, sometimes remind the mainland how much Taiwan has contributed to its economic development, and how the mainland has not been thankful to Taiwan and has not promised to renounce the use of force against the island. Both Tse-kang Leng and Tien Hung-mao, for example, have often reported the millions of jobs that are generated by Taiwan-funded factories on the mainland, the proportion of China's exports that is linked to Taiwanese firms, the technologies and management skills that come with Taiwanese investments, and the economic prosperity and wealth created by Taiwanese firms in China's coastal areas. Leng even praised Taiwanese firms for establishing recreation and education centers, which contribute to China's social welfare. They are proud of Taiwan's achievement. However, when they come to Taiwan's favorable trade balance with China, these scholars are not thankful either; they talk in negative terms, expressing worries over trade dependence on the mainland.

On the mainland side, the high-handed way of Taiwanese bosses has caused grievances among the local workers. Mainland news reports have targeted the demeaning and derogatory treatments of local workers by Taiwanese employers. Hsing reported incidents of Taiwanese managers beating up Chinese workers badly, harsh scolding and shouting, stringent rules in worker dormitories, long hours of work, and "military-like training" that requires workers to stand for hours and punishes those who spite, talk, or fail to walk in a straight line.<sup>118</sup> While Taiwanese scholars spoke highly of Taiwan's role in China's economic development, Professor Zhao from the mainland said that in China "many believe Taiwan has received disproportionate gains in the economic

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<sup>118</sup> Hsing, 99-104 (chapter 4 on culture and labor discipline).

exchange because of the disparities and they have become resentful of the structure and practice of Taiwan investment.”<sup>119</sup> Zhao noted that the “Taiwanese bear little social welfare burden, enjoy tax breaks, and frequently evade taxes. Generally speaking Taiwanese businesses do not chip in much for education or compensation for unemployment, nor do they care much about environmental issues.”<sup>120</sup> Although Taiwanese businesses have invested a considerable amount of money in China, Zhu Zhiqun, a scholar from the mainland, criticized Taiwan for not using its financial resources to help the mainland. Commenting on the proper use of Taiwan’s foreign reserve, Zhu said, “If this huge amount of capital is used to help the mainland to develop its economy, it will be a memorable contribution to economic reciprocity across the Strait, to improvement of livelihood on both sides, and to a steady and healthy development of cross-Strait relations.”<sup>121</sup> However, it is not known why Taiwan should not use its money to help itself first rather than its adversary. Zhu’s reasoning shows a big gap in expectation between Taiwanese and mainland scholars.

To some mainlanders, Taiwanese business people are hardworking and smart, but they also frequent karaoke bars and nightclubs, drink and indulge in dissipation. Some people also frown at the phenomenon of *bao er nai*—keeping a second wife or, more accurately, a mistress on the mainland by Taiwanese managers. A short-lived but widely reported measure by Chinese authorities was that the Taiwanese business people who

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<sup>119</sup> Zhao, 37.

<sup>120</sup> Ibid., 37.

<sup>121</sup> Zhu Zhiqun, “cong liang guo luan kan zhong mei tai san jiao guan xi,” (Triangular Relations Among China, the United States, and Taiwan Viewed from the “Two States Theory”) in *Tai Hai Liang an de Fa Zhan Qian Jing* (*Prospects for Cross-Taiwan Strait Development*), ed. Lin Gang and Chen Weixing (Hong Kong: Yazhou ke xue chu ban she, 2000), 195.



were caught visiting a prostitute by police would have the word *piao-ke* (whoremonger) stamped on their passports; embarrassed, these Taiwanese would declare loss of their passports when they arrived in Hong Kong on their way home to Taiwan.<sup>122</sup>

The social gap is also great. Very often, one can tell whether a person is from the mainland or Taiwan by reading his name. A person whose name is Zhang Jun (Zhang Army) is likely to be a mainland Chinese, and a person whose name is Hou Hsiao-hsien (Hou, filial piety, virtue) is likely to be a Taiwanese. In the United States one seldom sees Taiwanese students going out with mainland students. It is true that a large number of Taiwanese work in China today. "But Taiwanese don't really want to be treated like locals and few Taiwanese are being won over by mainland ways, according to Lin Chia-lung of the department of political science at Taiwan's National Chung Cheng University."<sup>123</sup> Professor Lin cited several surveys to show that "Taiwanese residents on the mainland actively strive to maintain their separate identity. And, indeed, Taiwanese tend to socialize among themselves, patronize Taiwanese-invested karaoke bars and restaurants, and use Taiwanese contractors for their businesses."<sup>124</sup> According to Hsing You-tien, although Taiwanese managers do work and live in China, they deliberately "instituted a social distance between themselves and the workers" as they practiced a "paternalistic management that was reinforced by the hierarchical structure of factory organization." "A hierarchical management structure was created to inculcate the workers with obedience and respect, which was further reinforced by the social gap

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<sup>122</sup> Willem Van Kemenade, *China, Hong Kong, Taiwan, Inc.* (New York: Alfred A. Knopf, 1997), 198.

<sup>123</sup> David Murphy and Maureen Pao, "A Place to Call Home," *Far Eastern Economic Review*, July 5, 2001, P. 59.

<sup>124</sup> *Ibid.*

between Taiwanese and Chinese personnel.”<sup>125</sup> This social gap manifested in many aspects, such as separate dining halls, different dormitories, and so on.

So far, Chen Shui-bian has refused to identify himself as a *zhongguo ren*, and only says he is a *hua ren*. The former means Chinese, Chinese national, or Chinese citizen. The latter means a person of Chinese descent, who may or may not be a Chinese national, may or may not live in China, and is likely to be the offspring of Chinese parents who have emigrated abroad.<sup>126</sup>

From Beijing’s perspective, using the Taiwanese identity to stress the differences between the two sides of the Taiwan Strait is purely an excuse. Ethnically, Taiwanese are Han Chinese and they are closer to the majority of the Chinese on the mainland than the Chinese of minority nationalities, such as the Manchu who pronounce their popular surname as Aixin Jueluo, or the Tibetans whose names include Gyaltzen Norbu and Dorjee Tsering, or the Mongols whose names include Buhe and Uyunqing, or the Uygur Moslems in Xinjiang whose names include Ismail Amat and Abulahat Abudrixit. Since these people can stay together, there is no reason why the Chinese on the mainland and the Taiwanese on the island cannot stay together.

Beijing hoped that as the people from Taiwan visit the mainland, they would witness China’s ancient grandeur and modern progress and become increasingly aware of their Chinese roots. This did happen to many Taiwanese visitors but, as Garver observed, “Many others were repelled by the poverty, hide-bound traditionalism, and repression

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<sup>125</sup> Hsing, 101.

<sup>126</sup> “Chen Shui-bian Says He Is *Hua Ren*, Not *Zhongguo Ren*,” *Ming Pao*, October 18, 2000, p. B15; and “Lien Chan [KMT chairman] Persuades Chen Shui-bian to Acknowledge He Is *Zhongguo Ren*,” *Ming Pao*, October 24, 2000, p. A14. Chen’s reason was that if *zhongguo* (China) means the PRC, and *zhongguo ren* (Chinese) means PRC citizen, then he is not a *zhongguo ren*.

they found. Many Taiwan citizens deeply valued the individual freedom, democracy, and modernity that Taiwan was then achieving. What they found on the mainland was far from the ideals they identified with and aspired to for their country.”<sup>127</sup> To many Taiwanese, their trips to the mainland ended up with an unexpected sense of “difference” they felt between themselves and the people on the mainland.<sup>128</sup>

Taiwanese people and scholars have a series of reasons to refuse unification, one of which is that unification must have the consent of the people in Taiwan, another is that the mainland must first develop its economy in order to narrow the gap in living standards between the two places. Furthermore, they say that unification is out of the question before China democratizes. Taipei said that according to a survey done by China Credit Information in May 21-23, 2001, “76.6 percent [of the respondents] agreed with the view that, in order to have dialogue on the issue of unification, Mainland China must implement democracy.”<sup>129</sup> Democratization on the mainland is one of the conditions to be achieved in the first phase of cross-Strait interactions according to Taipei’s Guidelines for National Unification, which stated that “a democratic, free, and equitably prosperous China” is the ultimate goal of unification. Taipei’s insistence on China’s democratization as a condition for unification prompts Professor Jianwei Wang, a scholar from the mainland who teaches in the United States, to criticize Taipei’s “radicalized” demand, which is a change of the mainland’s social system while the

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<sup>127</sup> Garver, *Face Off*, 17.

<sup>128</sup> Wheeler, 92.

<sup>129</sup> *Republic of China Yearbook 2001* (Taipei: Government Information Office, 2001), p. 117.

mainland can tolerate Taiwan's system.<sup>130</sup> Wang was referring to "one country, two systems," which the Taiwanese people dislike. Amid the development of economic ties, scholars argue among themselves on what to expect.

The difference in political system between the two places has widened amid growing economic ties. In the 1970s the government in Taiwan and the government in China were both characterized by authoritarianism, but by the turn of the century Taiwan had developed into a democracy. Democratization on the island has complicated China's reunification process because more political parties must be included for talks, different interests must be accommodated, and the people's consent must be sought, although not necessarily through a referendum. But most importantly, "Democratization is in fact an exercise in nation-building," as James Hsiung from New York University observes, and "it is closely linked to the rise of nationalist sentiments, or an 'us vs. them' psychic condition."<sup>131</sup> Seen from this perspective, it is understandable why Beijing reacted strongly to Taiwan's presidential elections and declared that whichever way the Taiwanese choose their leaders would not change the fact that Taiwan is a part of China.<sup>132</sup> Meanwhile, Jianwei Wang held that China is also in a stage of nation building

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<sup>130</sup> Jianwei Wang, "Democratization and China's Nation Building," in *What If China Doesn't Democratize*, ed. Edward Friedman and Barrett L. McCormick (Armonk, NY: M.E. Sharpe, 2000), 65.

<sup>131</sup> James C. Hsiung, "Shadow Boxing or Real Movement? Cross-Strait Relations in 1998," in *China Review*, ed. Chong Chor Lau and Geng Xiao (Hong Kong: Chinese University Press, 1999), 96.

<sup>132</sup> The official New China News Agency (Xinhua) reported shortly after Lee Teng-hui was elected president in 1996: "Neither changes in the way in which Taiwan leaders are produced nor their result can change the fact that Taiwan is a part of China's territory." See Seth Faison, "China Says Taiwan Election Shows That Voters Oppose Separation from the Mainland," *New York Times*, March 24, 1996, p. 16. Shortly after Chen Shui-bian was elected president in 2000, General Zhang Wannian, vice chairman of the powerful Central Military Commission, told Chile's visiting military chief Ricardo Izurieta: "The election of a new leader in the Taiwan region does not change the fact that it is an inalienable part of Chinese territory." See AFP, "China's Military Warn Chen: We will Smash Any Independence Bid," April 5, 2000.

because “it has yet to achieve its national unification or to solve territorial disputes with many of its neighbors,” and in such a stage it is “ultrasensitive about national sovereignty and territorial integrity.”<sup>133</sup> Garver articulated a similar theme and wrote that China’s “National Humiliation” in the century following the 1842 Opium War had a profound impact on China’s foreign policy, which aimed at righting the wrong done to it by the great powers and restoring its position on the world stage, and Beijing viewed Taiwan’s separation from China as a product of such “National Humiliation.”<sup>134</sup> Under such circumstances, China will never let Taiwan break away. However, “Taiwan is also in an early stage of nation-building” and “democratization made many Taiwanese feel different from the Chinese in the mainland and further stimulated their seeking of a separate national identity,” according to Wang.<sup>135</sup> If these observations are correct, then both sides are on a collision course. Democratization on Taiwan also allows Taipei to claim that any change to the status quo, including unification, must have the people’s consent, which may be sought through a referendum. Beijing hinted that if a referendum was needed, it must be carried out in the whole nation and not confined to the island of Taiwan. Economic relations across the Taiwan Strait cannot narrow these gaps, which have taken shape and widened amid economic cooperation.

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<sup>133</sup> Wang, 64.

<sup>134</sup> Garver, *Foreign Relations* (chapter 1).

<sup>135</sup> *Ibid.*, 65.

## VII. Do Current Political Events Affect Economic Ties?

The above evidence suggests that the Beijing-Taipei conflict remains as acute as before. In other words, economic ties have not reduced their conflict. To show the dominating role of politics in cross-Strait relations, some of the current political events will be briefly treated here as the independent variable and their inhibiting effects on economic cooperation examined. Because the effects of politics on economics have been shown by the quantitative analysis in Chapter 4, a few qualitative examples suffice.

First, because Beijing insists on the one-China principle as a precondition for talks while Taipei refuses to recognize that principle, talks on direct transportation links cannot be opened. Beijing has tried to break the logjam by suggesting talks on a people-to-people, business-to-business, and company-to-company basis—a method that would not confer equal governmental status upon Taiwan. Taipei has yet to respond favorably. The lack of direct transportation links increases the costs of business transactions, and put Taiwanese firms in an unfavorable position in competition with foreign enterprises. Beijing certainly wants to establish direct transportation links across the Strait, for these links would bring in more trade and investment, promote closer economic ties with Taiwan, and intertwine the two economies so as to make it difficult for Taiwan to break away. From an economic perspective, these links will be beneficial to Taiwan, because they could bolster Taiwan's economy by increasing trade and investment activities, and enhance the competitiveness of Taiwanese businesses by reducing operating costs. Taiwan is experiencing the worst economic recession in decades and its economy can be given a boost by direct transportation links with the mainland, but Taipei does not want to bow to Beijing's pressure in order to take these benefits; it cherishes its autonomy as

much as it cherishes economic gains, and it holds out the “three links” in the hope that Beijing will make political concessions. Beijing, too, cannot give up its one-China principle for more cross-Strait trade and investment. Thus, there are economic benefits to be reaped, but political reasons prevent them from being reaped.

The private sectors on both sides indicate that they are prepared for cross-Strait flights. In October 2001, representatives from six Taiwan-based airlines and three mainland aviation groups—Air China, China Southern Airlines and China Eastern Airlines—reached an agreement after two hours of discussions in Beijing that direct flights across the Strait should be opened as soon as possible.<sup>136</sup> When meeting the Taiwan delegation, Chen Yunlin, director of the State Council’s Taiwan Affairs Office, reiterated that direct cross-Strait air links be negotiated between companies and treated as internal affairs within one country. There can be no doubt that the airlines on both sides have discussed how to cooperate once the ban on direct flights is lifted. But they are still waiting for the green light from the political decision makers, who cannot find an easy way out of the political logjam, even though economically speaking there are immediate profits to make. A rarely noticed fact is that Wang Yung-ching, chairman of Formosa Plastics, wrote the preface for Chen Shui-bian’s book, *Son of Taiwan*, before Chen rose to power. This fact points to the close relations between Chen and the business community, but these close relations neither make it possible for Chen to heed the business people’s demands after assuming presidency, nor make it easier for the business

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<sup>136</sup> Guo Aibing, “Air Links Get New Push,” *China Daily*, October 13, 2001, p. 1.

community to push Chen to establish closer links with the mainland. The structural constrain in the conflict is quite apparent.

Regarding direct shipping links, Taiwan established a transshipment center in Kaohsiung in 1997. Foreign-flagged feeder ships, registered outside Taiwan and the mainland, can sail between the two sides after first stopping at third destinations, like Hong Kong or Okinawa. But the measure neither allows direct import of Chinese products into Taiwan nor permits direct export of Taiwanese goods to the mainland. It allows transit of mainland goods through the transshipment center to third countries, as well as transit of goods from third countries through the transshipment center to the mainland. Taipei defines the transshipment center as follows: "A transshipment center combines goods from small cargo ships in the region and forwards them in large cargo ships to the rest of the world. At the same time, it also splits up large cargoes for distribution to smaller ports regionally."<sup>137</sup> Taiwan-based Evergreen Marine, Yang Ming Marine Transport, Wan Hai Lines and five other companies, including some from the mainland, are currently engaged in transshipping on this route with foreign-registered ships, and the route has been defined as a special route rather than as international or domestic one.<sup>138</sup> Although foreign products can be transshipped via Kaohsiung to the mainland, few is interested in this option, and only the Taiwanese businesses near Xiamen and Fuzhou are transshipping mainland exports to other regions via Kaohsiung. The explanation for establishing the transshipment center is that Kaohsiung is cheaper than Hong Kong in operation cost, and therefore feeder ships from the south China coast

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<sup>137</sup> Chiu Yueh-wen, "Transshipment Center Promoted," *Taipei Journal*, August 3, 2001, p. 3.

<sup>138</sup> *Ibid.*



will be heading to Kaohsiung rather than Hong Kong once the transshipment center is opened. But Kaohsiung proves to be no match for Hong Kong in carrying Chinese products to the world, and it is not known why a third country should send its mainland-bound goods to Taiwan when it hears that even Taiwanese goods cannot be directly shipped to the mainland. In fact, if the feeder ships could ply the waters across the Taiwan Strait, a function they would be able to play other than carrying mainland products to the transshipment center in Kaohsiung is to carry Taiwanese goods to the mainland, a function they are forbidden to play at this moment. In light of the large volume of Taiwanese exports to the mainland, this would generate business and give Kaohsiung's handling capacity a full play. However, talks on cross-Strait shipping links cannot be opened because of the current political impasse.

Second, security concerns on the part of Taiwan have been affecting cross-Strait economic cooperation. There is every reason to believe that, if Taiwan eases its restrictions on imports from the mainland, trade volume between the two sides will increase. Actually, an increase in imports from the mainland would not severely affect Taiwan's security, but it would increase Taiwan's trade dependence on China and decrease Taiwan's favorable trade balance with it. Some analysts in Taiwan fear that this would allow China to more easily apply economic sanctions against the island. If this kind of calculation in cross-Strait trade is removed, the volume of trade between the two sides should greatly increase.

Not only has the Taiwanese government restricted mainland-bound investments, but it has also tried to divert the island's investments to Southeast Asia. "Taiwan's special interest in diversifying its investments away from China led a state-run ROC

agency to finance a 100-acre 'industrial park' near the Hanoi airport that helped firms from the island become acclimatized before they established operations further afield in Vietnam."<sup>139</sup> During his trips to the Philippines and Indonesia, Lee Teng-hui brought with him a large entourage of economic officials and business people, who struck deals on investments in these countries.

It has already been noted that for security reasons, Taipei banned investments in high-tech manufacturing such as notebook computers and mobile phones (restrictions eased at the end of 2001) and infrastructure projects such as railways, highways, power plants, and ports on the mainland. While firms from other countries competed for contracts, Taiwan shut itself out from these lucrative deals. The opportunity cost to Taiwanese investors could be considerable because of these restrictions. Formosa Plastics chairman Wang Yung-ching wrote a long letter in 2001 to criticize Lee Teng-hui's "no haste, be patient" policy. Wang explained his plan to invest in a power plant in Zhangzhou, Fujian province around 1996. He said tender for the power plant was opened to international competition, and that if Formosa Plastics could not build it, firms from other countries could build it. On the one hand, China wanted to use foreign capital to build the plant in order to rapidly increase power supply, and on the other hand, the investor could obtain profits, so it was a reciprocal deal. Beijing favored Formosa Plastics but the conglomerate was persuaded by Taipei to suspend the project. Wang said that "business opportunity could be lost in a fleeting moment" as China decided to build all power plants with its own funds and shut out foreign investors. Wang seemed to have

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<sup>139</sup> Lynn White III, 162.

a lot of grievances because he even attributed Taiwan's economic recession to the "no haste, be patient" policy.<sup>140</sup>

Jiang Zemin once said: "We hold that political differences should not affect and hinder cross-Strait economic cooperation."<sup>141</sup> This was a lofty idea that carried a lot of foresight. Despite these words, political differences are hindering economic cooperation. The demand for an explicit allegiance to the one-China principle, defined largely in Beijing's terms, is obstructing talks on transportation links. The lack of flexibility regarding the nature of those links has added difficulty to the issue. Li Biancai, deputy director of the State Council's Taiwan Affairs Office, stressed in June 2002 that Beijing opposes "state-to-state" or "semi-international" mode of cross-Strait transportation links.<sup>142</sup> Li, however, reiterated that Beijing continues to refrain from allowing political differences to affect and hinder cross-Strait economic cooperation.<sup>143</sup> The words of Chinese officials show that they know they must separate politics from economics if they were to achieve a higher degree of cross-Strait economic interdependence that would facilitate national reunification, but current events show that they have not been quite successful in such a separation and in preventing politics from interfering with economics.

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<sup>140</sup> Chong Wei-liang, "Wang Yung-ching Writes a 40,000-Character Letter Criticizing 'No Haste, Be Patient' Policy," *Ming Pao*, September 6, 2001.

<sup>141</sup> Fifth point of Jiang's 1995 eight-point proposal.

<sup>142</sup> "Beijing Insists on Separating Politics from Economics," *Ming Pao*, June 5, 2002.

<sup>143</sup> *Ibid.*

### VIII. Summary and Conclusion

The conflict between Beijing and Taipei remains as tenacious as 15 years ago. At this moment, Taipei and Beijing cannot carry out an official political dialogue. They have not shown any flexibility on matters of political principle. They cannot agree on any form of political association. Their policies are not becoming more compatible in the international arena. The military competition persists. The effect of economic exchanges on closing the social and perceptual gaps between the two societies remains to be seen. Finally, current political events continue to affect economic cooperation. Table 5.8 sums up the findings.

Table 5.8. Summary of the Findings on the Seven Indicators

| Questions                                                                  | Answers |      |
|----------------------------------------------------------------------------|---------|------|
|                                                                            | 2002    | 1987 |
| 1. Can both sides carry out a political negotiation?                       | No      | No   |
| 2. Have they compromised on matters of political principle?                | No      | No   |
| 3. Can they agree on any form of politico-economic integration?            | No      | No   |
| 4. Are their policies becoming more compatible in the international arena? | No      | No   |
| 5. Is there an arms buildup on either side?                                | Yes     | Yes  |
| 6. Are the social and perceptual gaps between the two societies narrowing? | *       | No   |
| 7. Do current political events inhibit development of economic ties?       | Yes     | Yes  |

\* indeterminate

Generally speaking, optimists see the pacifying effects of cross-Strait economic cooperation in two ways: (1) as cross-Strait economic interdependence increases, any belligerent behavior causing a disruption of business would be prohibitively costly to all the parties involved;<sup>144</sup> and (2) the economic relations between the two sides provide a context for the people and even officials from both sides to meet, interact, and get acquainted, so it is a golden opportunity for them to sort out their differences and develop personal ties that would help resolving disputes.<sup>145</sup>

However, cost-benefit analysis cannot explain the disruptive behavior in the Taiwan Strait during 1995-96, for it neglects to incorporate the objectives other than economic gains that are equally cherished by, or more important to, both sides. Analysts often see the cost of disruptive behavior and fail to see the cost of not resorting to disruptive behavior under certain circumstances. From Beijing's perspective, there could be economic loss in its disruptive behavior in 1995-96, but there was also a cost of not reacting to Taiwan's pro-independence activities. The cost-benefit analysis is useful only when what exactly is the tolerable cost to the mainland of not reacting to the maneuver by Taipei, and vice versa, can be ascertained. Even if this cost can be identified, it is by no means constant, for there is no guarantee that it will not change over time. It is a

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<sup>144</sup> For example, Zbigniew Brzezinski wrote, "Any attempt at forcible reunification would not only place the American-Chinese relationship in jeopardy but would inevitably generate adverse consequences for China's capacity to attract foreign capital and sustain its development. China's own aspirations to regional preeminence and global status would thereby be victimized." in *The Grand Chessboard* (New York: Basic Books, 1997), 206. Another argument holds that Taiwan is protected by a "silicon shield," for it is the world's third largest producer of information technology hardware and fourth largest producer of semiconductors, and thus China dares not attack because such an attack would antagonize the United States, whose evolving digital economies are based on Taiwan's silicon products (*Taipei Journal* on October 19, 2001, cited Craig Addison's book *Silicon Shield* in reporting such an argument).

<sup>145</sup> This is similar to the liberal theory that suggests that when officials from different countries meet in international organizations, they get acquainted, develop personal ties, discuss differences and resolve disputes.

conceivable scenario that the more China develops, the more it will aspire to accomplish its great goal of national reunification, and thus the less it will tolerate the status quo. At present, as it was in 1987, it is prohibitively costly to Beijing if it allowed Taipei to creep away, and it is equally costly to Taipei if it became a special administrative region of the PRC. Of course, a conflict would be costly, but so are the weapons bought by both sides, the conscription arrangements in Taiwan, and the defense budgets.

It is true that cross-Strait economic interactions have provided an opportunity for the people and even officials from both sides to meet, but this does not mean they will soften their stances or abandon their firmly held convictions. For example, in September 2001, China's Finance Minister Xiang Huaicheng met Taiwan's Finance Minister Yen Ching-chang on the sidelines of the APEC ministerial meeting. "We had very good talks," Xiang told reporters after the meeting, "the two sides have many views in common on economic questions." Yen echoed the sentiment, saying, "We have very friendly discussions." Despite all the common views, warmth, and smiles, there was a reminder of the simmering political tensions between the two sides, as Xiang referred to Yen as "mister" instead of "minister." In June of the same year, Taiwanese Economic Minister Lin Hsin-I met mainland Trade Minister Shi Guangsheng, also on the sidelines of the APEC meeting, after Taipei protested that China had snubbed Lin by leaving his ministerial title off the invitation to the meeting.<sup>146</sup> Beijing makes it clear that economic cooperation will not confer upon Taiwan the status of a sovereign state. Taipei refuses to be treated in Beijing's way. Thus, more contacts do not necessarily mean compromises; they may mean more opportunities for disputes.

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<sup>146</sup> "China and Taiwan Find Common Ground at APEC," *South China Morning Post*, September 7, 2001.

As both sides stand firm on their respective positions and refuse to accept the arrangements by the other side, cross-Strait economic cooperation plays little role in resolving cross-Strait political conflict. Evidence suggests that the conflict has not become obsolete owing to the development of economic ties, which have not brought about a closer political relationship. By comparing 2002 with 1987, hypothesis 2 is tested, and proved correct. Hypothesis 2 is restated: *Economic cooperation between Beijing and Taipei, as a cause, has little effect on reducing their political conflict.*

## Chapter 6

### Motives and Concerns

Beijing and Taipei have different motives and concerns for their economic cooperation. An analysis of these motives and concerns will shed light on the role of politics in economic exchanges between the two sides. This chapter (1) analyzes these motives and concerns, and (2) critically reviews the theoretical soundness of two frameworks used to explain cross-Strait commerce. The second task is related to the first because it aims to deepen the understanding of those motives and concerns.

A brief note on the two frameworks follows. The first framework is the “relative gains” approach, which explains the difficulty in economic cooperation among states by assuming that a state will refuse to join, will sharply limit, or will leave a cooperative arrangement that allows its partner larger gains, because such gains tilt the balance of power and can be transformed into military might, which can be used to do harm once the partner becomes an enemy. States therefore care not just about absolute gains but also relative gains; actually, their foremost concern is not to maximize absolute gains but to watch out for relative gains.<sup>1</sup> They do so because they are motivated by the desire to survive, and to prevent the possibility of being encroached upon in the future. The relative gains concept is therefore largely based on states’ motive for survival, security

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<sup>1</sup> Joseph, M. Grieco, “Anarchy and the Limits of Cooperation: A Realist Critique of the Newest Liberal Institutionalism,” *International Organization*, vol. 42, no. 3 (Summer 1988): 485-507.



and autonomy. In this framework, Taiwan's restriction on investment in China is explained in terms of its relative gains concern. Based on the concept of relative gains, the fundamental goal of Taiwan in conducting economic exchanges with China is not to maximize absolute gains but to prevent China from achieving advances in its relative capabilities.<sup>2</sup> By this logic, removing Taiwan's relative gains concern would result in the lifting of restrictions on cross-Strait investment, and thus greatly increase cross-Strait economic exchanges. However, using this framework to explain Taiwan's restriction on China-bound investment is misleading, as will be explained later.

The second framework is the "weak state" theory, which says developments inside and outside of a state may weaken its ability to regulate its affairs. Joel Migdal defines strong states and weak states in terms of their capabilities to achieve the objectives their leaders sought through state planning, policies, and actions. Migdal wrote, "Capabilities include the capacities to *penetrate* society, *regulate* social relationships, *extract* resources, and *appropriate* or use resources in determined ways. Strong states are those with high capabilities to complete these tasks, while weak states are on the low end of a spectrum of capabilities."<sup>3</sup> In the case of Taiwan, Tse-kang Leng argued that democratization weakens the government's ability to restrict cross-Strait trade, and globalization makes it difficult to regulate the investment activities of large

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<sup>2</sup> Ping Deng, "Taiwan's Restriction of Investment in China in the 1990s: A Relative Gains Approach," *Asian Survey* (November/December 2000): 958-980.

<sup>3</sup> Joel S. Migdal, *Strong Societies and Weak States: State-Society Relations and State Capabilities in the Third World* (Princeton, NJ: Princeton University Press, 1988), 4-5.

enterprises.<sup>4</sup> Regarding globalization, Leng held that “as Taiwanese enterprises become internationalized, it has become harder for the government to control capital flows to mainland China,”<sup>5</sup> and “the Taiwanese state tries to limit capital and personnel outflows to China but falls short of operational instruments in the era of economic globalization.”<sup>6</sup> This is because large conglomerates can raise funds in the international market and invest in China through their overseas subsidiaries. Leng’s observation is keen, but does not tell the whole story. Through an analysis and a critique, this chapter further illuminates the role of politics in cross-Straits economic cooperation. The analysis begins on the mainland side, for which the following quotations are useful:

### **I. On the Mainland Side**

Chinese President Yang Shangkun said in 1990:

Grasp all good opportunities, make the best use of the situation, break the wall of the KMT, open the “three links” as soon as possible, and foster a dense network of ties across the Strait, so as to gradually form a pattern in which both sides are closely linked and become inseparable.

To vigorously develop cross-Straits ties, the emphasis is on trade, investment, and various exchanges; regarding cross-Straits interaction, let economics push politics, let the people push the officials, to a direction that is conducive to national reunification and our modernization drive.

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<sup>4</sup> Leng developed the first theme (democratization) in his 1996 book, *The Taiwan-China Connection*, and the second theme (globalization) in his articles, “Dynamics of Taiwan-Mainland China Economic Relations: the Role of Private Firms,” *Asian Survey* (May 1998): 494-509; and “Economic Globalization and IT Talent Flows Across the Taiwan Strait: the Taipei/Shanghai/Silicon Valley Triangle,” *Asian Survey* (March 2002): 230-250.

<sup>5</sup> Leng 1998, “Dynamics of Taiwan-Mainland China Relations,” p. 501.

<sup>6</sup> Leng 2002, p. 231.

The significance of trade and economic cooperation with Taiwan must be understood from the strategic height of the country's peaceful reunification. Developing bilateral trade and economic cooperation so as to foster a denser network of ties between the two sides, is a good measure to check the separatist tendencies on Taiwan and promote peaceful reunification. The work on trade and economic cooperation with Taiwan must observe the law of economics on the one hand, and on the other hand, serve the political mission of promoting peaceful reunification.<sup>7</sup>

Chinese President Jiang Zemin said in 1995:

We hold that *political disputes must not affect nor interfere with cross-Straits economic cooperation*...we will earnestly protect all the legitimate rights and interests of Taiwanese businesspeople, under whatever circumstances (emphasis added).<sup>8</sup>

State Councilor Wu Yi, who used to oversee China's foreign trade, said in 1999:

Although the current work on trade and economic cooperation with Taiwan is being affected by Lee Teng-hui's "two states theory," new opportunities exist. The trade and economic relations between Hong Kong and Macau on the one hand, and Taiwan on the other hand, have already become an important and special component of cross-Straits relations. We must fully utilize the favorable conditions of Hong Kong and Macau to promote the "three links," strengthen the work on trade and economic cooperation with Taiwan, *and create conditions for eventually realizing peaceful reunification of the country* (emphasis added).<sup>9</sup>

State Council's Taiwan Affairs Office Deputy Director Li Bingcai said in 2002:

Beijing continues to refrain from allowing political differences to affect and hinder cross-Straits economic cooperation.<sup>10</sup>

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<sup>7</sup> Yang Shangkun's speech to the National Conference on Taiwan Work, December 6, 1990; the speech was printed and issued by the Central Committee of the Communist Party of China, January 28, 1991. Taipei-based *China Times* carried it on April 14, 1991. Quoted in Wu, 397, 398, 400.

<sup>8</sup> Fifth point of Jiang's 1995 eight-point proposal.

<sup>9</sup> Wu Yi's speech, entitled "Guided by the Spirit of the Central Economic Work Conference, Do a Good Job in Foreign Trade in 2000," was delivered on December 22, 1999, and printed as preface to the *China's White Paper on Foreign Trade and Economic Cooperation, 2000* (in Chinese) (Beijing: China Social Science Press House, 2000), 14.

<sup>10</sup> "Beijing Insists on Separating Politics from Economics," *Ming Pao*, June 5, 2002.

At first glance, Beijing has contradictory goals in its economic exchanges with Taipei. President Yang saw a great deal of political functions of such exchanges, which could facilitate China's reunification. President Jiang tried to separate political disputes from economic cooperation. State Councilor Wu Yi thought that economic cooperation with Taiwan was to create conditions for realizing the country's reunification. Taiwan Affairs Office Deputy Director Li Bingcai again tried to separate politics from economics.

But a closer look at the goals reveals nothing contradictory. These are signs that Beijing's leaders do have a political motive in conducting cross-Straits trade, but they realize that stressing such a motive too much will cause concerns on the part of Taiwan, which will then try to keep Beijing at arm's length, therefore an emphasis on the political functions of cross-Straits trade would be self-defeating. Regarding what they want to do with the economic ties, mainland officials have realized that they should do it, but not talk about it, and if they talk too much about it, they cannot do it. Beijing has reassured Taiwanese business people that no matter what happens, their interests would be protected, and it has acquiesced in Taiwan's huge surplus in cross-Straits trade. Such acquiescence cannot be convincingly explained purely in economic terms, because an economic explanation would require Beijing to complain about its unfavorable trade balance with Taipei. From Beijing's perspective, given more time, the economies on both sides of the Taiwan Strait will be intertwined to the extent that it will be next to

impossible for Taiwan to break away.<sup>11</sup>

Of course, cross-Strait trade and investment bring about both economic and political benefits. Harry Harding observes:

The governments of principal Chinese societies are not simply removing past obstructions and adopting a neutral posture towards economic relationships. Instead, they remain deeply involved in promoting and guiding the commercial ties among their economies. What is more, they are doing so for strikingly different motives. From Beijing's perspective, *economic interaction is viewed as a way of facilitating the eventual political reunification of China*. The mainland government has therefore adopted a series of policies to stimulate commercial relations with Hong Kong and Taiwan, most notably the creation of special economic zones directly opposite them, *for political as well as for purely commercial reasons* (emphasis added).<sup>12</sup>

Wu Hsin-hsing succinctly sums up Beijing's strategy: "Apparently, the PRC's pragmatism on trade and economic matters is an end (development of the economy on the mainland) and at the same time a means (to create conditions for China's reunification). To the PRC, the short- and medium-term goal in cross-Strait relations is characterized by economic pragmatism, and the long-term goal is political unification."<sup>13</sup>

As mentioned earlier, Beijing opposes Taipei's participation in the United Nations (UN) and the World Health Organization (WHO), but does not oppose Taipei's membership in the Asian Development Bank (ADB), the Asia-Pacific Economic

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<sup>11</sup> Jiang Zemin said in 1994, "More work must be done on Taiwan's medium-sized and large enterprises, to attract Taiwanese capital—especially the large ones—to the mainland, and to intermingle the two economies and make them inseparable, so as to pin down Taiwan economically. This is to promote reunification with economics." *Lien Ho Pao* (Taiwan), March 1, 1994, p. 4; quoted in Wu, 193. The occasion on which Jiang made the remarks was not known, but it seems to be a speech to Chinese cadres. The Mainland Affairs Council has quoted some of these words, thus confirming their credibility. While meeting a group of 60 senior Taiwanese executives in Beijing in 1996, Jiang told them that political differences should not be allowed to interfere with economic cooperation between the two sides. See Clough, 53. This shows that Jiang has two versions, one for Chinese cadres and one for external audience.

<sup>12</sup> Harry Harding 1993, p. 666.

<sup>13</sup> Wu, 194.

Cooperation (APEC) forum, and the World Trade Organization (WTO). A closer look at Beijing's handling of Taipei's participation in international organizations finds a principle at work. The ADB, APEC, and WTO are different from the UN and the WHO in that they are purely economic bodies. Beijing does not oppose the development of economic relations between Taiwan and other countries, but opposes Taipei's participation in the international organizations that are set up to deliberate world affairs, and it views Taipei's bid to join the WHO as an abuse of the grey zone, because the WHO is different from the UN but still is a specialized agency of the UN, and not devoted to economic matters. Beijing tolerates Taipei's participation in international economic organizations because it will help Taiwan's economic development, which will then necessitate economic cooperation with the mainland. Already, Taipei has talked about developing itself into an Asia-Pacific Regional Operation Center that is the business and transportation hub in the region, and former Taiwanese premier Vincent Siew has talked about forming a Chinese Common Market including the mainland and Taiwan. But all this cannot materialize without China's support and, most importantly, without economic prosperity on the part of Taiwan; and when they materialize, they will link Taiwan's economy more closely to that of the mainland. Beijing sees itself as the hinterland on which Taiwan will increasingly depend—Lee Teng-hui actually called for using China as Taiwan's economic hinterland in his 1995 proposal—and Taiwan's economic prosperity will accelerate that process. Since Beijing's grand design is to let economic integration lead to political union, Taiwan's participation in the international organizations that can promote cross-Straits economic integration is allowed, but Taiwan's participation in the international organizations that can complicate political unification is opposed.

Beijing has little concern about developing economic ties with Taiwan except when Taiwanese investors follow the motto: "Move all your obsolete machinery to the mainland and keep the quotas and orders from the international market."<sup>14</sup> Chinese Premier Li Peng once said, "Taiwan has people who wish to move 'sunset industries' to the mainland. We have openly expressed the fact that we do not welcome 'sunset industries.' We welcome high technology, and we welcome externally oriented projects that can export."<sup>15</sup> "Sunset industries" cause environmental pollution and are not helpful in the transfer of technology, although they can generate employment opportunities. Jiang Zemin welcomes large Taiwanese firms because, apart from the political motive mentioned above, these firms bring about large investments and advanced technologies.

## II. On the Taiwan Side

In Taipei, the decision to go ahead with cross-Straits trade and investment is driven by economic benefits as well as the desire to exchange economic prowess for political influence. First, with regard to economic benefits, Taiwan has obtained a huge surplus in its trade with the mainland since the early 1990s. Taiwanese investments in China have good returns, despite occasional reports of losses. Since the mainland is willing to open its market for Taiwanese products, to supply land and labor at low cost, and to make preferential policies for Taiwanese firms, Taiwanese business people would find themselves fools not to grasp that opportunity. When there is money to be made, the

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<sup>14</sup> Willem Van Kemenade, 193.

<sup>15</sup> Li Peng, "Make an Effort to Get the Market Moving: Create an Appropriate Development of Production," *People's Daily (Overseas Edition)*, October 9, 1990; quoted in Naughton, 101.

government in Taipei allows its businesspeople to make it, and at the same time holds the purse strings by maintaining control over the importation of mainland goods. Taiwanese business people understand the animosity between the two governments, but they also believe in “no risks, no gains.”

Second, Taipei wanted to offer economic benefits to the mainland in exchange for three things: (1) renunciation of force by the mainland; (2) permission for Taiwan to have a larger voice in the international arena; and (3) an equal footing for negotiations—but not party versus party. This is clearly seen in Lee Teng-hui’s 1995 response to Jiang Zemin’s eight-point proposal, and in several Mainland Affairs Council (MAC) statements. As Naughton observed, “the government of Taiwan has a long-term interest in delaying economic contacts and holding them hostage to a greater degree of official recognition.”<sup>16</sup> Taipei’s delaying tactics on the issue of the “three links” are not just for security reasons but also an effort to extract political concessions from Beijing. There are many imaginable economic levers Taipei can use: (1) opening a shipping route between Taiwan and the mainland; (2) opening an aviation route between Taiwan and the mainland; (3) implementing these links for cargoes but not for passengers; (4) implementing these links for both cargoes and passengers; (5) increasing these routes from one to several; (6) allowing mainland workers into Taiwan; (7) allowing mainland investors into Taiwan; (8) importing more mainland products; (9) stopping the effort to divert investments away from China; (10) permitting investments in high-tech projects and currently prohibited infrastructure projects; and (11) carrying out technological and scientific cooperation with the mainland. Of course, all these moves will tie Taiwan’s

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<sup>16</sup> Naughton, 83.



economy more closely to that of the mainland, but they may also bring about political concessions and official recognition that can guarantee Taiwan's position.

Third, a less well-known motive on the part of Taipei, deliberated more by the academic community and less by the government, is to change the way of thinking and the society on the mainland. China says this is an attempt at "peaceful evolution." Deng Xiaoping warned his people in 1985 that "an ideological trend has appeared that we call bourgeois liberalization. Its exponents worship the 'democracy' and 'freedom' of the Western capitalist countries and oppose socialism. This cannot be allowed. China must modernize; it must not liberalize."<sup>17</sup> Shortly after the Tiananmen incident in 1989, Deng told former Tanzanian president Julius Nyerere: "The Western countries are staging a third world war without gunsmoke. By that I mean they want to bring about the peaceful evolution of socialist countries towards capitalism."<sup>18</sup> As a Taiwanese scholar observes, "from Beijing's perspective, the Western world, including Taiwan, has always tried to use the opportunity from China's reform and opening up, to promote Western-style democracy and human rights, to 'engage in bourgeois liberalization,' and to carry out a peaceful evolution of the PRC, in order to topple socialist China."<sup>19</sup> Although the Chinese press has condemned this plot, judged from China's enthusiasm for foreign trade and investment, it seems that Beijing is quite confident that economic prosperity will give it political legitimacy, and therefore it has not expressed a real concern about it.

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<sup>17</sup> "Bourgeois Liberalization Means Taking the Capitalist Road," in *Selected Works of Deng Xiaoping*, vol. III, 1982-1992, p. 129.

<sup>18</sup> "We Must Adhere to Socialism and Prevent Peaceful Evolution Towards Capitalism," a Talk with Julius Kambarage Nyerere, former President of Tanzania, on November 23, 1989. See *Selected Works of Deng Xiaoping*, vol. III, 1982-1992, p. 333.

<sup>19</sup> Wu 21.

Taipei realizes that it is geographically close to the mainland, that it is within the magnetic field of the latter in political and economic influences, and that it might have to reconcile itself with these facts some day. If a political association with the mainland were ultimately unavoidable, it would be better to unite with a prosperous, modern, and benign China that can be molded through economic interactions, which will hopefully narrow the differences in mentality and living standards between the two sides. Taipei has dubbed itself a lighthouse for China, which it says should borrow its experience in political democratization and economic development. *The Republic of China Yearbook 2001* explained:

If interaction between the people of the two sides could be gradually increased, then ideological conflicts could eventually be set aside and differences in the ways of thinking and living could be ameliorated. Unfortunately, much to the disappointment of the ROC government, this was not to be the case.<sup>20</sup>

The MAC said in its statement on cross-Strait relations in 1994:

Taiwan, the mainland, and Hong Kong joined the APEC in 1991. In the future, both sides of the Strait will join the General Agreement on Tariff and Trade. Economic and trade liberalization in the Asia-Pacific region will bring prosperity to the region, and induce the PRC to quicken its pace in reform and opening up. This will be conducive to the development of cross-Strait ties, and *narrow the gap in economic development between the two sides, so as to provide a favorable condition for peaceful unification of China* (emphasis mine).<sup>21</sup>

Taiwanese scholars have pointed out the political functions of economic cooperation between the two sides. For example, much in the same vein written by Erich Weede,<sup>22</sup> who says economic prosperity will lead to political democracy, which will then

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<sup>20</sup> *Republic of China Yearbook 2001* (Taipei: Government Information Office, 2001), 158.

<sup>21</sup> Quoted in Wu, 475.

<sup>22</sup> Erich Weede, *Economic Development, Social Order, and World Politics: With Special Emphasis on War, Freedoms, the Rise and Decline of the West, and the Future of East Asia* (Boulder, Colorado: L. Rienner Publishers, 1996).

lead to peace, Chang Tsan-ho suggests that economic development in China can lead to democratization, which is a condition for unification:

To the Taiwan authorities and people who favor unification, it is necessary to set aside temporarily the political disputes between the two sides, and work on the economic and cultural development on the mainland. We can certainly imagine that when the mainland's economy has developed, when its people's educational standards have improved, and when a civil society based on a middle and intellectual class has taken shape, it will become impossible for the Chinese communists to carry on their single-party dictatorship even if they want to do so.<sup>23</sup>

However, as Taiwanese investments go across the Strait, a theory on "hollowing out of industries" (*chanye kongdong hua*) emerges. Briefly put, the theory says that inadequate domestic investment in Taiwan resulting from the capital flight to China will retard Taiwan's industrial development and infrastructure construction, while relocation of industries to China results in closing down of factories and job losses. It was reported that a \$100 investment by Taiwanese firms on the mainland would reduce investment in Taiwan by at least \$20.<sup>24</sup> The theory is still being debated and a clear-cut conclusion seems unlikely, but the fact that it exists is a sign of concern on Taiwan.

Actually, relocation of obsolete industries to the mainland is a good measure for Taiwan to upgrade its industries. There are two sides of the coin: Jobs may be lost and factories closed down, but pressure for industrial upgrading also mounts. Leng wrote, "Taiwan can create a 'vertical division of labor' in its internationalization and thus keep capital-intensive industries and research and development on domestic soil. If this is

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<sup>23</sup> Chang, 409.

<sup>24</sup> Gao Zang and Wu Shiyang, "Taishang Pu Dalu Touzi," (Taiwanese Businesses Investing on the Mainland), *Qianzhan*, July 5, 1995, pp. 40-44; quoted in Liew, 162.

realized, Taiwan need not worry about the 'hollowing out' effect on its manufacturing industries. Moving labor-intensive industries to mainland China... would be a natural trend under the framework of the vertical division of labor."<sup>25</sup> At the end of 2001, MAC Chairwoman Tsai Ing-wen noted that, as relocation of labor-intensive industries to the mainland has increased, the share of high-tech products in total exports in Taiwan has increased to 55.8 percent. "This indicates that the industrial structure is being upgraded and that industrial hollowing-out is no longer a major concern of Taiwan's mainland investment policy."<sup>26</sup> Tsai's view shows that industrial hollowing-out has been a concern, though it is now found that it can facilitate Taiwan's industrial upgrading.

Taipei certainly understands Beijing's short-term economic pragmatism and long-term political goal; it is concerned about Beijing's desire to "make the best possible use" of the economic ties. Taipei's concern was further summed up by MAC Vice-Chairman Lin Chong-ping, who warned in 2001 that "communist China's intention to get us is growing," as it tries to diplomatically suffocate, politically coerce, economically hollow (*tao kong*), militarily threaten, and socially integrate with Taiwan.<sup>27</sup> In a frightening cartoon that was found in a September 2001 issue of the *Taipei Journal*, a huge Chinese crocodile opens its mouth wide in front of a tiny and puzzled Taiwanese businessman, and says, "Come in! I'll let you keep everything else."

Already, Beijing has warned Taiwanese business people that they cannot make profits in China on the one hand, and support Taiwanese independence on the other

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<sup>25</sup> Leng 1998, "Dynamics of Taiwan-Mainland China Relations," p. 509.

<sup>26</sup> "Mainland Trade Rules Relaxed," *Taipei Journal*, November 23, 2001, p. 2.

<sup>27</sup> "MAC Condemns Beijing for Blocking Taiwan's Contacts with Foreign Banks," *Ming Pao*, September 8, 2001.

hand.<sup>28</sup> Byron Weng, a former professor with the Chinese University of Hong Kong and now an adviser to the president in Taiwan, reported that “there were also warnings by He Zhiming, the [Central People’s Government] liaison office’s deputy director of Taiwan Affairs [in Hong Kong], that Hong Kong businesses should not have dealings with Taiwanese companies that support Taiwan independence.”<sup>29</sup> A measure Beijing can use (and is reported to have used) to check the pro-independence tendency on Taiwan is to give business contracts to the conglomerates that call for closer links with the mainland, and to honor the leaders of these conglomerates by granting them meetings with top Chinese officials. Formosa Plastics chairman Wang Yung-ching dined with Zhu Rongji in Beijing during a tour in 1996. In May 2002, Taiwan Affairs Office director Chen Yunlin suggested that Wang Yung-ching, as well as Kao Ching-yuan of Uni-President Enterprises Corp, could represent Taiwan in the negotiation on opening direct shipping links, thus honoring them by signaling Beijing’s trust in them.<sup>30</sup> Both Wang and Kao have substantial investments in China. Kao is a Central Committee member of the KMT, which calls for unification. Beijing’s *China Daily* praised, “Taiwan’s business circle, led by tycoon Wang Yung-ching, has pressured Taiwan’s authorities to end the five-decade ban on direct shipping, postal and air links between Taiwan and the mainland.”<sup>31</sup>

Professor Liew observed that China’s “closer economic links with Taiwan will allow the

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<sup>28</sup> “Taiwan: Businesses Told to Shun Separatists,” *China Daily*, December 27, 2001, p. 2. Commenting on some Taiwanese business people’s preparation for former leader Lee Teng-hui’s think tank, “Taiwan Advocates,” Taiwan Affairs Office spokesman Zhang Mingqing said that business people should have a clear understanding of the purpose of this separatist organization.

<sup>29</sup> Byron Weng, “Beijing Quashing Hong Kong Freedoms,” *Taipei Journal*, September 13, 2002, p. 7.

<sup>30</sup> Wang Touh (a DPP legislator), “Misleading Public on Direct Links a Big No-No,” *Taipei Times*, May 27, 2002; and Lin Miao-jung, “Tsai Offers Criteria for Negotiators,” *Taipei Times*, May 23, 2002.

<sup>31</sup> Xing Zhigang, “Taiwan Leader Urged to Honor Pledge on Links,” *China Daily*, May 22, 2002.

Mainland to cultivate Taiwanese public opinion more effectively.”<sup>32</sup> One way to do so is to win over large Taiwanese firms, which would hopefully articulate Beijing’s interest on the island. Wang Yung-ching has told reporters that Taiwanese are Chinese, China “also belongs to us,” and communists are “not that bad.”

Taiwanese business people on the mainland generally acquiesce in Beijing’s pressures on Taipei. They keep a low profile and refrain from openly talking about sensitive political issues while concentrating on running their businesses. According to a report from Kunshan, which is about 55 miles from Shanghai and is a popular place for Taiwanese investors, the local authorities have adopted a “don’t ask, don’t tell” attitude toward politics, and “Taiwanese business people in Kunshan say officials they meet do not try to discover whether they support President Chen. The businessmen, in turn, are usually careful not to get publicly involved in debates about the politically and emotionally charged issue of reunification.”<sup>33</sup> Most of them also want an end to the five-decades-old ban on direct transportation links, because that would help their businesses. But they also realize their delicate position in cross-Strait relations. Chang Fu-mei, chairman of the Taiwanese Businessmen Association for Friendship and Progress in Shanghai, said after the air raid drill in Shanghai in August 2002, that it was “to use businessmen to pressure politicians,” because the drill was conducted in Changling District, a rendezvous for Taiwanese business people.<sup>34</sup>

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<sup>32</sup> Liew, 159.

<sup>33</sup> “China and Taiwan; Business Trumps Politics,” *The Economist*, July 28, 2001, p. 44.

<sup>34</sup> *Oriental Daily News*, August 14, 2002.

### Summing Up

Why would Taiwan trade with, and invest in, its major adversary? This is a question of how Taipei balances risks and economic gains. Taipei knows that China needs a period of peace to concentrate on economic development. Deng Xiaoping explained in 1984: “China is still poor, with a per capita GNP of only US\$300. We aim to increase this to \$800 by the end of the century, which is a lofty goal. Eight hundred dollars is nothing to developed countries, but it is an ambitious target for China, meaning a GNP of \$1 trillion at the end of the century.”<sup>35</sup> Deng’s goal was realized, because by 2000 China’s GNP had increased to US\$1,065 billion. After coming out of the chaos of the Cultural Revolution, Deng told his people that “we are wholeheartedly devoting ourselves to the modernization program to develop our country,” and “the aim of our foreign policy is world peace,” which would ensure “that no war will break out and that peace will be long-lasting, so that we can concentrate on the drive to modernize our country.”<sup>36</sup> In 1984, Deng Xiaoping reiterated this position to a Georgetown University delegation, saying that China hopes for a stable world situation and a peaceful environment for at least two decades, for it would give the Chinese people time to concentrate on modernization.<sup>37</sup> There is no doubt that Deng’s vision has become a consistent policy, because China has not fought any war since the clash with Vietnam in

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<sup>35</sup> “We Must Safeguard World Peace and Ensure Domestic Development—Excerpt From a Talk with President Joao Baptista de Oliveira Figueiredo of Brazil, May 29, 1984,” *Selected Works of Deng Xiaoping vol. III, 1982-1992*, pp. 66-67.

<sup>36</sup> Ibid.

<sup>37</sup> *Beijing Review*, March 5, 1984, p. 7.

1979, and it has made an effort to improve relations with its neighbors. In 1997, Liu Huaqiu, one of China's top foreign affairs officials, wrote in the same vein: "The fundamental task of our country's diplomatic work is to serve the purpose of its reform, opening up, and socialist modernization; to secure a peaceful international environment for a fairly long time to come; and to maintain good relations with our surrounding countries."<sup>38</sup>

Taipei fully understood Beijing's desire for stability and peace. Although economic cooperation with its adversary poses risks, Taipei thinks that such risks are not imminent because, in the short term, belligerence on the part of the PRC is unlikely if there is no provocation on the part of Taiwan, while economic gains are immediate. Taipei knows, as Singapore's Lee Kuan Yew explains, that "in the next 50 years, the Chinese will have to complete three transitions: from a planned to a market economy, from a rural to an urban base, from a tightly controlled communist society to an open civic one. Several factors can derail China from its present track of catching up with the industrial nations. The first and most important is Taiwan."<sup>39</sup> Because China does not want to be derailed from its present track of modernization, it would not attack Taiwan unless it has to. Beijing has enough trouble of its own, as *Taipei Times* proclaims in its editorial: "China faces an avalanche of internal woes, such as bureaucratic corruption, failing state-owned enterprises, massive unemployment, an economy that needs a drastic overhaul and a lack of human rights. Its plate is full for the moment."<sup>40</sup> It will take time

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<sup>38</sup> Liu, Huaqiu, "Strive for a Peaceful International Environment," *Jiefang Ribao* (Liberation Daily, Shanghai), November 3, 1997; quoted in David Shambaugh and Orville Schell, eds., *China Reader: the Reform Era* (New York: Vintage Books, 1999), 464.

<sup>39</sup> Lee, 726.

<sup>40</sup> "Editorial: It's Time for Sense and Sensibility," *Taipei Times*, March 17, 2001.



and energy to fix these problems. Meanwhile, new problems arise in the course of economic reform. Since the “iron rice bowl” is broken for workers in many state-owned enterprises, protests from the laid-off are a new phenomenon with which Beijing will have to cope.<sup>41</sup> Under such circumstances, Beijing is more likely to fight with its internal woes than fighting against Taiwan, so long as Taipei refrains from changing the status quo. Chen Shui-bian realized this because he said he would not allow Beijing to find any excuse to attack Taiwan when he prepared for his inauguration speech. Seeing no imminent danger, and that to some extent the initiative is in its own hands, Taipei went ahead with the economic exchanges across the Taiwan Strait.

The same logic that Beijing can be tied down by other priorities and will not become belligerent as a result, so that trade and investment across the Strait are safe, is reflected in Taiwan’s support for Beijing’s bid for Olympics in 2008. To Taipei, Beijing’s endeavor to host a round of Olympics will reduce the possibility that it might use military force against Taiwan.<sup>42</sup> After Beijing won the bid in July 2001, Taipei extended its congratulations, and the director-general of the Government Information Office said, “We also hope the mainland will pursue a vision of world peace and renounce the option of using force in the Taiwan Strait and the Asia-Pacific region, so as to maintain regional peace and stability and live out the spirit of the Olympic Games.”<sup>43</sup> Meanwhile, “some business groups in Taiwan see the IOC [International Olympic

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<sup>41</sup> “Urban Discontent,” *The Economist*, June 15, 2002, p. 13.

<sup>42</sup> “If Beijing Hosts the Olympics, the Possibility of its Using Force Against Taiwan is Reduced,” *World Journal*, July 11, 2001, p. A1; and Jane Perlez, “U.S. Won’t Block China’s Bid for Olympics,” *New York Times*, July 11, 2001, p. A6.

<sup>43</sup> Catherine Hsieh, “Taiwan Welcomes IOC Decision, Urges Olympic Spirit for Beijing,” *Taipei Journal*, July 20, 2001.

Committee] decision to allow Beijing to host the games as a seven-year-long insurance policy, which will safeguard peace across the Taiwan Strait.”<sup>44</sup>

Seeing that there is a chance to influence China, there are profits to make and opportunities to win political concessions, Taipei allows economic transactions to take place, but it also intermittently voices concern. The MAC said in its statement: “In cross-Strait trade and economic exchanges, the PRC says ‘no one swallows anyone,’ but in reality it has used a strategy by which ‘the big eats the small.’ It says the trade and economic exchanges between the two sides should be viewed from a strategic height, in order to ‘pin down Taiwan.’”<sup>45</sup> Taipei’s concern originated from its unwillingness to be pinned down. Liew succinctly sums up Taipei’s concern:

There is some caution in the Taiwanese government about closer economic relations with the Mainland. The Taiwanese government is concerned that an over reliance on the Mainland as a market for its exports and a destination for its investment capital would enable the Mainland to use these as leverage against it in any future political dispute...greater economic interdependence with the Mainland is also likely to rule out formal independence as a realistic option for Taiwan.<sup>46</sup>

Economic ties across the Strait limit Taiwan’s freedom of action and choices and provide China with a means to pressure Taiwan. The leverage Liew mentioned might include a boycott of Taiwanese goods so as to deny Taiwan the trade surplus, or persuading Taiwanese business people to exert pressure on their government. Theoretically, China may freeze Taiwanese assets on the mainland should a serious armed conflict erupt and Beijing thought that these assets were being funneled to finance

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<sup>44</sup> Ibid.

<sup>45</sup> Wu, 474.

<sup>46</sup> Liew, 159, 171.

Taiwan's war effort. These prospects concern Taiwan as it tries to preserve its freedom and autonomy, especially when Beijing talks about realizing reunification through economic integration.

### III. A Critique of Two Frameworks

A requirement in social science research is to apply a theoretical framework to an empirical phenomenon in order to account for it. So driven, a researcher sometimes grabs whatever model is fashionable and applies it to his case without considering whether it is an appropriate one. This can do more harm than good. Ping Deng applies the "relative gains" approach to the study of cross-Strait economic ties.<sup>47</sup> Developed by the realists, the concept of relative gains stresses the difficulty in international cooperation. According to realism, in international politics there is no guarantee that today's friend will not become tomorrow's enemy, therefore partners in economic cooperation are concerned about not only absolute gains but also relative gains, because these gains could be turned into military might for future confrontation. In Waltz's words, "when faced with the possibility of cooperating for mutual gains, states that feel insecure must ask how the gains will be divided. They are compelled to ask not 'Will both of us gain?' but 'Who will gain more?'"<sup>48</sup> Joseph Grieco, another realist, wrote:

A state will decline to join, will leave, or will sharply limit its commitment to a cooperative arrangement if it believes that gaps in gains will substantially favor

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<sup>47</sup> Ping Deng, 958-980.

<sup>48</sup> Waltz 1979, p. 105.

partners. It will so eschew cooperation even if participation in the arrangement was providing it, or would have provided it, with large absolute gains.<sup>49</sup>

The underlying logic for this behavior is that in an anarchic world that is characterized by the principle of self-help, states are concerned about their physical survival and political independence, and thus they try to prevent increases in relative capabilities of other states that might become detrimental to their survival. States, according to Waltz's assumption, *"are unitary actors who, at a minimum, seek their own preservation and, at a maximum, drive for world domination."*<sup>50</sup> Waltz said, "I assume that states seek to ensure their survival," although he allowed for the possibility that some states may seek goals which they value more highly than survival—they may, for example, prefer amalgamation with other states to their own survival in form.<sup>51</sup> At present, because the ROC on Taiwan prefers survival to amalgamation; therefore, it may be sensitive to relative gains in its economic cooperation with the PRC on the mainland.

Following this hint, Ping Deng attributed Taiwan's restriction on China-bound investment to its relative gains concern, and Ping Deng wrote:

Based upon the above theoretical discussion [on relative gains], the central hypothesis of this article is that, as Taiwan constantly faces a military threat and zero-sum political competition from China, Taiwan remains extremely sensitive to relative gains. For this reason, it has restricted its mainland investments so as to avoid possible economic dependence upon China.<sup>52</sup>

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<sup>49</sup> Grieco, 499.

<sup>50</sup> Waltz 1979, p. 118.

<sup>51</sup> Ibid., 91-92.

<sup>52</sup> Ping Deng, 961.

Few people will disagree that Taiwan faces a military threat and a zero-sum political competition from China. In fact, the case of China-Taiwan relations seems to be a good one for relative gains analysis, because the regimes on the two sides of the Taiwan Strait are clearly identified adversaries. The Taiwan Strait is one of the dangerous flashpoints in world politics, and the use of force is always at issue. The case therefore meets a significant criterion for relative gains concern to take place as suggested by Robert Keohane: "When there is some likelihood that subsequent advantages in power may be used against oneself."<sup>53</sup> It also conforms to the model offered by Robert Powell, who assumes that states maximize profits in cooperation but begin to worry about relative gains when the use of force is at issue.<sup>54</sup> However, to apply the relative gains concept correctly, Ping Deng should have said, "For this reason, it [Taiwan] has restricted its mainland investments *so as to prevent China from obtaining disproportionately larger gains*," rather than "so as to avoid possible economic dependence upon China." Taiwan has restricted investment in China, but it does so not because it wants to prevent China from receiving larger gains; it does so because it wants to avoid excessive dependence on China. These are different concepts. Preventing someone from obtaining larger gains is different from avoiding relying on someone for those gains. I might try to prevent you from getting a larger slice after we bake a pie, but that is different from a situation in which I try to avoid relying on your skills to bake the pie. Peng Ding provided no evidence to support his claim that Taiwan is "extremely sensitive" to relative gains; if

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<sup>53</sup> Robert Keohane, "Institutional Theory and the Realist Challenge after the Cold War," in *Neorealism and Neoliberalism*, ed. David A. Baldwin (New York: Columbia University Press, 1993), 275.

<sup>54</sup> Robert Powell, "Absolute and Relative Gains in International Relations Theory," in *Neorealism and Neoliberalism*, ed. David A. Baldwin (New York: Columbia University Press, 1993), 211.

Taiwan were extremely sensitive to relative gains, it would have tried to find ways to prevent China from obtaining larger gains in the cooperative arrangement, and its fundamental goal in the economic cooperation with China would have to be preventing China from achieving advances in relative capabilities. It turns out that Taiwan has reservations about relying on China for trade and investment, but it has no plan to prevent China from obtaining larger gains. Taipei worries about economic dependence on the mainland, not about China's "larger" gains, because, as will be shown below, it is Taiwan which has received larger gains in the economic cooperation.

The second problem with Ping Deng's approach is that it assumes China has obtained, or would obtain, the larger gains in cross-Straits economic cooperation. This is an unwarranted assumption. The relative gains approach dwells on distributional issues; and measured in monetary terms, it is Taiwan that has consistently obtained a trade surplus. In cross-Straits economic cooperation, it would be controversial to say who depends more on whom. For example, it is difficult to say that China obtains more than Taiwan when Taiwanese firms invest in the mainland. It is true that Taiwanese investments set up factories, create jobs, and bolster China's exports. But Taiwanese investors also obtain good returns on these investments; their "sunset industries," owing to the mainland's cheap land and labor costs, are not going down to the horizon; and as MAC Chairwoman Tsai Ing-wen said, the "hollowing out" of industries had actually helped Taiwan's industrial upgrading. The difficulty in the relative gains approach to the study of cross-Straits economic ties lies in the fact that Taipei has apparently obtained an equal if not larger share of the gains. If that had not been the case, Taipei would not have allowed cross-Straits trade and investment to continue. With so many partners in the

region to choose from, why would Taipei tolerate economic dependence on China and at the same time be willing to receive smaller gains? Beijing's acquiescence to Taipei's restrictions on Chinese investment in Taiwan and on imports of Chinese goods, has contributed to Taiwan's arguably larger gains; its tolerance for Taiwan's huge trade surplus and its preferential policies for Taiwanese firms, suggest that some sort of political strategy is at work, which is to allow Taiwan the larger gains in order to "pin down Taiwan economically." The relative gains approach is inappropriate in the study of cross-Straits economic cooperation, because that cooperation is largely reciprocal. Had it not been the case, both sides would not have been able to use their economic cooperation to extract political concessions.

The third problem with the relative gains approach is that in cross-Straits economic cooperation, Taipei does not seem to worry about relative gains. In fact, Taiwan has never complained about that problem. The relative gains problem is more real between two opponents of equal strength. Taiwan and China differ greatly in size, strength, and population. If a 400-lb wrestler can easily overwhelm an opponent who is 100 pounds in weight, it does not matter whether the giant wrestler grows 20 pounds heavier or not. Whatever disproportionate gains obtained by China, they will not make a decisive difference in China's strength vis-à-vis Taiwan, because the gap is already large, and Taiwan understands this. Thus, Taipei has indeed restricted China-bound investment, but it has done so to avoid dependence on China, not out of fear for the "larger" gains obtained by Beijing.

Fourth, the relative gains approach to the study of cross-Straits economic relations would be more useful if China and Taiwan were, like North Korea and Laos, isolated

backwaters in the commercial world. But that is not the case. With or without Taiwan, China will continue to receive investments from around the world. According to the World Bank, in recent years China was the most popular destination for foreign direct investment (FDI) among the developing countries. In 1998, China received US\$43.7 billion of FDI; Brazil, US\$31.9 billion; and Mexico, US\$10.2 billion. During the same year, the Philippines received only US\$1.7 billion; Vietnam, US\$1.2 billion; Malaysia, US\$5.0 billion; and South Korea, US\$5.4 billion.<sup>55</sup> According to the United Nations Conference on Trade and Development (UNCTAD), in 2001 China attracted US\$47 billion in FDI, a 15 percent increase over 2000, and “low wage costs, a solid export platform through membership of the World Trade Organization and a rapidly developing consumer market add up to make China the most highly favored destination for FDI in Asia.”<sup>56</sup> According to the Ministry of Foreign Trade and Economic Cooperation in Beijing, China’s FDI is forecast to exceed US\$50 billion in 2002.<sup>57</sup>

Finally, the problem of the relative gains approach can also be shown by a simple example. Taiwan prohibited investments in high-tech projects on the mainland, and the reason was presumably to prevent China from obtaining Taiwan’s advanced technologies that can be used in an armed conflict. But for a country that can launch an unmanned spacecraft and recover it, enough technology is in place to deal a severe blow to Taiwan, although more technologies are always welcome. Furthermore, even if China cannot get these technologies from Taiwan, it can always get them from elsewhere. For example,

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<sup>55</sup> *World Development Report 2000/2001* (Washington, DC: World Bank), table 21 on pp. 314-15.

<sup>56</sup> Tom Holland, “China Dream,” *Far Eastern Economic Review*, October 10, 2002, p. 51.

<sup>57</sup> Dai Yan “FDI Influx Set to Exceed US\$50 Billion,” *China Daily*, December 13, 2002.



Shanghai has the world's first commercial magnetic-levitation train, which is a product of Sino-German technological cooperation. Taipei realizes this fact, and its decision in late 2001 to liberalize restrictions on investments in notebook computers and mobile phones on the mainland is an example. It can be argued that Taipei's ban on investments in high-tech projects on the mainland stems from a desire to retain valuable technologies, which will be released gradually when Taiwan climbs the technological ladder. Taiwan also wants to keep the research and development (R&D) activities at home in a "vertical division of labor" with China. Taipei's ban on investments in infrastructure projects on the mainland reflected a desire to keep investments at home, as illustrated by the case of Formosa Plastics, which won a contract to build a bigger petrochemical complex in Miaoli, Taiwan in exchange for its cancellation of a similar project in Haichang, Fujian on the mainland. The ban may be eased, depending on the political concessions from China.

As mentioned, economic ties across the Strait limit Taiwan's freedoms and choices, and provide China with possible means to coerce Taiwan. In response, Taipei wants to keep Beijing at arm's length in order to safeguard its autonomy and position, and one way to do so is to avoid excessive dependence on China. Thus, the relative gains approach in equation 1 should be replaced by a better formulation in equation 2:

(1) Political conflict → security concern → relative gains concern → avoidance of dependence = restriction on investment.

(2) Political conflict → security concern → avoidance of dependence → restriction on investment and trade = low level of economic interdependence (note: the element of relative gains is absent).

Another theoretical framework to account for the development of cross-Strait economic relations is offered by Tse-kang Leng. Examining the economic ties largely from Taiwan's standpoint, Leng explained that democratization in Taiwan has weakened the state's control over private business activities. Democratization leads to liberalization of policies and representation of business interests in the government, making it harder for Taipei to control the movements of cross-Strait capital and goods. Globalization adds fuel to the flames, because investments in the mainland can be made by the overseas subsidiaries of powerful Taiwanese conglomerates; alternatively, these investments may be made through joint ventures with foreign companies. Formosa Plastics Group's 1997 plan to invest in Houshi Power Station in Zhangzhou, Fujian province, was implemented by the group's U.S. subsidiary, which held 40 percent of the stake. Leng's argument is similar to the theme articulated by Saskia Sassen in her book, *Losing Control? Sovereignty in an Age of Globalization*, in which she talked about "the shrinking capacity of the state to regulate many of its industries," although Leng did not dwell on the issue of sovereignty.<sup>58</sup> Leng's conclusion is that "the Taiwanese state's capacity to execute its policy of indirect trade and investment is weak," and that "the state also lacks effective policy instruments to regulate business motivation and behavior."<sup>59</sup>

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<sup>58</sup> Saskia Sassen, *Losing Control? Sovereignty in an Age of Globalization* (New York: Columbia University Press, 1996), 28.

<sup>59</sup> Leng 1996, pp. 108, 110-111.

Apparently, Leng's framework for examining the development of cross-Strait economic ties is superior to Ping Deng's. In fact, the economic relations between the two sides of the Taiwan Strait grew alongside political liberalization on Taiwan, as well as internationalization of Taiwanese businesses. Situating the issue in the context of state-society relations, Leng pointed out that the Taiwanese state in the authoritarian era had tighter control over businesses, but democratization and globalization had eroded the state's capacity to maintain that kind of control.<sup>60</sup> As a result, "few businesspeople have bothered to register [their investments in China] with the MOEA [ministry of economic affairs]."<sup>61</sup>

However, attributing the growth of cross-Strait economic relations to a "weak" state in Taiwan tells only part of the story. To get a difficult job done, there must be a will to do it, not just the capacity to do it. If the Taiwanese state can maintain its frequently assaulted conscription system, there is no reason to believe that it cannot maintain tight control over cross-Strait trade and investment. Motivated by the prospect of economic gains, the control is half-heartedly maintained; faced with the threat from China, the conscription system is wholeheartedly enforced. It can hardly be a convincing explanation that the Taiwanese state is "weak" in controlling businesses and strong in recruiting conscripts and purchasing weapons. If Taipei made up its mind to curtail cross-Strait commerce, it could do so. The fact that it is not doing so is an issue of will more than an issue of capacity. It can impose fines on violators and give tax breaks to the

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<sup>60</sup> Leng uses the term "state-business relations," but his conceptualization was apparently close to "state-society relations" developed by such scholars as Peter Evans (*Embedded Autonomy*, 1995), and Joel Migdal (*Strong Societies and Weak States*, 1988).

<sup>61</sup> Leng 1996, p. 113.

enterprises that invest in Southeast Asia. It can establish industrial parks like the one it set up in Vietnam. But Taipei's indeterminacy is shown by the words of Vice President Annette Lu. At the eighth annual meeting of the Council of Taiwanese Chambers of Commerce in Asia, held in Kaohsiung on July 23, 2001, Lu urged Taiwanese business people investing abroad to return home and invest in Taiwan. "Lu cautioned against investing in China, saying that corruption there is rife, social order is in a bad state, and also that it is not a country ruled by law, adding that 'less than one third' of Taiwan businesspeople have made money on their investments there."<sup>62</sup> Having said that, Lu said if Taiwanese investors still wanted to go to China, she hoped they could "make goods in China (*shengchan zhongguo hua*)," "sell goods to the world (*xingxiao quanqiu hua*)," and "remit profits to Taiwan (*yingyu Taiwan hua*)."<sup>63</sup> That certainly is a wonderful picture. President Chen Shui-bian said he "believed that when Taiwanese business people move to the mainland, to earn money from the mainland, they would maintain their roots in Taiwan, and put their hearts in Taiwan."<sup>64</sup> After all, a complete elimination of the economic ties with Beijing would deprive Taipei a means to bargain with Beijing. As mentioned, the economic cooperation between the two sides provides Taipei with a means to extract official recognition and political concessions, although to no avail most of the time.

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<sup>62</sup> "Lu Urges Businesspeople 'Return, Invest in Taiwan,'" *Taipei Times*, July 24, 2001.

<sup>63</sup> "Lu Said at Annual Meeting of Taiwanese Business People: Don't Go to China to Invest," Duowei News Portal, July 23, 2001, at [www.Chinesenewsnet.com](http://www.Chinesenewsnet.com) (accessed July 23, 2001).

<sup>64</sup> Chen Shui-bian, 246.

#### **IV. Conclusion**

To conclude, both Beijing and Taipei have economic and political goals to achieve in their business cooperation. The short-terms goals are economic benefits. As for the long-term goals, both sides want to use their economic cooperation to influence the development of the situation. Beijing wants to use the economic ties to create conditions for political reunification; Taipei wants to use the economic ties to protect its position. At the same time, both sides have expressed concerns about what the other side wants to do with the economic ties.

## **Chapter 7**

### **Conclusion**

This study straddles two distinctive academic fields in order to examine a phenomenon. The methods developed in this research for measuring trade and investment, both nominal and comparative, will still be useful decades from now, and can be employed at any time to measure economic cooperation between Beijing and Taipei. The seven indicators of the Beijing-Taipei political relationship can also be used to determine if there is any improvement in political ties a decade from now, alongside the measurement of economic cooperation. By doing so it is possible to observe once again the effects of politics on economics, and the effects of economics on politics.

Ten years from now, four alternative possibilities are likely to exist. First, trade and investment across the Taiwan Strait will have increased, and political relations improved. Thus, a positive correlation between economics and politics would be evidenced, although the direction of causality would remain to be determined. Second, cross-Strait economic cooperation will have increased, but the political stalemate would remain. If this were the case, the increase in economic cooperation between the two sides is likely to be very small, owing to the effect of the conflict. Third, political relations between Beijing and Taipei will have improved, but their economic cooperation will not have increased. This is highly unlikely, because improved political ties are conducive to more economic cooperation. Fourth, political relations between Beijing and Taipei will have deteriorated, leading to a decrease in economic cooperation. This is a possible scenario if Taiwan moved toward independence and Beijing reacted strongly, and it

would show a positive correlation between politics and economics, as well as the direction of causality.

This study shows that the current situation resembles the second scenario mentioned above; that is, cross-Strait economic cooperation has slowly increased, but the political stalemate persists. Actually, cross-Strait trade has begun to fluctuate, although Taiwanese investment in China has continued to increase. In 1996, the volume of cross-Strait trade was US\$23 billion, which increased to US\$26 billion in 1997, dropped back to US\$23 billion in 1998, increased to US\$25 billion in 1999, and further increased to US\$31 billion in 2000, then decreased to US\$27 billion in 2001 (see Table 5.1). Regarding Taiwanese investment in China, the momentum is still there, but there have also been increases and decreases since the early 1990s, as data from both sides show. In other words, the increases in trade and investment are not steady, although there is still an upward trend. Since cross-Strait trade is largely investment-driven (meaning that Taiwanese firms in China import parts and components from Taiwan for production in China), so long as Taiwanese investment continues to flow to China, the volume of trade will be sustained.

If, as this research has shown, political relations determine economic cooperation, then what determines political relations? Imaginable possibilities include the forming of an alliance between two rivals for the purpose of balancing or opposing an adversary, or normalization of relations between two former adversaries, or cooperation arising from common ideology and values. Whichever way it happens, a good political relationship almost always leads to a closer economic cooperation. For example, the United States normalized relations with Vietnam in 1995, after ties between the two countries warmed

up in 1994 when President Clinton lifted the trade embargo against Hanoi in response to its cooperation in finding Americans missing from the war. Bilateral trade increased rapidly as a result. In 1993, Vietnam exported only US\$0.1 million worth of goods to the United States, but in 1994 the volume rapidly increased to US\$94.9 million, which then soared to US\$169.7 million in 1995, the year when the two countries established diplomatic relations. In 1993, Vietnam imported merely US\$4 million worth of goods from the United States, but in 1994 the volume increased 11 times to US\$44 million, which soared to US\$130 million in 1995 (see Table 7.1). The example of U.S.-Vietnamese trade once again shows how much a political relationship can affect economic cooperation.

Table 7.1. Vietnam's Trade with the United States, 1990-1995 (US\$millions)

|                                | 1990 | 1991 | 1992 | 1993 | 1994 | 1995  |
|--------------------------------|------|------|------|------|------|-------|
| Exports to the United States   | 0.0  | 0.0  | 0.1  | 0.1  | 94.9 | 169.7 |
| Imports from the United States | .... | .... | 2    | 4    | 44   | 130   |

Source: Export figures from the Asian Development Bank, *Key Indicators 2001*, pp. 436-437. Import figures from IMF, *Direction of Trade Statistics Yearbook 1999* (p. 477) and 2000 (p. 484).

How much can a bad political relationship affect economic cooperation? The bilateral trade between Iraq and the United States provides a good answer. Before the Gulf War in 1991, Iraq was one of the important trade partners to the United States. In 1990, Iraq imported US\$3.24 billion of goods from the United States, and exported US\$640 million of goods in return. But in 1991, trade between the two countries was



abruptly suspended, and in the following decade, nothing much was recorded. Table 7.2 shows how a bad political relationship can affect trade flows.

Table 7.2. Iraq's Trade with the United States, 1989-1995 (US\$millions)

|                 | 1989  | 1990  | 1991 | 1992 | 1993 | 1994 | 1995 |
|-----------------|-------|-------|------|------|------|------|------|
| Exports to US   | 1,174 | 640   | .... | .... | 4    | 1    | .... |
| Imports from US | 2,557 | 3,247 | .... | .... | .... | .... | .... |

Source: IMF, *Direction of Trade Statistics Yearbook 1996*, p. 446.

The case of Vietnam shows how improved relations can increase trade; the case of Iraq shows how deteriorated relations can diminish trade. A good example of political effects on economic cooperation also comes from the situation of trade between Pakistan and India, two contiguous countries. Both Pakistan and India have sizeable economies, and India has the world's second largest population. These two countries have strained relations, and heightened tensions are caused by sporadic armed clashes, which often resulted in deaths and casualties. The poor relations between these two countries have seriously affected their bilateral trade. The research takes a quick look at the imports of these two countries because, as suggested earlier, an importer that can decide on where to spend its money will buy from friends rather than from foes. It is found that in 2000, Pakistan bought more from its allies and neutral countries than from India; not only so, it bought more from Korea, which was in Northeast Asia, and from Singapore, the tiny city-state with 4 million people in Southeast Asia, than from India which is its neighbor and has 1,002 million people (see Table 7.3).

Table 7.3. Pakistan's Imports from Selected Countries, 1995-2000 (US\$millions)

| From          | Relations    | 1995   | 1996   | 1997   | 1998  | 1999   | 2000   |
|---------------|--------------|--------|--------|--------|-------|--------|--------|
| India         | Hostile      | 81     | 212    | 142    | 154   | 134    | 181    |
| Korea         | Neutral      | 343    | 325    | 308    | 378   | 353    | 361    |
| China         | Pro-Pakistan | 543    | 561    | 493    | 415   | 400    | 351    |
| Japan         | Neutral      | 1,229  | 1,239  | 872    | 749   | 790    | 617    |
| US            | Neutral      | 1,065  | 1,291  | 1,368  | 914   | 660    | 663    |
| Malaysia      | Pro-Moslem   | 969    | 652    | 640    | 729   | 560    | 446    |
| Singapore     | Neutral      | 221    | 198    | 190    | 298   | 295    | 306    |
| Total imports |              | 11,461 | 12,150 | 11,611 | 9,308 | 10,297 | 11,049 |

Source: IMF, *Direction of Trade Statistics Yearbook 2001*, p. 365-366. Relationships are the author's own estimations.

On the other side of the boundary, India bought very little from Pakistan. In 2000, India's imports from such countries as far away as Nigeria and South Africa, as small as Singapore, and as poor as Nepal were all larger than its imports from Pakistan (see Table 7.4). The small trade volume between India and Pakistan cannot be explained by saying that there is nothing to trade between these two countries; it can only be attributed to India's unwillingness to trade with Pakistan. Apparently, the poor political relations between these two countries explain the low trade volume between them.

Table 7.4. India's Imports from Selected Countries (Territory), 2000 (US\$millions)

| From:         | Amount |
|---------------|--------|
| Pakistan      | 65     |
| Kenya         | 154    |
| Nepal         | 179    |
| Nigeria       | 240    |
| South Africa  | 527    |
| Thailand      | 622    |
| Indonesia     | 1,266  |
| Hong Kong     | 1,427  |
| Korea         | 1,459  |
| Malaysia      | 2,117  |
| Singapore     | 3,158  |
| Total imports | 49,724 |

Source: IMF, *Direction of Trade Statistics Yearbook 2001*, p. 257.

How do we explain the phenomenon in which Britain and Germany before World War I and the United States and Japan before World War II traded until war was virtually upon them?<sup>1</sup> Is it not implying that conflict has no effect on economic cooperation? But the question is whether Britain saw Germany as a definite enemy in an unavoidable conflict before the outbreak of World War I, and whether the United States identified Japan as an unambiguous foe before it attacked the Pearl Harbor. Shortly before the outbreak of World War II, British Prime Minister Chamberlain's appeasement policy toward Germany, and Washington's strategy of exerting pressure on Japan by threatening an oil embargo so as to make it comply with U.S. demands, suggested that they did not see war as inevitable, nor did they see Germany or Japan as predestined enemy. Even a

<sup>1</sup> Peter Liberman, "Trading with the Enemy: Security and Relative Economic Gains," *International Security*, vol. 21, no. 1 (Summer 1996): 150.

few months before the Pearl Harbor attack in December 1941, the United States supplied 80 percent of the oil needed by Japan—read the Japanese navy.<sup>2</sup> Under such circumstances, trade continued.

How do we explain Taiwan's economic ties with China since Taiwan has identified China as its major adversary? Taiwan allows one-third of its overseas investment to go to China, exports 17 percent of its goods to China, and relies on China for its trade surplus. Other than the motives that are mentioned in Chapter 6, the research finds Robert Gilpin's conceptualization of political economy quite useful. Gilpin defines political economy as "the reciprocal and dynamic interaction...of the pursuit of wealth and the pursuit of power."<sup>3</sup> Taiwan wants both wealth and power. To Taipei, an economic cooperation with Beijing brings about wealth, while a refusal to seize the business opportunities in China could result in self-marginalization, which is something to be avoided in a world of fierce business competition; however, an economic dependence on China may establish a power relationship that is detrimental to its autonomy. Trying to balance benefits and disadvantages, Taipei proceeds in cross-Strait economic exchanges with caution and concern, which result in a low level of cross-Strait economic interdependence.

In his subsequent work, Gilpin situates the study of political economy in a context in which the state versus the market, and suggests that "neither state nor market is primary [in determining economic activities]; the causal relationships are interactive and

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<sup>2</sup> See Scott D. Sagan, "The Origins of the Pacific War," in *The Origin and Prevention of Major Wars*, ed. Robert I. Rotberg and Theodore K. Rabb (New York: Cambridge University Press, 1989), 334.

<sup>3</sup> Robert Gilpin, *U.S. Power and the Multinational Corporation: The Political Economy of Foreign Direct Investment* (New York: Basic Books, 1975), 43.

indeed cyclical.”<sup>4</sup> He says this conceptualization is different from the previous one in that he sees some tension between state and market. Gilpin has taken a middle road, which is different from the liberal assertion that emphasizes the role of economics (i.e., the market), and from the realist assumption that stresses the role of politics (i.e., the state). Compared with the liberals such as Bruce Russett and Solomon Polachek who hold that trade reduces conflict, and with the realists such as Kenneth Waltz and Brian Pollins who maintain that conflict inhibits trade, Gilpin has taken a centrist position, which entails a hypothesis that cannot be falsified.

Using the Beijing-Taipei relationship as an empirical case, this research shows the tremendous effect of politics on economics. The research shows, in Gilpin’s terms, how the state continues to regulate the market. Not only so, the state continues to use the market as a chip for political bargaining. With respect to the liberal-realist debate on the effect of trade and conflict, this research lends support to the realist position regarding the effect of conflict on trade. However, the analysis finds that the relative gains approach, a realist formulation, is not applicable to the empirical case. The desire to avoid economic dependence on the part of Taiwan, and the use of economics for political bargaining by both sides, seem to explain the current state of cross-Strait economic relations.<sup>5</sup>

Regarding future research, it would be interesting to see a case study that shows how a sustained economic cooperation progressively reduces a conflict. How about a

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<sup>4</sup> Robert Gilpin, *The Political Economy of International Relations* (Princeton, NJ: Princeton University Press, 1987), 9.

<sup>5</sup> Increased interdependence means closer links, which might pose security threats. A concrete example is from the explanation by John Chang, a KMT legislator, who said that the air force has prepared contingency plans for 28 possible security threats that could result from direct flights. Among them: passenger jets that try to land in Taiwan full of Chinese commandos. *Far Eastern Economic Review*, November 14, 2002, p. 8.

“breaking dike theory,” which envisages growing trade and investment to resemble gradually and incessantly rising level of water in a reservoir that would burst the dike some day?<sup>6</sup> This research does not exclude that possibility. Such a scene would indeed be gratifying. But Germany’s unification did not seem to come from increasing trade and investment, although the sudden burst of events very much resembled a breaking dike. In 1989, when the Berlin Wall was torn down, East Germany’s top three trade partners were Czechoslovakia, Poland, and Hungary, in the order; and the IMF did not record any trade flows between the two Germanys, for that year or for the years before then.<sup>7</sup>

If trade and investment cannot reduce the conflict between Taipei and Beijing, then the implication is that it will be futile to pin hopes on their effects. Will the ROC on Taiwan sell off its sovereignty and statehood for economic benefits? Will Beijing allow Taiwan to break away for economic interests? The conflict will have to be solved by other means, which include political negotiations and use of force. Of course, it is also possible that no great effort will be made to vigorously resolve the conflict in a long time to come, thus perpetuating the status quo.

Although closer economic ties cannot solve the conflict, they are still desirable because presumably they can do no harm. However, owing to the political conflict, it is likely that cross-Strait economic cooperation will cease increasing and start to hover at a low level. An increase from that level will require a proper handling of the conflict, a removal of which will free the constraint on economic cooperation. Peter Chow, an economist at the City University of New York, forecasts that after China and Taiwan join

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<sup>6</sup> The theory is coined by this author.

<sup>7</sup> IMF, *Direction of Trade Statistics Yearbook 1992* (Washington, DC: IMF, 1992), 187-88.

the World Trade Organization (WTO), “Taiwan’s export dependence on China’s market will increase the most by 5.8 percentage point from the 1995 level. Overall, Taiwan’s export dependence on China (23.8 percent) and Hong Kong (5.6 percent) combined will reach nearly 30 percent levels after it joins the WTO.”<sup>8</sup> Chow did not give the time span for this to happen. A 30 percent export dependence rate is quite high, although it is still much lower than the rates that Mexico and Canada have with the United States. The import dependence rate is unknown, depending on Taiwan’s willingness to take Chinese goods. According to the World Bank’s projections, China’s merchandise exports to Taiwan should account for 3.6 percent of China’s total merchandise exports by 2020.<sup>9</sup> Since China’s exports to Taiwan accounted for 2.49 percent of China’s total exports in 2000 (see Table 4.05), it means that in 20 years China’s exports to Taiwan as a share of China’s total exports would increase by only one percentage point. In 2000, China’s exports to the United States, Japan, and South Korea as a share of China’s total exports were 20.91 percent, 16.72 percent, and 4.53 percent respectively.<sup>10</sup> In other words, if the World Bank’s projections were valid, then China’s exports to Taiwan by 2020 would still be less than China’s exports to South Korea in 2000. South Korea is a comparable country, and the World Bank’s projections said that China’s exports to that country would account for five percent of China’s total exports by 2020.<sup>11</sup>

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<sup>8</sup> Peter Chow, “Economic Integration and Political Sovereignty: Problems and Prospects for an Integrated Chinese Economic Area,” paper presented at the 19<sup>th</sup> International Conference on Asian Affairs, St. John’s University, New York, November 3, 2001, p. 31. Note: in 1995, Taiwan’s exports to China and Hong Kong accounted for 18 percent and 6 percent, respectively, of Taiwan’s total exports.

<sup>9</sup> World Bank, *China Engaged: Integration with the Global Economy* (Washington, DC: World Bank, 1997), p. 26 (box 4.2).

<sup>10</sup> *China Statistical Yearbook 2001* (Beijing: National Bureau of Statistics, 2001), p. 591.

<sup>11</sup> World Bank, *China Engaged*, p. 26.

Chow observes that economic cooperation increases when partners move from preferential trade agreement, to free trade area, to customs union, to common market, and to economic union. Noting that there is little institutionalization of the trading framework between Beijing and Taipei, Chow holds that none of the proposals for economic integration across the Taiwan Strait, “be it a free trade area, a common market or an economic union, could move forward any single inch unless Beijing and Taipei resolve the disputed sovereignty.”<sup>12</sup> This is a sharp observation, which is different from the claim on a rapidly and unconditionally developing economic interdependence across the Taiwan Strait.<sup>13</sup>

In short, Beijing and Taipei may try to circumvent their political dispute (which is not merely the issue of sovereignty as Chow perceived) for the sake of developing economic ties, but as they travel down the road of economic cooperation, they will find less room to maneuver to sidestep their dispute, which will hinder further development of economic cooperation, causing it to stabilize at a low plateau. Thereafter, some sort of treatment of the conflict, not necessarily induced by economic cooperation, is needed in order to allow the economic ties to develop. It may come about as time goes by, enabling both sides to build trust, allowing values to change, or rendering the conflict obsolete.

To conclude, the empirical case study supports the theory that, in general, economic cooperation is contingent upon political relations, not the other way round. This finding is also supported by a few more examples presented above. The research

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<sup>12</sup> Ibid., p. 25.

<sup>13</sup> For example, Professor William Kirby at Harvard University said during an interview, “You can have fantastic amounts of social and economic integration, a great cross-Strait intermingling, without a political relationship.” See Mark Landler, “Money Might Not Be Able to Buy Political Ties, Either,” *New York Times*, December 9, 2001, p. 4wk.



makes up for the lack of an intensive study of an empirical case in the liberal-realist argument concerning the mutual effect of economic exchanges and political conflicts, because all recent researches have relied on econometric method. As for the Beijing-Taipei relationship, their economic cooperation should not be a cause for complacency, and both sides still need to handle their political relations with great care.

Appendix Table I. China's Major Trade Partners, 1991-2000 (in US\$billions)

|             | 1991    |         |       | 1992    |         |       |
|-------------|---------|---------|-------|---------|---------|-------|
|             | Exports | Imports | Total | Exports | Imports | Total |
| Japan       | 10.21   | 10.03   | 20.25 | 11.67   | 13.68   | 25.36 |
| US          | 6.15    | 8.00    | 14.16 | 8.59    | 8.90    | 17.49 |
| Hong Kong   | 32.13   | 17.46   | 49.60 | 37.51   | 20.53   | 58.04 |
| Korea       | 2.17    | 1.06    | 3.24  | 2.40    | 2.62    | 5.02  |
| Taiwan      | 0.59    | 3.63    | 4.23  | 0.69    | 5.86    | 6.55  |
| Germany     | 2.35    | 3.04    | 5.40  | 2.44    | 4.01    | 6.46  |
| Singapore   | 2.01    | 1.06    | 3.07  | 2.03    | 1.23    | 3.26  |
| UK          | 0.72    | 0.94    | 1.66  | 0.92    | 1.01    | 1.93  |
| Australia   | 0.55    | 1.55    | 2.11  | 0.66    | 1.67    | 2.33  |
| Russia      | ...     | ...     | ...   | 2.33    | 3.52    | 5.86  |
| Netherlands | 1.06    | 0.42    | 1.49  | 1.20    | 0.50    | 1.70  |
| France      | 0.73    | 1.57    | 2.30  | 0.76    | 1.49    | 2.25  |
| Italy       | 0.93    | 1.45    | 2.38  | 1.09    | 1.74    | 2.84  |

|             | 1993    |         |       | 1994    |         |       |
|-------------|---------|---------|-------|---------|---------|-------|
|             | Exports | Imports | Total | Exports | Imports | Total |
| Japan       | 15.77   | 23.25   | 39.03 | 21.57   | 26.32   | 47.90 |
| US          | 16.96   | 10.68   | 27.65 | 21.46   | 13.89   | 35.35 |
| Hong Kong   | 22.06   | 10.47   | 32.53 | 32.36   | 9.44    | 41.80 |
| Korea       | 2.86    | 5.35    | 8.22  | 4.40    | 7.31    | 11.72 |
| Taiwan      | 1.46    | 12.93   | 14.39 | 2.24    | 14.08   | 16.32 |
| Germany     | 3.96    | 6.03    | 10.00 | 4.76    | 7.13    | 11.89 |
| Singapore   | 2.24    | 2.64    | 4.89  | 2.55    | 2.49    | 5.04  |
| UK          | 1.92    | 1.66    | 3.59  | 2.41    | 1.76    | 4.18  |
| Australia   | 1.06    | 1.94    | 3.00  | 1.48    | 2.45    | 3.93  |
| Russia      | 2.69    | 4.98    | 7.67  | 1.58    | 3.49    | 5.07  |
| Netherlands | 1.60    | 0.71    | 2.32  | 2.26    | 0.70    | 2.97  |
| France      | 1.29    | 1.64    | 2.93  | 1.42    | 1.93    | 3.36  |
| Italy       | 1.30    | 2.73    | 4.04  | 1.59    | 3.06    | 4.65  |

Appendix Table I—continued

|             | 1995    |         |       | 1996    |         |       |
|-------------|---------|---------|-------|---------|---------|-------|
|             | Exports | Imports | Total | Exports | Imports | Total |
| Japan       | 28.46   | 29.00   | 57.46 | 30.88   | 29.18   | 60.06 |
| US          | 24.71   | 16.11   | 40.82 | 26.68   | 16.15   | 42.83 |
| Hong Kong   | 35.98   | 8.59    | 44.57 | 32.90   | 7.82    | 40.73 |
| Korea       | 6.68    | 10.29   | 16.98 | 7.49    | 12.48   | 19.98 |
| Taiwan      | 3.09    | 14.78   | 17.88 | 2.80    | 16.18   | 18.98 |
| Germany     | 5.67    | 8.03    | 13.70 | 5.84    | 7.32    | 13.16 |
| Singapore   | 3.50    | 3.39    | 6.89  | 3.74    | 3.60    | 7.34  |
| UK          | 2.79    | 1.97    | 4.76  | 3.20    | 1.88    | 5.08  |
| Australia   | 1.62    | 2.58    | 4.21  | 1.67    | 3.43    | 5.10  |
| Russia      | 1.66    | 3.79    | 5.46  | 1.69    | 5.15    | 6.84  |
| Netherlands | 3.23    | 0.81    | 4.05  | 3.53    | 0.91    | 4.45  |
| France      | 1.84    | 2.64    | 4.49  | 1.90    | 2.24    | 4.14  |
| Italy       | 2.06    | 3.11    | 5.18  | 1.83    | 3.24    | 5.07  |

|             | 1997    |         |       | 1998    |         |       |
|-------------|---------|---------|-------|---------|---------|-------|
|             | Exports | Imports | Total | Exports | Imports | Total |
| Japan       | 31.81   | 28.99   | 60.81 | 29.66   | 28.27   | 57.93 |
| US          | 32.69   | 16.29   | 48.99 | 37.94   | 16.88   | 54.83 |
| Hong Kong   | 43.78   | 6.99    | 50.77 | 38.74   | 6.65    | 45.39 |
| Korea       | 9.11    | 14.92   | 24.04 | 6.25    | 15.01   | 21.26 |
| Taiwan      | 3.39    | 16.44   | 19.83 | 3.86    | 16.63   | 20.49 |
| Germany     | 6.49    | 6.17    | 12.67 | 7.35    | 7.02    | 14.37 |
| Singapore   | 4.31    | 4.46    | 8.78  | 3.94    | 4.23    | 8.17  |
| UK          | 3.81    | 1.97    | 5.79  | 4.63    | 1.95    | 6.58  |
| Australia   | 2.05    | 3.24    | 5.30  | 2.36    | 2.68    | 5.04  |
| Russia      | 2.03    | 4.08    | 6.11  | 1.83    | 3.64    | 5.47  |
| Netherlands | 4.40    | 1.07    | 5.47  | 5.16    | 0.83    | 5.99  |
| France      | 2.32    | 3.24    | 5.57  | 2.82    | 3.20    | 6.02  |
| Italy       | 2.23    | 2.45    | 4.68  | 2.57    | 2.27    | 4.85  |

Appendix Table I—continued

|             | 1999    |         |       | 2000    |         |       |
|-------------|---------|---------|-------|---------|---------|-------|
|             | Exports | Imports | Total | Exports | Imports | Total |
| Japan       | 32.41   | 33.76   | 66.17 | 41.65   | 41.50   | 83.16 |
| US          | 41.94   | 19.47   | 61.42 | 52.09   | 22.36   | 74.46 |
| Hong Kong   | 36.86   | 6.89    | 43.75 | 44.51   | 9.42    | 53.94 |
| Korea       | 7.80    | 17.22   | 25.03 | 11.29   | 23.20   | 34.49 |
| Taiwan      | 3.94    | 19.52   | 23.47 | 5.03    | 25.49   | 30.53 |
| Germany     | 7.77    | 8.33    | 16.11 | 9.27    | 10.40   | 19.68 |
| Singapore   | 4.50    | 4.06    | 8.56  | 5.76    | 5.05    | 10.82 |
| UK          | 4.88    | 2.99    | 7.87  | 6.31    | 3.59    | 9.90  |
| Australia   | 2.70    | 3.60    | 6.31  | 3.42    | 5.02    | 8.45  |
| Russia      | 1.49    | 4.22    | 5.71  | 2.23    | 5.76    | 8.00  |
| Netherlands | 5.41    | 1.01    | 6.42  | 6.68    | 1.23    | 7.92  |
| France      | 2.92    | 3.78    | 6.70  | 3.70    | 3.94    | 7.65  |
| Italy       | 2.92    | 2.67    | 5.60  | 3.80    | 3.07    | 6.88  |

Source: *China Statistical Yearbook* (Beijing: National Bureau of Statistics, 1993-2001).

Note: “Exports” means export to; “Imports” means import from.

Appendix Table II. Taiwan's Major Trade Partners, 1990-2000 (in US\$billions)

|           | 1990    |         |       | 1991    |         |       |
|-----------|---------|---------|-------|---------|---------|-------|
|           | Exports | Imports | Total | Exports | Imports | Total |
| US        | 21.74   | 12.61   | 34.35 | 22.31   | 14.11   | 36.43 |
| Japan     | 8.33    | 15.99   | 24.37 | 18.86   | 9.16    | 28.02 |
| Hong Kong | 8.55    | 1.44    | 10.00 | 12.43   | 1.94    | 14.37 |
| Germany   | 3.18    | 2.66    | 5.85  | 3.86    | 3.00    | 6.88  |
| Singapore | 2.20    | 1.40    | 3.60  | 2.40    | 1.44    | 3.84  |
| UK        | 1.97    | 1.15    | 3.13  | 2.07    | 1.12    | 3.19  |
| Korea     | 1.28    | 1.74    | 2.55  | 1.21    | 1.34    | 3.03  |
| Holland   | 1.86    | 0.72    | 2.58  | 2.17    | 0.80    | 2.97  |
| France    | 1.13    | 1.13    | 2.26  | 1.35    | 1.14    | 2.49  |
| China     | 3.27    | 0.76    | 4.04  | 4.66    | 1.12    | 5.79  |

|           | 1992    |         |       | 1993    |         |       |
|-----------|---------|---------|-------|---------|---------|-------|
|           | Exports | Imports | Total | Exports | Imports | Total |
| US        | 23.57   | 15.77   | 39.34 | 23.47   | 16.72   | 40.19 |
| Japan     | 8.89    | 21.79   | 30.68 | 8.96    | 23.19   | 32.16 |
| Hong Kong | 15.41   | 1.78    | 17.19 | 12.04   | 0.80    | 12.84 |
| Germany   | 3.60    | 3.91    | 7.52  | 3.50    | 4.22    | 7.72  |
| Singapore | 2.50    | 1.69    | 4.20  | 2.87    | 1.86    | 4.74  |
| UK        | 2.20    | 1.33    | 3.54  | 2.16    | 1.19    | 3.35  |
| Korea     | 1.15    | 2.30    | 3.54  | 1.27    | 2.53    | 3.80  |
| Holland   | 2.19    | 0.87    | 3.07  | 2.11    | 1.00    | 3.11  |
| France    | 1.24    | 1.39    | 2.63  | 1.07    | 1.26    | 2.34  |
| China (1) | 6.28    | 1.11    | 7.40  | 7.58    | 1.10    | 8.68  |
| China (2) | ...     | ...     | ...   | 13.99   | 1.10    | 15.09 |

Appendix Table II—continued

|           | 1994    |         |       | 1995    |         |       |
|-----------|---------|---------|-------|---------|---------|-------|
|           | Exports | Imports | Total | Exports | Imports | Total |
| US        | 24.35   | 18.04   | 42.38 | 26.41   | 20.76   | 47.19 |
| Japan     | 10.22   | 24.79   | 35.05 | 13.16   | 30.27   | 43.43 |
| Hong Kong | 21.26   | 1.53    | 22.79 | 26.12   | 1.84    | 27.96 |
| Germany   | 3.25    | 4.78    | 8.03  | 3.83    | 5.68    | 9.52  |
| Singapore | 3.36    | 2.41    | 5.77  | 4.40    | 2.95    | 7.36  |
| UK        | 2.17    | 1.52    | 3.70  | 2.40    | 1.64    | 4.05  |
| Korea     | 1.74    | 3.01    | 4.75  | 2.57    | 4.32    | 6.90  |
| Holland   | 2.37    | 1.14    | 3.52  | 3.20    | 1.32    | 4.52  |
| France    | 0.96    | 1.45    | 2.41  | 1.20    | 1.78    | 2.98  |
| China (1) | 8.51    | 1.29    | 9.80  | 9.88    | 1.57    | 11.45 |
| China (2) | 16.02   | 1.85    | 17.88 | 19.43   | 3.09    | 22.52 |

|           | 1996    |         |       | 1997    |         |       |
|-----------|---------|---------|-------|---------|---------|-------|
|           | Exports | Imports | Total | Exports | Imports | Total |
| US        | 26.86   | 19.97   | 46.84 | 29.55   | 23.24   | 52.79 |
| Japan     | 13.66   | 27.49   | 41.16 | 11.70   | 29.02   | 40.72 |
| Hong Kong | 26.80   | 1.70    | 28.50 | 28.70   | 1.99    | 30.70 |
| Germany   | 3.64    | 5.02    | 8.66  | 3.69    | 5.32    | 9.06  |
| Singapore | 4.57    | 2.78    | 7.36  | 4.89    | 3.15    | 8.04  |
| UK        | 2.80    | 1.80    | 4.61  | 3.27    | 1.95    | 5.23  |
| Korea     | 2.66    | 4.16    | 6.82  | 2.36    | 5.02    | 7.39  |
| Holland   | 3.82    | 1.47    | 5.29  | 4.29    | 1.63    | 5.93  |
| France    | 1.30    | 2.90    | 4.26  | 1.39    | 4.72    | 6.12  |
| Malaysia  | ...     | ...     | ...   | 3.04    | 4.23    | 7.26  |
| China (1) | 9.71    | 1.58    | 11.30 | 9.71    | 1.74    | 11.45 |
| China (2) | 20.72   | 3.05    | 23.78 | 22.45   | 3.91    | 26.37 |

Appendix Table II—continued

|           | 1998    |         |       | 1999    |         |       |
|-----------|---------|---------|-------|---------|---------|-------|
|           | Exports | Imports | Total | Exports | Imports | Total |
| US        | 29.38   | 19.68   | 49.06 | 30.90   | 19.69   | 50.59 |
| Japan     | 9.32    | 27.00   | 36.33 | 11.90   | 30.59   | 42.49 |
| Hong Kong | 24.82   | 1.95    | 26.77 | 26.01   | 2.09    | 28.11 |
| Germany   | 4.08    | 5.15    | 9.23  | 4.08    | 5.31    | 9.39  |
| Singapore | 3.26    | 2.70    | 5.95  | 3.82    | 3.31    | 7.13  |
| UK        | 3.28    | 1.68    | 4.96  | 3.83    | 1.72    | 5.55  |
| Korea     | 1.49    | 5.67    | 7.16  | 2.60    | 7.19    | 9.80  |
| Holland   | 4.37    | 1.57    | 5.93  | 4.21    | 1.71    | 5.92  |
| Malaysia  | 2.29    | 3.62    | 5.91  | 1.79    | 5.09    | 6.87  |
| China (1) | 8.36    | 1.65    | 10.02 | 8.17    | 1.63    | 9.80  |
| China (2) | 19.84   | 4.11    | 23.95 | 21.31   | 4.52    | 25.83 |

|           | 2000    |         |       |
|-----------|---------|---------|-------|
|           | Exports | Imports | Total |
| US        | 34.82   | 25.13   | 59.95 |
| Japan     | 16.61   | 38.56   | 55.17 |
| Hong Kong | 31.36   | 2.19    | 33.54 |
| Korea     | 3.91    | 8.99    | 12.90 |
| Germany   | 4.89    | 5.54    | 10.43 |
| Singapore | 5.46    | 5.01    | 10.48 |
| Malaysia  | 3.61    | 5.33    | 8.94  |
| Holland   | 4.93    | 2.09    | 7.02  |
| UK        | 4.51    | 1.94    | 6.45  |
| China (1) | 9.59    | 1.98    | 11.57 |
| China (2) | 25.03   | 6.22    | 31.25 |

Source: *Cross-Strait Economic Statistics Monthly* (Taipei: MAC), no. 17, January 1994, p. 50; no. 53, January 1997, p. 57; and no. 101, January 2001, p. 52.

China (1) data come from Hong Kong Customs statistics.

China (2) data are estimations by Mainland Affairs Council.

Note: “Exports” means export to; “Imports” means import from.

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