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# BUSINESS DYNAMISM ACROSS THE TAIWAN STRAIT

## *The Implications for Cross-Strait Relations*

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Analyses of relations across the Taiwan Strait have often considered the roles of economics and commerce as secondary to political and geostrategic factors in terms of overall impact on interaction.<sup>1</sup> Economic interests do not trump security concerns, but neither should they be given short shrift. While political tensions and strategic concerns place substantial limits on cross-Strait economic interactions, it is important not to disproportionately downplay the role that growing commercial ties have played—and will continue to play, even in the face of ongoing restrictions and risk—in linking Taiwan’s economic future to that of the People’s Republic of China (PRC). Such ties over time are fostering increasingly complex interests across the Strait and influencing the direction of cross-Strait policies.

A review of cross-Strait developments shows a dynamic of business interests pulling government policy along as policy makers struggle to keep pace with commercial reality. This pattern is likely to continue as cross-Strait relations enter a new stage in which both Beijing and Taipei are represented in

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1. Some notable exceptions of recent analysis include Xiangming Chen, “Business over Politics,” *China Business Review* (March/April 1999), pp. 8–13; Nancy Bernkopf Tucker, “The Taiwan Factor in the Vote on PNTR for China and Its WTO Accession,” *NBR [National Bureau of Research] Analysis* 11:2, Essay 1 (2000), pp. 112; Tse-Kang Leng, “Dynamics of Taiwan-Mainland China Economic Relations,” *Asian Survey* 38:5 (May 1998), pp. 494–509; and Frank Carlucci, “High Stakes in the Taiwan Strait” (editorial), *Asian Wall Street Journal*, May 22, 2001.

the World Trade Organization (WTO) and the two countries' economies are increasingly interdependent. Political jockeying to gain credit for shifts in policy and security concerns about the pace and scope of liberalization will continue to burden officials, especially in Taiwan. But enticed by an economic upswing in China, the opening of new markets in both the PRC and Taiwan as a consequence of WTO accession, and Taiwan's ongoing goal to become a regional operations center, business interests are likely to continue to nudge policy makers along a course of further liberalization and integration. Inherent in these burgeoning commercial ties lies the growing reality that the emerging structure of relations between the PRC and Taiwan is not necessarily a zero-sum one. Provided that commerce is allowed to flourish and there is not a radical deviation from current policy trajectories on both sides of the Strait, creative solutions to defining relations in terms other than the traditional political ones of "unification" or "independence" could emerge over time.

### New Personal and Commercial Realities

Burgeoning people-to-people and commercial ties across the Strait have been challenging government policies to keep pace since the opening of the PRC to foreign goods, capital, and people in the early 1980s. But it is important to consider not only policy changes but also the commercial fundamentals that pushed for these shifts. While the lifting of restrictions has significantly boosted cross-Strait interactions, fundamentally it has been a combination of the pressure to ease restrictions with the successful circumvention of regulations that has led both governments, especially that in Taipei, to seek ways to manage growing contacts across the Strait. Business pressure and government policy have together formed a mutually reinforcing dynamic. The Taiwan business community has effectively lobbied for liberalization of government restrictions both directly by expressing its concerns and, perhaps more important, indirectly by bypassing regulations to satisfy commercial demand in the PRC. In response, the Taipei government has made a policy of regulating certain of those exchanges, in essence legalizing what is already taking place. This in turn has had a multiplier effect with business responding to the government's voice of confidence by expanding trade and investment.

Cross-Strait travel has had its role to play as well. By the mid-1980s, the volume of Taiwan visitors traveling illegally to the mainland via Hong Kong had grown so large that Taipei in particular, but also Beijing, realized it was necessary to legalize the flow and establish government mechanisms to control these exchanges. Such mechanisms were also necessary to cope with ancillary disputes that inevitably result from increased contacts. There was added pressure from an aging mainlander population in Taiwan that wished to return home and visit with relatives in the PRC before the end of their

lives. In November 1987, the Taiwan government moved to allow Taiwan citizens to visit relatives on the mainland. In 1991 the Straits Exchange Foundation and Association for Relations Across the Taiwan Strait mechanisms were established in Taipei and Beijing, respectively. In 1992 Beijing announced the "Statute Governing Relations between Peoples of the Taiwan Area and Mainland Area," which was followed a year later with the enactment of "Guidelines Governing the Entry of People of the Taiwan Area into the Mainland Area." Guidelines covering traffic in the reverse direction were issued in 1993 as well, although Taiwan retained restrictions about who was allowed to come from the mainland. These two sets of legislation from Taipei and Beijing greatly facilitated the travel of people across the Strait, primarily from Taiwan to the mainland. Furthermore, although these mechanisms were created in response to the growing reality of Taiwan citizens wishing to and actually already making trips to the PRC, creating the mechanisms also boosted confidence. Combined with the business upturn in China in the early 1990s, they helped to dramatically boost the volume of people traveling from Taiwan to the mainland.<sup>2</sup>

### Trade and Investment

Cross-Strait trade and Taiwan investment in the PRC have followed a similar pattern. Although Taiwan firms were officially prohibited from directly trading with or investing in the PRC under Chiang Ching-Kuo's "three no's policy" of 1979 (no contact, no negotiation, no compromise), the Taiwan government began to realize that such prohibitions were ineffective, especially in light of new incentives and opportunities opening in the PRC. In 1983 Beijing enacted the "Guidance on Taiwanese Investments in Special Economic Zones and Related Favorable Policies." The PRC's State Council moved to offer further incentives and a legal foundation for Taiwan investment in July 1988 with the issuance of "Regulations for Encouraging Investment by Taiwan Compatriots," which was followed in May 1989 by the establishment of two investment zones for Taiwan firms in Xiamen and Fuzhou cities, both in Fujian Province. And in 1994 the National People's Congress passed legislation protecting investment by Taiwan firms. Although capital and people could still not travel directly, the creation of a legal framework for Taiwan investment and the easing of travel restrictions significantly boosted cross-Strait trade and Taiwan investment in the PRC at a time when the latter was entering an upward business cycle.

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2. For a good cross-Strait chronology, see the one provided at the Mainland Affairs Council home page at <<http://www.mac.gov.tw/english/chronology/scemap.htm>>. This same website has statistics on travel since 1985, the most recent of which were updated July 2001, <<http://www.mac.gov.tw/english/CSExchan/EMST900701.GIF>>.

In October 1990, the Taipei government issued "Regulations on Indirect Investment or Technical Cooperation in the Mainland Area." This was Taiwan's first regulation to deal directly with the issue of Taiwan investment in the PRC. The new measures allowed Taiwan firms to invest in 3,353 products, mostly in labor-intensive industries such as apparel, footwear, household electronics, and food processing. This list of permissible investments was expanded to 4,895 products in 1996, even though at the same time Taiwan was trying to divert investment to Southeast Asia. The 1990 rules stipulated that the Ministry of Economic Affairs should be notified within six months after a contract signing for any investments under \$1 million. Projects over this amount required government approval in advance of a contract signing.<sup>3</sup>

Taiwan President Lee Teng-hui's attempt to divert investment away from mainland China toward Southeast Asia in 1993 with his "Go South" policy failed to divert enthusiasm significantly from business opportunities in the PRC. Concern over the dramatic rise in Taiwan investment in the PRC during the China investment boom of the mid-1990s, combined with increased cross-Strait tensions in 1995 and 1996, prompted Taipei in August 1996 to enact the "Be Patient, Go Slow" policy and related restrictions prohibiting investment in particular sectors, capping investment for individual projects at \$50 million, and reducing the ceiling for Taiwan equity in PRC joint ventures from 40% to 30%.<sup>4</sup> These policies may have somewhat slowed or delayed but ultimately did not deter plans for major investments in China as they ran counter to the very reasons Taiwanese firms were moving into the China market in the first place. Taiwan firms, like companies anywhere, base business decisions on careful calculations of opportunities and risk. These deliberations include both commercial and political factors. While Taiwan government policies cannot be ignored, it is equally important to remember that such factors as the boom investment cycles in China, the Southeast Asian financial crises, U.S. economic conditions, and economic hardship in Taiwan were all important to strategic business calculations in the 1990s and will be into the early 2000s. Formosa Plastics is a good example in this regard. Although the company postponed its major mainland petrochemical projects in 1996, by the late 1990s it was moving even more aggressively than ever into the PRC as the petrochemical market picked up there and the company struggled to remain globally competitive.

Until recently, the Taiwan government prohibited investments in the PRC that are over \$50 million and required a case-by-case review of investments in sensitive sectors such as information technology, chemicals, real estate,

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3. See Chen, "Business over Politics," p. 8.

4. *Ibid.*

and infrastructure. Investments under \$30 million in permitted or encouraged sectors require only local government approval in the PRC, giving Taiwanese investors an added incentive in certain cases to stay below this threshold. In addition, many early investors in Taiwan were small firms particularly adept at seeking opportunities in gray areas such as retail. The Ministry of Economic Affairs (MOEA) classifies potential investments in China as allowed, prohibited, and special case. Permitted projects are in industries that are no longer internationally competitive in Taiwan, not a critical part of a production chain, labor intensive, or ones for which the PRC can supply key raw materials for production. Prohibited investments include projects that involve critical technologies and products used in national defense, strategic industries, and infrastructure. Special case categories tend to include those projects that overlap characteristics for the allowed and prohibited categories.

MOEA reviews proposed investments on a case-by-case basis and uses a rating system to assess a variety of factors. Special case investments are generally supposed to be under \$50 million. Taiwan also imposes a general system of limits on Taiwan firms' investments in the PRC. For small- and medium-sized firms, the limit is NT\$ 60 million. Private firms' investment may not exceed 40% of net assets or capital or NT\$ 60 million, whichever is higher. And for listed companies, the following rules apply: For firms with under NT\$ 5 billion in assets, their investments may not exceed 40% of their capital or net assets, whichever is higher. For firms with between NT\$ 5 billion and NT\$ 10 billion, their investments may not exceed 40% of NT\$ 5 billion plus 30% of the portion of their assets over NT\$ 5 billion. And for firms with over NT\$ 10 billion in assets, their investments may not exceed 40% of NT\$ 5 billion plus 30% of the part over NT\$ 5 billion plus 20% of assets over NT\$ 10 billion.<sup>5</sup> Taiwan's Executive Yuan has proposed simplifying the classification into a general category that will require case-by-case approval and a prohibited category. The plan also includes the much-discussed lifting of the \$50 million ceiling on individual investments and a simplification of approvals for investment projects under \$20 million. If approved, Taiwan is expected to implement this plan in 2002.<sup>6</sup>

Even in the face of government restrictions and political tensions, Taiwan has pushed forward into the mainland over the past 20 years. Restrictions

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5. MOEA Investment Commission statistics reported in Jerry Xiaoxun Lu, "Taiwan High-Tech in China," *CLSA Emerging Markets Report*, no. 10, May 7, 2001. CLSA is a Hong Kong-based brokerage.

6. See Republic of China (ROC), Mainland Affairs Division, Economic Development Advisory Conference (EDAC), *Final Summary Report*, August 26, 2001, <<http://www.taipei.org/press/mac0828.htm>>; Chiu Yeh-Wen, "Mainland Trade Rules Relaxed," *Taipei Journal*, November 23, 2001, p. 2; and "Government Eases Restrictions on Trade with Mainland," *Tecro Taipei Update*, November 28, 2001, p. 3.

slowed the process of exchange and made transactions inefficient, and yet capital, goods, and know-how have continued to move across the Strait. Growing business ties across the Strait are a result of the complementary nature of the Taiwan and PRC economies. As Taiwan manufacturers strove for economic efficiency in the 1980s, they relocated manufacturing for textiles, footwear, and toys offshore, partly to Southeast Asia but mostly to the PRC. Geographic proximity, cultural affinity, and a common language facilitated contact. As costs of manufacturing rose in Taiwan, relocation to China made sense. Taiwan's ability to provide capital, middle-range technology, and managerial expertise fit well with the PRC's need for capital and the availability there of a low-cost workforce, weaker environmental standards, and tax incentives. By the mid-1990s, Taiwanese firms began to shift from labor-intensive and low-value manufacturing to more capital- and technology-intensive investments such as computers and petrochemicals. As China began to emerge as a global computer-manufacturing base, Taiwan firms began to relocate information technology (IT) components businesses in the PRC. Taiwan firms also relocated food processing and chemicals operations and moved into China's retail sector.<sup>7</sup>

In some cases, restrictions have encouraged entrepreneurs to incorporate in Hong Kong or increasingly free ports like the Cayman Islands and British Virgin Islands in order to bypass the rules. As Grace Group was breaking ground on its new facility in Pudong, legislators in Taipei were still debating on whether or not to ease restrictions on semiconductor investments in the PRC. In other cases, major investments are phased in over time to avoid restrictions. Companies have dealt with investment caps by structuring abroad in free ports like the British Virgin Islands and forming international consortia of several players to attract necessary capital. In the case of Grace Group, it attracted several partners for a major semiconductor integrated-circuit investment that ultimately is projected to reach over \$6 billion with foreign investors contributing the initial \$1.6 billion and the Shanghai government expected to match that money up to \$6 billion over time.<sup>8</sup>

Cross-Strait commercial trends also result from wider dynamics. Growing Taiwan investment in the PRC and intensified trade across the Strait is part of larger East Asian and global economic trends. East Asian firms became increasingly tied to the dynamism of China in the 1990s. In its May 2001 *White Paper on Trade*, Japan's Ministry of Economic Trade and Industry analyzed how China emerged as the center of growth in East Asia. China's

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7. Chen, "Business over Politics," pp. 10–11; and Lu, "Taiwan High-Tech," pp. 4–16.

8. Allen T. Cheng, "Bargaining Chips," *Asiaweek.com*, February 9, 2001, <<http://www.asiaweek.com/asiaweek/technology/article/0,8707,97635,00.html>>.

share of East Asian GDP grew from 25% in 1980 to 37% in 1999.<sup>9</sup> This phenomenon was driven in large part by two key trends: PRC liberalization of tariffs and investment opportunities and a large influx of foreign direct investment (FDI). Competition intensified significantly in East Asia in the 1990s with the quadrupling of FDI into the region, further liberalization of trade and investment barriers, and the subsequent cross-border specialization occurring in the region as evidenced by the rapid growth in the trade of intermediate goods. The trading structure of the major East Asian economies including Taiwan has become increasingly dependent on trade within the region, especially of intermediate goods. China has been central to this rapid transformation through its ability to attract inward FDI and lower trade barriers; it has quickly advanced from being a destination for labor-intensive industries such as textiles to attracting more technology-intensive industries such as machinery and electronics. These trends will intensify with China's accession to the WTO, as barriers will fall further and allow for even more cross-border specialization and efficiency. For example, as signatories to the WTO's Information Technology Agreement, the PRC and Taiwan must lower tariffs for most IT imports to 0% over a five-year period.<sup>10</sup>

By the end of 2000, Taiwan had committed a total stock of \$51.86 billion in investment in the PRC. Actualized Taiwan investment in the PRC by the end of 2000 reached \$28.46 billion according to PRC statistics.<sup>11</sup> Table 1 offers a history of contracted investment, which is based on contracts signed, and actual Taiwan investment in the PRC over the past decade according to PRC statistics. Contracted investment is likely to be as high as \$70 billion to \$100 billion in view of investment by Taiwan firms via offshore companies in Hong Kong and the free ports, which is not typically calculated as Taiwan investment in either PRC or Taiwan statistics.<sup>12</sup> When these indirect investments are included, an estimated 50% of Taiwan's outbound FDI is now in-

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9. Government of Japan, Ministry of Economy, Trade and Industry, *White Paper on International Trade 2001 Key Points: External Economic Policy Challenges in the 21st Century*, May 18, 2001, <<http://www.meti.go.jp/english/report/data/gwp2001cpe.htm>>.

10. For a summary of China's WTO commitments on IT products and in other areas, see *White House Factsheets* data at U.S.-China Business Council home page, February 17, 2000, <<http://www.uschina.org/public/wto/factsheets/>>. A copy of the U.S.-China bilateral market access agreement is also available at this site.

11. *Ibid.*

12. Author's estimate based on PRC Ministry of Foreign Trade and Economic Cooperation (MOFTEC) statistics for direct investment from Taiwan and indirect Taiwan investment via Hong Kong, British Virgin Islands, and the Cayman Islands. See *Statistics on FDI by Countries/Regions for 2000/1999/1998*, March 18, 2002, <<http://www.chinafdi.org.cn/english/o1/f/21/5.htm>>, for data that demonstrate the growing role of the free ports as a source of FDI for the PRC.

TABLE 1 *Taiwan's Foreign Direct Investment in the PRC (1989–2000)*

Year	Number of Projects			Contracted Investment (\$ million)			Utilized Investment (\$ million)		
	Taiwan	Total	%	Taiwan	Total	%	Taiwan	Total	%
		PRC	Share		PRC	Share		PRC	Share
1989	539	5,779	9.33	431.69	5,599.76	7.71	154.79	3,392.57	4.56
1990	1,103	7,273	15.17	889.97	6,596.11	13.49	222.40	3,487.11	6.38
1991	1,735	12,978	13.37	1,388.52	11,976.82	11.59	466.41	4,366.34	10.68
1992	6,430	48,764	13.19	5,543.35	58,123.51	9.54	1,050.50	11,007.51	9.54
1993	10,948	83,437	13.12	9,964.87	111,435.66	8.94	3,138.59	27,514.95	11.41
1994	6,247	47,549	13.14	5,394.88	82,679.77	6.53	3,391.04	33,766.50	10.04
1995	4,847	37,011	13.01	5,849.07	91,281.53	6.41	3,161.55	37,520.53	8.43
1996	3,184	24,556	12.97	5,140.98	73,276.42	7.02	3,474.84	41,725.52	8.33
1997	3,014	21,001	14.35	2,814.49	51,003.53	5.52	3,289.39	45,257.04	7.27
1998	2,970	19,799	15.00	2,981.68	52,102.05	5.72	2,915.21	45,462.75	6.41
1999	2,499	16,918	14.77	3,374.44	41,223.02	8.19	2,598.70	40,318.71	6.45
2000	3,108	22,347	13.91	4,041.89	62,379.52	6.48	2,296.28	40,714.81	5.64
2001	4,196	26,139	16.05	6,903.99	69,190.68	9.98	3,158.00	46,845.52	6.74

SOURCE: PRC, Ministry of Foreign Trade and Economic Cooperation, "Statistics on FDI from Taiwan, 1989–2000," May 30, 2001, <<http://www.chinafdi.org.cn/english/O1/f/23/19.htm>>, and "Statistics on FDI from Taiwan, 1991–2001," March 21, 2002, <<http://www.chinafdi.org.cn/english/O1/f/23/4.asp>>.

NOTE: Taiwan = Number of projects or amount of investment in the PRC from Taiwan. Total PRC = Total number of projects or amount of foreign investment in the PRC. % share = % of PRC total that is from Taiwan.

vested in the PRC.<sup>13</sup> According to Taiwan's MOEA, by the end of 2000 almost three-quarters of Taiwanese firms that had invested overseas had investments in the PRC.<sup>14</sup> The majority of investments over the past 10 years

13. The 50% figure is a conservative estimate that can be derived in part from two charts, ROC, MOEA, "Taiwan's Approved Outward Investment," October 12, 2001, <<http://www.mac.gov.tw/english/CSEXchan/9010b.gif>> and PRC, Ministry of Foreign Trade and Economic Cooperation, "Statistics on FDI from Taiwan," <<http://www.chinafdi.org.cn/english/O1/f/23/4.asp>>. In the former chart, the MOEA states that 38.8% of outward FDI went directly to the PRC. When one calculates for indirect investment, a large percentage of the 20.86% that MOEA indicated went to "tax havens in British Central America" and the 2.55% that went to Hong Kong in fact went onward toward PRC investments. There's another way to get closer to the real figures. As of 2000 Taiwan had approved \$44.06 billion FDI, according to the MOEA chart. Looking back at the PRC stats, Taiwan's cumulative actual investment in the PRC as of the end of 2000 is seen to be approximately \$26.2 billion—over half of Taiwan's stated outgoing FDI of \$44.06 billion.

14. See "China Most Popular Spot for Taiwan Investors: MOEA," *Taiwan Economic News*, March 12, 2002, reproduced at the ROC Government Information Office's (GIO) *Taiwan Headlines* home page at <[http://th.gio.gov.tw/show.cfm?news\\_id=13896](http://th.gio.gov.tw/show.cfm?news_id=13896)>; and "ROC Investments in PRC Increasingly Profitable: Poll," Central News Agency, April 3, 2001, *ibid.*, <[http://th.gio.gov.tw/show.cfm?news\\_id=8277](http://th.gio.gov.tw/show.cfm?news_id=8277)>.

have been in electronics, basic metals and metal products, petrochemicals and plastics, food and beverage processing, non-metallic minerals, medical equipment, and services. Until recently Taiwan investment was concentrated in Guangdong, Fujian, and Zhejiang Provinces. Seventy percent of investment was from small firms and approximately 75% was in export-processing ventures. More recently, as investment has shifted to electronics and IT production, Taiwan investment has increased dramatically in and around Shanghai. According to the MOEA, between 1997 and 2000 electronics jumped from 20% to 60% of all approved Taiwan investment in the PRC.<sup>15</sup> The real figure is likely even higher considering the many IT investments that were structured offshore during this period. Investment projects are larger-scale and many firms are increasingly producing for the local market, although the majority of investment is still for components that eventually find their way into exports.<sup>16</sup>

Trade and investment remain weighted in favor of goods and capital flowing from Taiwan to the PRC. According to PRC Customs' statistics, total trade in 2000 reached approximately \$30.5 billion with a surplus in the amount of some \$20.5 billion for Taiwan (see Table 2). The bulk of cross-strait trade continues to be processing-related. Top trade products include machinery and mechanical appliances and parts, electrical machinery and parts, chemicals, plastics, base metals (especially iron and steel, and copper), and textiles and textile articles.

### New Options and Pressures

Cross-strait commercial relations are potentially on the cusp of the most significant breakthrough since the legalization of travel in 1987 and the Koo-Wang talks of 1993. Growing business pressures and WTO commitments are converging in a way that will add pressure for the establishment of direct links and significant reductions in barriers to trade and investment in both the PRC and Taiwan. The road of liberalization may not be smooth. Political jockeying, security concerns, and market protection efforts portend that the governments on both sides are likely to move more slowly than some expect to liberalize cross-strait trade and investment. But the process of opening and integration already well underway is likely to persist.

As in the past, in this new phase of relations business interests are likely to continue their calls for increased interdependence across the Strait. The Tai-

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15. Lu, p. 1.

16. PRC, MOFTEC, *Statistics on FDI by Countries/Regions for 2000/1999/1998*; U.S.-China Business Council, *White House Factsheets*; Lu, "Taiwan High-Tech," pp. 13-16; and Allen T. Cheung, "The United States of China: How Business Is Moving Taipei and Beijing Together," *Asiaweek.Com*, July 6, 2001, at <<http://www.asiaweek.com/asiaweek/magazine/business/0,8782,165847,00.html>>.

TABLE 2 *Cross-Strait Trade, 1990–2001*

Year	Total		PRC Imports		PRC Exports	
	(\$ million)	% Change	from Taiwan (\$ million)	PRC Imports % Change	to Taiwan (\$ million)	PRC Exports % Change
1990	2,574.0		2,254.3	21.4	319.7	241.9
1991	4,233.0	64.5	3,369.0	61.3	594.8	86.0
1992	6,578.1	55.4	5,880.1	61.6	698.0	17.3
1993	14,934.8	119.4	12,933.1	120.4	1,461.8	110.7
1994	16,327.0	13.4	14,084.8	8.9	2,242.2	53.3
1995	17,882.0	9.5	14,783.9	4.9	3,098.1	38.1
1996	18,984.9	6.1	16,182.2	9.4	2,802.7	-9.5
1997	19,838.2	4.5	16,441.7	1.6	3,396.5	21.2
1998	20,499.2	3.3	16,629.6	1.1	3,869.6	13.9
1999	23,478.6	14.5	19,528.5	17.4	3,950.1	2.1
2000	30,533.3	30.1	25,493.7	30.6	5,039.6	27.6
2001	32,339.7	5.9	27,339.4	7.2	5,000.2	-0.8

SOURCE: PRC, General Administration of Customs, *China's Customs Statistics* (Hong Kong: Economic Information & Agency). The December issues were used for each year with the exception of 2000 and 2001 for which the September issues were used.

wan government will find it has to address these demands and the commercial reality of what is already taking place while protecting national security and fostering the health of domestic industries based on the island. Ultimately, business yet again will likely find itself pushing for more flexible policies while testing and skirting incumbent restrictions. Government policy will likely continue to lag behind commercial reality. While policy can slow the process of integration, in the age of globalization the Taiwan government will be limited in its ability to control the flow of capital, goods, and know-how across the Strait. However, it will maintain some ability to slow the commercial flow in the reverse direction from the PRC into Taiwan.

### Direct Links

The impetus for direct links (shipping, aviation, and communications) has been building for some time as the volume of PRC-Taiwan trade and travel via Hong Kong and Macau has continued to grow exponentially. In the context of imminent WTO accession, it is important to note that direct links are not covered by WTO commitments; these rights traditionally are still negotiated bilaterally. In Taiwan, the question has evolved from one of whether direct links should happen at all, to a debate about timing and strategy. This policy consensus over the imperative to realize direct links as soon as possible was reflected in the platforms of the three major candidates in Taiwan's

March 2000 presidential elections.<sup>17</sup> In August 2001, Taiwan President Chen Shuibian's newly formed Economic Development Advisory Council (EDAC) agreed on a range of economic recommendations, including the liberalization of direct trade and investment, the creation of more flexible cross-Straits capital flow mechanisms, and the opening of travel and tourism.<sup>18</sup> It is significant that all the major political parties and groupings as well as business in Taiwan are represented on the EDAC. The council's statements offer an important source of support and legitimacy that allow Chen's administration to pursue liberalization.

Political jockeying both across the Strait and within Taiwan in particular may put off more bold policy shifts until after China's leadership succession in 2002–03 and Taiwan's presidential elections in 2004. Looking at the reality of further economic opening, leaders on both sides have been positioning themselves to garner credit for the process of opening and integration. Beijing and Taipei played a cat and mouse game on the establishment of "mini links," which finally materialized in a trial shipment in early January 2001 and the establishment of small-scale direct links via Jinmen (Quemoy), Matsu, and Penghu. For the most part, this trade is symbolic and merely legitimizes products that were likely being smuggled from these offshore islands anyway.<sup>19</sup> While the PRC is supportive of direct trade, Beijing held back both to avoid giving Chen Shuibian too much credit and to attempt to push further on direct links and obtaining a more definitive commitment to "one China." Senior level political opposition leaders from Taiwan also have reportedly encouraged Beijing to wait out Chen's term before embarking on major cross-Straits liberalization initiatives.<sup>20</sup>

The major political parties in Taipei—the Democratic Progressive Party (DPP), the Kuomintang (KMT), and the People's First Party (PFP)—are competing to package this liberalization and therefore get the credit. While all parties are represented on the EDAC, the two likely 2004 presidential candidates from the KMT and PFP, Lien Chan and James Soong, respec-

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17. Karen M. Sutter, *Taiwan's New Face: The Transition and Future Policy*, CAPS [Chinese Council of Advanced Policy Studies] Papers, no. 28 (Taipei, Taiwan: CAPS, May 2000), pp. 12–13.

18. For the official summary, see Republic of China, Mainland Affairs Division, Economic Development Advisory Conference, *Final Summary Report*, August 26, 2001, <<http://www.taipei.org/press/mac0828.htm>>.

19. For a statistical summary of the number, volume, and value of these shipments, see the tables on the mini-links at the Mainland Affairs Council (MAC) home page, June 30, 2001, <<http://www.mac.gov.tw/english/CSExchan/3link9007.htm>>.

20. Bonnie S. Glaser, "China's Taiwan Policy: Still Listening and Watching," *PacNet*, no. 33, August 17, 2001, <<http://www.csis.org/pacfor/pac0133.htm>>; and "Disputed Article Not from CSIS, Says Writer," *TaiwanHeadlines*, August 20, 2001, <[http://th.gio.gov.tw/show.cfm?news\\_id=10623](http://th.gio.gov.tw/show.cfm?news_id=10623)>.

tively, declined President Chen's invitation to participate. While there are many potential reasons for their decision, in part it could have been fueled by a desire not to lend their senior legitimacy to the panel and keep their options open for their own respective initiatives.<sup>21</sup> Leading KMT figures Vincent Siew and Ma Ying-jeoh hit the ground running in 2001 with a common market agenda. The facts of the KMT plan remain relatively vague, and those details offered actually sound less forthcoming than what WTO liberalization allows, but nevertheless position the KMT with its own economic plan of action.

While forward movement may be slow, there is strong support and pressure on political leaders to try to move in that direction. Both government agencies and entrepreneurs are positioning themselves for eventual opening. Party positioning within Taiwan is not just for political gain. The KMT for example contains a significant business arm that stands to benefit from market opening. Former premier Vincent Siew's common market proposal includes not only a policy framework for cross-Strait economic integration but also involves a foundation that was established in March 2001 whose 20 members each invested five million Taiwan dollars.<sup>22</sup> There also will be significant benefits for PRC localities that establish direct trade links. Shanghai has been positioning itself as the key entry point. In fact, the vice mayor of Shanghai traveled to Taiwan in 2000 in an unofficial capacity.

In an effort to meet business needs in the absence of movement on direct links, Taiwan's Ministry of Transportation and Communications has been simultaneously pushing for an expanded role of transshipment centers. Part of this proposal includes allowing PRC products to clear customs, which would facilitate packaging and processing in Taiwan as well as cargo transshipment via air; this latter program is now being piloted out of Taiwan CKS International Airport outside Taipei and Hsiaokang Airport in Kaohsiung. Depending on how broad the measures are, it also could allow for an increased percentage of products to be imported to Taiwan for domestic use. Another aspect of the request includes allowing all of Taiwan's ports to act as offshore transshipment centers. Currently, only Kaohsiung, Taichung, and Keelung are authorized to handle cross-Strait shipments via offshore transshipment centers. Taiwan's China Airlines reportedly acquired a 25% stake, valued at \$45 million, in the PRC's China Eastern Airlines in September 2001. The deal, which still requires both governments' approval would allow cross-

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21. For information on EDAC participation, see Irene Yeung, "Advisory Council Takes Shape," *Taipei Journal*, July 13, 2001, p. 3; and "Advising Group Gears Up to Tackle Economy," *ibid.*, July 27, 2001, p. 1.

22. "Taiwan Ex-PM to Sell Common Market Idea to China," Reuters, May 8, 2001.

Strait passenger and cargo flights.<sup>23</sup> China Airlines in cooperation with three other Taiwan firms, EVA Airways, Corp., Far Eastern Air Transport Co., and Taiwan Airport Service Co., own a 49% stake in the Gaoqi cargo air terminal in Xiamen, Fujian, which is expected to open in 2003. And the PRC's China Ocean Shipping Co. (COSCO) has been negotiating to invest in cargo facilities at Taipei port, though it might face PRC government hurdles in addition to Taiwan restrictions.

## Economic Security

There is a concern in some quarters in Taiwan and the U.S. that from a national security perspective Taiwan is becoming overly dependent on the PRC market. Policy makers in Taipei are also worried about the speed and direction of economic integration with further liberalization following WTO accession. The current economic relationship is extremely skewed, with the majority of goods and services flowing from Taiwan to the PRC. Of special concern is how goods and capital might flow from the PRC to Taiwan, with new trade and investment openings toward the PRC required of Taiwan under the WTO. Inherent in all of these debates is the question of leverage and the extent to which Beijing gains an advantage over Taiwan as Taiwanese firms enmesh Taiwan's economic future with that of the mainland. There is also concern within quarters of the DPP and the KMT in particular about how further economic interdependence may shift the debate about political identity in Taiwan. Specifically, they fear that Taiwan will be less inclined to consider the option of political independence as its economic survival and future are increasingly linked to those of the PRC. As Taiwan moves its IT manufacturing into the PRC, Taiwan security planners are concerned that Taiwan business may be indirectly helping develop the PRC's military capabilities.

While there is some basis for this concern, Taiwan's growing commercial ties to China's economy are part of a larger globalization trend that ultimately puts cross-Strait relations into a much larger scheme of regional and global economic interdependence that denies Beijing unilateral leverage over Taiwan. Furthermore, while Taiwan is dependent on the PRC as a manufacturing base and increasingly as a market, the PRC is also dependent on Taiwan for capital, technology, and know-how. Ironically, both sides gain leverage over time but lose their incentive to use it because the leverage could harm their own economies in the process.

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23. Zach Coleman and Jason Dean, "Taiwan Airline in Landmark China Deal," *Wall Street Journal*, September 6, 2001, p. A17; and "Airlines to Sign Cross-Strait Deals," *Muzi.com*, September 5, 2001, <<http://latelinenews.com/ll/english/1093287.shtml>>.

Protectionist forces remain considerable in Taiwan. With the economic downturn and rising unemployment in Taiwan, many are also beginning to argue that the island's high-tech sector may be localizing on the mainland too rapidly. Particular sectors are worried that if liberalization occurs too rapidly it will open Taiwan agriculture and industry to unfair competition. Taiwan analysts have argued for some time about the dangers that opening will pose to small farmers. Global competitive forces compounded by the economic downturn in Taiwan are compelling firms to relocate offshore to keep costs down, while at the same time labor pressures are mounting to keep these jobs within Taiwan. Official unemployment in 2001 was over 5%, although many analysts say it was much higher at 7% to 8% since many workers who have been laid off are now working in the informal sector.<sup>24</sup>

While the downturn is in part tied to the global slowdown in IT products, it also reflects the structural challenges Taiwan faces as traditional industries such as chemicals and manufacturing shed their competitiveness—a trend likely to continue. The Chen administration will be challenged simultaneously to address the needs of business to move offshore while at the same time to assist domestic labor hit hard by the current slowdown. Taipei will need to effectively devise policies to help both business and labor. Taiwan currently hosts an estimated 326,000 foreign workers<sup>25</sup> and will likely need to consider further liberalizing immigration laws in order to address labor shortages and keep manufacturing jobs on the island. It remains to be seen if the government might lift restrictions to allow some of this migrant labor to come from China in addition to the current supply from Southeast Asia. Taiwan also faces the interesting phenomenon of a growing workforce of Taiwan citizens based in the PRC. It will need to devise new policies to deal with this new group, and either intensified or new cross-Strait mechanisms will likely be necessary to cope with the inevitable issues that arise with increased contact.

### Moving Ahead Anyway

In spite of these concerns, as the PRC liberalizes investment opportunities in the very sectors that remain regulated by Taipei, many firms are skirting domestic ceilings. In order not to lose control, the Taiwan government is struggling to keep its policies realistic. Taiwan's Executive Yuan has proposed simplifying its investment approval process into two classifications: a general category that will require case-by-case approval and a prohibited category.

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24. Taiwan business association representative, personal conversation, July 5, 2001, Washington, D.C.

25. Mure Dickie, "Taiwan Looks for Answers to Rising Unemployment," *Financial Times*, May 11, 2001.

The plan also includes the much-discussed lifting of the \$50 million ceiling on individual investments and a simplification of approvals for investment projects under \$20 million. Taiwan is expected to implement this plan in 2002 if approved. The government is also reexamining restrictions on investment in semiconductors, and other sensitive sectors such as petrochemicals may not be far behind, despite strong resistance in some quarters, given the demands of Taiwan's major industry players themselves. While certain restrictions remain, Taiwan has been initiating reforms that could further boost investment and cross-Strait trade in support of these investments. Banks are now allowed to establish representative offices but not full-fledged branches, at least yet. Although the \$50 million capital cap on single investment projects remains, investors have been given the official blessing to raise the remaining capital overseas—a process long underway through finance companies established in the Cayman Islands and the British Virgin Islands.

As to liberalizing Taiwan's market, on December 5, 2000, Taiwan's Legislative Yuan revised the Statute Governing the Relations between the People of the Taiwan Area and the Mainland Area. The revisions relax restrictions on the travel of PRC citizens to Taiwan for pleasure and work and eliminate the provision that Taiwan citizens who live in the mainland for over four years automatically lose their citizenship. Earlier in the year, Taiwan also eased restrictions on the travel of PRC journalists to Taiwan. Driven in part by the economic downturn in Taiwan as well as the need to open to PRC firms upon accession to WTO, by year-end the Ministry of Economic Affairs was opening discussing the possibility of allowing PRC direct investment into Taiwan. Currently, the Statute only allows firms that have 20% or less of stake from PRC investors to open branch offices in Taiwan.

PRC exports to Taiwan are currently tightly controlled according to the Regulations Governing Permission of Trade Between the Taiwan Area and the Mainland Area, which were promulgated in April 1993 and amended in October 1996 by MOEA. Prior to WTO accession almost 50% of PRC agricultural and industrial goods were banned from the Taiwan market. Exceptions to this list had been made for raw materials and inputs used in export processing for re-export to third markets. According to Article 8 of these regulations, any PRC goods allowed to enter Taiwan may not endanger national security or have a negative impact on domestic industries. Taiwan's Ministry of Economic Affairs has prepared a "List of Mainland Agricultural and Industrial Products Allowed to Enter the Taiwan Market" that reportedly includes 482 agricultural products and 5,295 industrial products to be allowed

as part of Taiwan's WTO commitments and/or when direct links are initiated.<sup>26</sup>

## WTO Membership

With both Beijing and Taipei now members, WTO membership presents new opportunities and challenges for both governments.<sup>27</sup> Entrepreneurs on both sides of the Strait are now examining new opportunities that will open in agriculture, manufacturing, and services. Although it may be slower and messier than some expect, WTO-induced liberalization will occur across the Strait.

Liberalization presents new security concerns for Taiwan as it faces the impact of opening its agricultural sector to PRC imports, its services to PRC investment, and its manufacturing sector to even more rapid relocation offshore in the mainland. Many foresee that Taiwan will not block opening, but at the same time it will likely move cautiously to shift its policies on goods and services from the PRC. According to Article 13 of the GATT (General Agreement on Tariffs and Trade)/WTO, at the time of accession a new member can opt not to apply the principles of the WTO to another member. In this event, the PRC would likely reciprocate meaning that both the PRC and Taiwan would be members of the WTO but would not apply the benefits to one another. Taiwan ultimately opted not to invoke Article 13, which it likely did in response to opposition from Taiwan's own business community and WTO members.

There also appears to be strong international pressure on Taiwan not to liberally invoke Article 21 of the GATT or Article 14 of the General Agreement on Trade in Services, which have been typically used only in rare instances as a temporary measure. Taipei has not ruled out these options as an emergency measure to restrict certain trade and investment vis-à-vis the PRC.

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26. ["Taiwan Secures WTO Membership," *Taiwan Economic News*, November 13, 2001; and "Many China Products to Be Allowed in Taiwan," *Liberty Times*, January 15, 2002. The draft list of goods to be approved by the Legislative Yuan as this article goes to press is available at Taiwan's Board of Foreign Trade home page at <http://www.trade.gov.tw/richnews/newscontent.asp?bbb=503&aaa=s&ccc=3070>.

27. For further discussion of this topic, see Karen M. Sutter, "WTO and the Taiwan Strait: New Considerations for Business," *China Business Review* (January/February 2001). China and Taiwan acceded to the WTO on December 11 and January 1, respectively. Taiwan acceded under the name of "Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu," or "Chinese Taipei" for short. Copies of China's WTO accession documents can be found at <http://www.uschina.org/workingpartyreport.doc/schedulec12.html> and <http://www.uschina.org/specificcommitment.doc>. Copies of Taiwan's accession documents can be found at [http://www.wto.org/english/thewto\\_e/protocols\\_acc\\_membership\\_e.htm#taipei](http://www.wto.org/english/thewto_e/protocols_acc_membership_e.htm#taipei). For a summary of Taiwan's commitments, see [http://www.wto.org/english/news\\_e/pres01\\_e/pr244\\_e.htm](http://www.wto.org/english/news_e/pres01_e/pr244_e.htm) and the World Trade Organization's home page at <http://www.wto.org>.

Nevertheless, these exemptions are controversial. Taiwan will most likely turn instead to widely used (and WTO-consistent) mechanisms such as quotas on textiles and other sensitive products, product-specific and general safeguards, subsidies, antidumping measures, export controls, and standards to control the flow of goods and services from the PRC to Taiwan.

Taiwan's accession to the WTO presents a host of contradictions for Beijing. Membership gives Taipei an equal status to that of Beijing in the WTO and the ability to discuss international trade issues based on parity. Membership enhances the ability of Taipei to work with other governments as well, somewhat eroding Beijing's attempts to isolate Taiwan internationally. On potential issues where Beijing and Taipei may not agree, the WTO allows for the multilateralization of their disputes, but only if either side opts to pursue them within the WTO context. Some analysts argue that Taiwan may test Beijing by maintaining many existing investment and trade restrictions it has against the PRC after accession to the WTO, knowing full well such restrictions are not WTO-compatible. This strategy would test Beijing's reluctance to challenge Taiwan in a multilateral setting, as it would call attention to the equal status of Taiwan and the PRC in the WTO. Many analysts argue that Beijing may be reluctant to challenge or work specifically on issues involving Taiwan through WTO multilateral procedures and will continue to try to work bilaterally. But some PRC analysts appear to be arguing for a multilateral route with Taiwan, and Beijing's willingness to initiate or respond to a challenge from Taiwan in the WTO should not be ruled out as a possibility.<sup>28</sup>

### The Emerging Agenda

Further cross-Strait economic integration and specialization seem inevitable given the highly complementary nature of the economies of the PRC and Taiwan. Despite the tendency to see relations as zero sum, both the PRC and Taiwan share a convergence of economic interests. For example, both are highly dependent on an open U.S. market, especially for jointly developed PRC-Taiwan exports. A large percentage of PRC exports to the U.S. (both via the PRC directly and Hong Kong) are exported by Taiwan-invested firms. While statistically Taiwan's exports appear to depend less on the U.S. market, in fact they depend on the health and openness of the U.S. market more than ever via their investments in the PRC. Many products that the U.S. used to import directly from Taiwan are now imported indirectly via Taiwan-invested firms in the PRC. Over the years, Taiwan has consistently supported the U.S. renewal of most-favored nation trading status—now called normal trading relations (NTR)—and permanent NTR status (PNTR) for the PRC.

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28. Conversations with academics from Taiwan's Institute of International Relations, June 7, 2001, Washington, D.C., and researchers in Beijing, November 6, 2001.

Traditionally, this support has been voiced through Taiwan's representative office in Washington, the Taipei Economic and Cultural Representative Office. During the summer 2000 U.S. congressional debate over whether to grant PNTR for China, President Chen himself issued a statement in support from Taipei.<sup>29</sup>

While senior policy makers in Beijing and Taipei are focused on the convergence of commercial interests, arguably Washington has been less so. Over time the U.S. may realize that the rules of the game have been changing. While Washington is focused on promoting cross-Strait dialogue, its greatest concern may actually become cross-Strait collusion and the need to find ways for U.S. firms to participate with PRC and Taiwan firms on an equal footing. U.S. firms are positioned to take advantage of falling barriers across the Strait, but will be able to do so only if allowed. Taiwan's maintenance of some barriers toward the PRC and PRC-invested entities may affect U.S. companies trying to trade with and invest in Taiwan via their PRC-based ventures. Some blanket protections prohibit U.S. companies from directly and indirectly exporting a variety of products, including IT hardware and chemicals, from their facilities in the PRC to customers in Taiwan. U.S. companies are already confronting cross-Strait protectionism in shipping and aviation. Only those carriers from China and Taiwan specifically licensed for cross-Strait trades have been designated to conduct direct links so far. Though it makes sense that such a sensitive sector would be opened first on a trial basis to PRC and Taiwan carriers, the question remains as to when shipping will open to U.S. and other foreign carriers. The U.S.-China Maritime Agreement has expired, and one outstanding dispute involves the inability of U.S. flag carriers to transship via Kaohsiung onward to PRC ports. Similar problems could develop with regard to passenger and air cargo rights. For example, China Airline's strategic acquisition of a 25% stake in China Eastern is aimed at helping both firms compete more effectively with not only the PRC's Air China but also United Parcel Service and FedEx Corp.

Deepening economic cooperation offers the hope for enhanced stability across the Strait as commercial interests in the PRC and Taiwan are increasingly intertwined. PRC and Taiwan firms engaged in commercial cooperation across the Strait are increasingly likely to share the priority of political stability, not an agenda of either unification or independence. The relationship of Taiwan business and politics is complex. Future policy choices likely fall somewhere between the often used and relatively clear-cut endpoints for Taiwan's political trajectory, with independence and unification serving as distant options. Since the 1980s, most businesspeople in Taiwan have simultaneously supported increased international space and representation for Tai-

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29. See Tucker's "The Taiwan Factor" for an excellent analysis of this issue.

wan to buttress business interests in international markets, together with easing restrictions so that they can expand in the PRC. These two desires have not been seen as mutually exclusive. The burgeoning cross-Strait commercial relationship offers a substantial body of new interests, perspectives, and experiences that can help ease tensions and work toward a peaceful resolution of the Taiwan-PRC political issue. While the U.S. will need to monitor and respond to PRC military developments, there is a danger that relations will become overly focused on strategic and military issues without adequately exploring the peacemaking opportunities that economic interaction offers.