The Economic Security of Taiwan:
A Case Study of Cross-Strait Relations between Taiwan and China,
2000-2004

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ABSTRACT

This thesis aims to demonstrate that economic security is also a significant pillar of safeguarding national security. Aside from military security measures, adopting peaceful economic engagement and economic measures can be an alternative security policy choice through which a state may achieve its national security agenda. To facilitate an understanding of economic security, this thesis submits a working definition of economic security, which has been delineated as 'the protection of a core value from all forms of potential or actualised threat by using economic measures and policies'. The core value refers to national interests and security objectives. With this framework, the current thesis takes Taiwan as a case study to assess Taiwan's effort of implementing economic security strategy to accomplish its national security agenda within the context of the complex and hostile cross-Strait relations yet growing economic integration. This research intends to answer three categories of questions. Firstly, how large is the cost to Taiwan of pursuing economic security vis-à-vis China, and what is Taiwan's capability to afford such cost? Secondly, what factors would contribute to or undermine Taiwan's efforts in practising economic security, and to what extent? Thirdly, do cross-Strait economic ties strengthen or weaken Taiwan's economic security with respect to its economic performance, and to what extent? From three perspectives, this study analyses the above questions. Firstly, it analyses how Taiwan has employed economic power to construct its national security within the international system. Secondly, it examines how Taiwan has utilised economic measures to resist China's political and economic influence. Thirdly, from an economic perspective, it examines whether Taiwan's economic security objectives, in the context of its capability of sustaining economic prosperity, have been enhanced when it has engaged in economic exchange with China.
Keywords: economic security, cross-Strait relations, national security, Taiwan, China
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CHAPTER ONE

INTRODUCTION

1.1 Research Rationale

There is a general consensus that military security plays a dominant role in safeguarding national security in international relations. This thesis aims to demonstrate that economic security is also a significant pillar of safeguarding national security. Peaceful economic engagement and economic measures can be an alternative security policy choice towards achieving a national security agenda in international relations. This research assesses Taiwan's economic security within the context of long-lasting and dangerous cross-Strait relations between Taiwan and China. It aims to find out to what extent and with what limitations economic security can serve Taiwan's security while it faces relative political and security weaknesses generated by China's diplomatic moves to isolate Taiwan internationally. Within the research it expects to set out a comprehensive framework for economic security in international relations, as well as to argue that economic security is an important means through which a state may achieve its national security agenda. The research is based on the work of those who have sought to broaden the concept of security from highlighting military-centred power to acknowledging the importance of economic power in international relations.

1 In this research the term 'cross-Strait' relations specifically refers to the relationship between the Republic of China (ROC), on the one hand, and the People's Republic of China (PRC), on the other, after the time when the central government of the ROC withdrew to Taiwan Island in 1949 and the PRC was established on 1 October 1949. Also for reasons of convenience, this research will refer to the 'PRC' as 'China' and to the 'ROC' as 'Taiwan', except on some occasions where it is advisable to use the countries' official titles to prevent misinterpretation. The term 'Taiwanese' refers to all of the citizens of the ROC who live in Taiwan, including Taiwanese mainlanders. The term 'Chinese' refers to all of the nationals of the PRC.
The basic function of states throughout history has been to provide security for their citizens by eliminating threats. As history has clearly illustrated, states failing in fulfilling their responsibilities as regards security have eventually succumbed to the fate of losing their legitimacy or have even disappeared completely from the international political map. In this regard, the objective of national security has always lain at the core of the national interests of individual states and among states. Despite the fact that sources of threats are various, the major source of threat to national security generally originates from the interaction among states when states perceive their national interests to be vulnerable. Hence, governments develop suitable and feasible security policies in order to protect and defend vital national interests against existing and potential adversaries. Among various forms of measures, military power has traditionally been considered as the most important instrument, presented as a nation's strength to safeguard its national security (Mearsheimer, 1990: 5-6).

This traditional conception of security derives from the Realist view of international relations (Stares, 1998: 12-13). The Realist paradigm of national security is to seek to maximise national power and advance national self-interest through military force. The search for security focuses overwhelmingly, therefore, on the protection of the homeland, which requires a military capacity and an effective military strategy. This is related to a nation's ability to prevent foreign adversaries from inflicting harm physically, economically, and socially. Military strength is the most powerful and direct measure that states can employ to resolve a security threat and to defend national security. In this regard, military defence is almost a synonym for security in the realm of security studies. Efforts towards preventing wars and maintaining peace are at the centre of the traditional concerns of policy makers and scholarly researchers (Bull, 1977: 187).
Nevertheless, whatever may be accomplished through military power, states cannot be truly secure without prosperity. History has illustrated that the rise and fall of power for states are demonstrably caused not only by military conflict, but also by the consequence of economic factors (Kennedy, 1988). The roots of true security go deeper than armies and missiles alone. States must seek both security and prosperity in the international environment. States usually have to rely on the world economy to provide the *matériel* and money for defence. In the most simple and direct way, economic potential supports the establishment of a military might and thus strengthens national security (Friedberg, 1991: 265). As Sir Ralph G. Hawtrey, former under-Secretary of the British Treasury, noted, ‘[w]ith given military skill and military virtues, the magnitude of the force that can be put into the field depends upon economic power’ (Hawtrey, 1930: 105). National security is improved and protected by secure economic power. Similarly, national economic power will be amplified and secured by national security. Utilisation of economic measures to achieve national interests in the face of threat can thus constitute a feasible means for national security ends.

This is especially so in the post-Cold War era. The end of the Cold War brought a reduction in the direct political and military threats to the international system. Although security concerns remained at the centre of the agenda in the minds of policy makers, some non-military security issues, such as economic, environmental, and societal subjects, began to attract the attention and support of policy makers and scholars. The meaning of security has come under intensive debate and re-assessment (Mathews, 1989; Buzan, 1991; Booth, 1991; Lipschutz, 1995). A contentious debate about the appropriate parameters and priorities of security policy has emerged (Buzan...
et al., 1998; Stares, 1998; Terriff et al., 1999). Although the end of Cold War did not diminish aspirations to national security, the nature of contemporary international society and its norms and values reflect the fact that military power alone cannot adequately deal with many non-military security issues, such as economic, environmental, and societal subjects (Bobbitt, 2002: xxii). With the progress in economic globalisation, international economic interaction for national economic growth and prosperity, as well as the use of economic power for security ends, are practised on a daily basis between and among states.

In fact, the employment of economic measures in the struggle among states is not a revolutionary idea. The linkage of economics and security is explicit. While an economic dispute itself may be a source of friction or even war between and among states, economic measures can also be an effective weapon to weaken or paralyse enemies. Japan’s Pearl Harbour attack on 7 December 1941 was an example of waging a military invasion abroad in order to solve economic vulnerabilities in the Japanese homeland (Barnhart, 1987; Keohane and Nye, 1989: 18). The Coordinating Committee for Multilateral Export Control (COCOM) was an example of taking economic measures as a security strategy against the Soviet Bloc during the Cold War.² A well-articulated economic policy can facilitate military operations. As the old military threats have receded in the post-Cold War era, and there have been massive and intensive trans-national economic interactions and engagements between and among states, economic issues and economic frictions have become the major source of influence on a nation’s interests and international relations vis-à-vis its counterparts.

² COCOM was established in 1947, during the Cold War, to place an embargo on Western exports to Eastern Bloc countries. This economic measure was a Cold War security strategy to prevent Western superiority in strategic military technologies exported into the Eastern Bloc. For a more detailed introduction to COCOM, see Cupitt (1992).
On this point, the concept of the national security spectrum must be broadened to include not only military security, but also economic security, as numerous scholars have suggested (e.g., Luttwak, 1990; Buzan, 1991; Hormats, 1991).

The notion of economic security is not, nevertheless, well articulated in the realms of international relations, although a wider perception of a national security agenda has been recognised by policy makers and scholars. The concept of employing 'economic security' for national security ends remains a vague impression in international politics. Furthermore, given that increasing attention is being paid to the usefulness of economic instruments as substitutes for or complements to military and political means of achieving national security and foreign policy objectives, most of the studies into the subject of deliberately expanding economic engagement ties for economic security objectives have been limited to the policies of great power states. At the same time, numerous literatures emphasise the utilisation of economic power as a negative form of coercive policies, such as economic sanctions, in the pursuit of economic security. In contrast, relatively little is known about how other small states also depend on an economic security policy in pursuing their specific aim of national security and thus in counteracting rivals.

1.2 Research Aims and Case Study

Drawn from the aforementioned observations, the research aims of this study are three-fold. Firstly, the study aims to provide a comprehensive conception of economic

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3 For a literature discussion on utilising economic measures as strategic policy features, see Mastanduno (1992); Davis (1999); Skalnes (2000); Papayoanou and Kastner (1999/2000); Copeland (1999/2000); Abdelal and Kirshner (1999/2000), and Wan (2001).

4 For literature on economic sanctions, see, for example, Doxey (1980); Daoudi and Dajani (1983); Nincic and Wallensteen (1983); Baldwin (1985); Hufbauer et al. (1991); Miyagawa (1992); Rogers (1996); Drezner (1999), and Cortright et al. (2000).
security in order to emphasise the significant role of the economic factor in the pursuit of national security within international politics. Secondly, the study aims to examine how small states practise an economic security policy to fulfil their respective security agendas and national interests. Thirdly, instead of discussing economic security from the traditional perspective of using economic strength to support military establishment and to use this as a negative form of coercive policy, the study aims to examine economic security from the perspective of how states use economic measures in the diplomatic arena and on the occasions of their economic engagement with political rivals.

In order to fulfil the above three research aims, the study will conduct a literature review to outline the evolution of the concept of security in international relations, and to demonstrate the role of economic security in the overall national security paradigm. After the concept of economic security has been submitted, the study will take Taiwan as a case study to explore how Taiwan has implemented its economic security strategy to accomplish its national security agenda vis-à-vis China, Taiwan’s long-lasting national security threat and rival. This case study of Taiwan within the framework of cross-Strait relations will provide a detailed assessment of the role of Taiwan’s economic security policy in pursuit of its national security. The case study expects to present a clearer understanding of both the concept of economic security and the cross-Strait relations.

The reasons for choosing Taiwan as the case study of this research are as follows. Firstly, Taiwan is a small state yet it faces an environment of threat generated by China’s movements both to isolate Taiwan international and to annex it politically. Taiwan has long encountered security struggles with China across and in the Taiwan
Strait and at the international level. Paradoxically, Taiwan and China have also maintained close, substantial economic ties since the end of the 1980s. This contradiction of the economic and the political situations across the Taiwan Strait provides an attractive incentive for an analysis of the political economy that currently obtains.

Secondly, the uniqueness of the political and economic relationship between Taiwan and China has provided a suitable background for examining how Taiwan has utilised its economic security policy to maintain its national security agenda. Several quantitative studies have shown that adversarial relations between countries tend to correspond to a reduction, rather than enhancement, in the level of trade (Pollins, 1989; Gowa, 1994). However, the trade and economic exchanges between Taiwan and China have grown intensively and immensely over years, given that the political hostility between Taiwan and China is in tense. Although China has never renounced the possibility of adopting military force towards Taiwan, and has deployed more than 700 ballistic missiles pointing towards Taiwan, China is Taiwan’s largest foreign direct investment recipient. Furthermore, since 2003 China has become Taiwan’s largest trading partner. This complexity of political hostility and economic integration provides an interesting case study in security studies.

Thirdly, given the contradiction of cross-Strait political antagonism and economic integration, Taiwan’s case can be used to explore the inadequacy of the liberal argument regarding the connection between economic interdependence and peace. The liberal highlights the role of inter-state economic engagement to facilitate the prevailing peace by contradicting war within and among states in international security relations. Nevertheless, Taiwan’s case shows otherwise. The number of
missiles aiming at Taiwan from China has increased in the same upward trend as have cross-Strait economic and trade exchange. On this point, this case study expects to fill the literature gap in the Liberal trade peace argument over Taiwan’s case within the uniqueness of cross-Strait relations.

1.3 Structure of the Thesis

The scheme that the thesis will take to examine the questions above is here described. Chapter One is the introductory chapter to the thesis. It presents the research rationale, the significance of the research aims, and the structure of the research. Chapter Two commences the literature review. The chapter outlines the evolution of the concept of security in international relations over the years since the Cold War. It demonstrates the tradition of military-centred thinking on the meaning of security, and highlights the debate among scholars about the emerging conception of economic security in international relations. The chapter aims to pave a background to the knowledge necessary for appreciating the concept of security in the international relations, and also to demonstrate the role of economic security in the overall national security paradigm. Chapter Three expands the concept of economic security by combining theoretical literature with the practicality of international relations. By bringing together academics’ and practitioners’ views of the relationship between economics, politics, and security, the chapter explores the concept of economic security in international politics. It aims both to facilitate a greater understanding of the concept of economic security, and to examine the practicality of economic security for national security objectives. Based on the aforementioned discussion, the chapter examines the concept of economic security and lays out typologies of economic security when a state interacts with other states within the international system. A
working definition of economic security will also be submitted on the basis of the above discussion in order to apply this to the case study that follows.

Chapter Four examines Taiwan’s security situation within the context of cross-Strait rivalry from the perspectives of political, military, diplomatic, and economic factors. The chapter illustrates the military confrontation, political hostility, diplomatic tug-of-war, and the rationale for the commencement of an economic engagement between Taiwan and China. A retrospective view of cross-Strait political rivalry aims to lay the foundation to allow an assessment of the types of economic security measures that may be taken by Taiwan to safeguard its national security agenda. Chapter Five discusses approaches towards conducting the research of case study. The chapter introduces the methodological approaches and determines the research approach for the subsequent case study. The research design outlines the research method, research hypothesis, data and information collection, interview design, interview questions, and interview itinerary.

Chapter Six illustrates Taiwan’s outward security objective at the international level. The chapter examines in detail Taiwan’s utilisation of economic power to implement its economic security strategy for the maintenance of formal diplomacy, admittance to international organisations, and the establishment of Free Trade Agreements (FTAs) within the environment of interference from China. The chapter will also examine the success and failure of Taiwan’s economic security agenda at this international level, as well as its scope, durability, and implications. Chapter Seven investigates Taiwan’s economic security approach by examining Taiwan’s utilisation of economic issues within the cross-Strait politico-economic engagement. The chapter surveys the ways in which both China and Taiwan have politicised cross-Strait economic relations,
mainly by tightly linking the economic relationship to their respective political agendas. It focuses on how Taiwan has utilised its economic measures to resist China's political manoeuvring and to secure Taiwan's own economic interests where these relate to its national security.

Chapter Eight continues the case study by detailing the impact of cross-Strait economic interaction on Taiwan's economic security. The chapter focuses on the trade and investment dimensions of the economic interaction between Taiwan and China, in order to analyse Taiwan's economic security in the context of its economic strength and capability of generating prosperity when it conducts economic engagements with China, under the given cross-Strait relations. Chapter Nine sets out the conclusions that are drawn from the research. Based on the findings and information yielded from the preceding chapters, a comprehensive discussion on the effects and consequences of Taiwan's economic security measures for security ends will be concluded.
CHAPTER TWO
CONCEPTUALISING AND UNDERSTANDING SECURITY

2.1 Introduction

The aim of this chapter is to review the evolution of the concept of security in international relations over the years since the Cold War. The chapter also aims to demonstrate that economic security is one aspect of the security paradigm emerging on the national security agenda. The chapter begins by outlining the general concept of security so as to provide a knowledge base for further developing the concept of security at the level of international politics. After that, the chapter then moves on to a theoretical framework of security in accordance with the Realist school of thought in International Relations. Given that the Cold War conceptions of what constitutes security and how to achieve it are generally based on the Realist assumptions, a review of the Realist paradigm is a conceivable path towards forming a stage for conceptualising security in international relations.

Examining the basic tenets of Realism, the chapter aims to introduce the traditional military power-centred concept of security still prevailing in the political realm, while accompanying this with certain other non-military aspects of security issues. The present section illustrates the mainstream of scholarly thought regarding, on the one hand, the traditional perception of security and, on the other, the key actors involved in formulating it. This section will also review the debates of the Realist school of thought within the environment of facing the gradual change of the world security
environment. Based on those debates, the concept of economic security that has emerged as a new aspect of the security paradigm will be discussed. The chapter then moves on to review security policies in the Cold War, the post-Cold War, and the current post-9/11 periods. Generally, the review will focus upon the prospective of the US. Although the US perception of security is less than sufficient to represent the overall concept of security, one may still argue that the US security policies outlined in its National Security Strategy (NSS) will have a far-reaching impact not only on America but also on most of the major countries worldwide. Given that the US is still the world's leading power, it retains a significant degree of influence over world events. Thus, the US concept of security can be seen as a significant global influence. Lastly, a conclusion to the chapter will be drawn in accordance with the concept explored in the above sections.

2.2 The General Concept of Security
Analysts and policy-makers have used 'security' in innumerable ways to highlight a range of issues considered as being important and relevant, reflecting different perspectives on what actually matters. Labelling an entity as a security issue instils it with a sense of urgency that legitimises the use of special measures other than the usual processes in addressing such matters. David Ignatius has made this situation clear by noting: '...but security is different. Like life itself, it is something for which people will pay almost any price' (Ignatius, 2001). Nevertheless, the self-evident importance has not helped to illustrate the meaning of security. Given the different value systems and different interests of each observer, the meaning of 'security' varies with their specific, separate perspectives and mindsets. Thus, 'security' is a term that has been used frequently yet with no consensus in its definition. It is still an
‘ambiguous symbol’ that allows free interpretation in accordance with respective interests and issues (Wolfers, 1952; 1962).

The word ‘security’ can be used as a synonym or shorthand for defence, guard, protection, safeguard, safety, shelter, guarantee, assurance, certainty, confidence, surety, safekeeping, *et cetera* (Treffry, 2000: 505-506). Hence, security can be interpreted, in general, as freedom from danger, threat, disaster, or injury, as freedom from anxiety or fear, and as a guarantee that an obligation will be met. Security is a condition of being protected against a variety of dangers or losses. Within this context, ‘security is a generic term that has a distinct meaning but varies in form’ (Buzan *et al.*, 1998: 27). The appearance of form depends on who ‘securitises’ on what issue, for whom, with what results, and under what conditions.¹

Despite interpretations from different perspectives, the concept of security is closely related with ‘an objective sense’ that ‘measures the absence of threats to acquired values’ as well as with ‘a subjective sense’ that perceives ‘the absence of fear that such value will be attacked’ (Wolfers, 1962: 150). With objective and subjective senses, there are some depictions, as follows. For example, Dent has stated that security ‘relates to guaranteeing the safety of some entity from extant dangers’ (Dent, 2002: 5). For Buzan *et al.*, ‘security means survival in the fact of existential threats’, while Terriff *et al.* have suggested ‘security – being or feeling safe from harm or danger – is usually a condition that is held to be a great value’ (Buzan *et al.*, 1998: 27; Terriff *et al.*, 1999: 1). Mroz points out that security is ‘the relative freedom from harmful threats’ (Mroz, 1980: 105). Freedman has suggested that ‘security is a combination of a physical condition, in the sense of being able to prevent others [from]

¹ ‘Securitization’ is the idea of labelling something as a security issue (Wæver, 1995).
inflicting harm, and a mental condition, in the sense of confidence' (Freedman, 1994: 4). Drawing on Garnett’s introduction, Robert McNamara’s concept of security is ‘not only confidence on the part of the state in its ability to maintain its prosperity and way of life, but also the freedom to develop and improve its position in the future’ (Garnett, 1970: 31).

Given the above many different means of interpretation, there is a consensus that security ‘implies freedom from threat to core values’ (Baylis, 1999: 194). When the core value is under either external threats or threats from within, the sense of insecurity is raised (Cameron and McCormick, 1954: 556-559). Thus, security and insecurity are two sides of the same coin. This dual character reflects the fact that the concept of security is inherently relational. The aim of security can be achieved not only by preventing threat constructively but also by preventing the vulnerability of insecurity reactively. In Wolfers’ words, ‘security after all is nothing but the absence of the evil of insecurity, a negative value so to speak’ (Wolfers, 1962: 153).

A sense of insecurity arises because of the feeling of vulnerability inferred from some of its supposed causes and effects. In other words, security involves reducing vulnerability to threat. In order to obtain security, some countermeasures must be taken and capability put into place against an external threat and to protect internal vulnerability. Those measures and capability are referred to as ‘power’. It is the ability to resist another’s deliberate intention to do harm to one’s core value. It is also one’s strength to take advantage of another’s weak point so as to strengthen one’s own security. From this context, an analysis of security involves an assessment of external threats as well as an evaluation of internal vulnerability and power. With different

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2 For a detail discussion about insecurity and vulnerabilities, see Buzan (1991: 113-116).
value systems and different inherent and acquired powers, security can therefore be defined as the protection of core values and interests from all forms of potential or actualised threat by using tangible measures and policies. Here, ‘core value’ broadly equates with fundamental and inalienable criteria within one’s value structure. Without such a subjective, either substantive or spiritual, criterion, the essence of existence would be totally surrendered. 3

2.3 Political Theory, International Relations and Security

2.3.1 Realism, Security and Sovereign States

In the discipline of International Relations (IR), the concept of security derives from what is generally referred to as the Realist view of international relations. 4 Generally, this Realist conception of security dominated security policy-making throughout the Cold War, especially in North America and Europe (Baldwin, 1995: 125). Many other theories and schools of thought are generally derived from criticisms of political Realism. 5 According to the Realist perceptive, states are the highest authorities and functional units with sovereignty in the national political system (Waltz, 1979: 95).

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3 It should be noted that ‘core value’ is a subject which to different people has different interpretations, given that different people hold differing value systems, experiences, and capacities.

4 Realism puts importance on elements of statism, survival and power. There are some differences between traditional Realism and neo-Realism. The post-war Realism was dominated by the writing of E.H. Carr, Hans Morgenthau, and John Herz, while neo-Realists were led by the work of Kenneth N. Waltz. Traditional Realism views states' struggle for power as deriving from human nature, and regards power as an end in itself. Neo-Realism is sometimes called Structural Realism. Neo-Realism argues that the anarchical international system, not human nature, is the cause of states' struggle for power, and defines power as a means to achieve states' goals. For classification and concise explanations, see Brooks (1997); Dunne (1999), and Vasquez and Elman (2003). For classical literature by Realists, see Carr (1946); Morgenthau (1978), and Waltz (1979). For arguments that attempt to establish 'real' Structural Realism by developing Waltz's Theory of International Politics, see Buzan et al. (1993). Although Realism refers to traditional Realism and neo-Realism in this thesis, the term 'Realism' rather than 'neo-Realism' is used.

5 Liberalism has dominated international relations theory from the end of the World War One in 1919 until realist school of thought regained the status of the mainstream in international relations theory by the World War Two. For discussion on categorisation and strands of liberalism, see Doyle (1986: 1151-1169); Nye (1988: 245-246), and Zacher and Matthew (1995: 120-137).
National politics is the realm of authority, of administration, and of law that is to be sharply distinguished from the international political system (Waltz, 1979: 113; Walker, 1990: 15). With sovereignty, the state is the supreme authority to exercise sovereign right over its own affairs independently, and to provide order, law, security, and well-being to people within the providing territory. Among those tasks, security is the highest priority obligation of a state government (Baylis, 1999: 195). The sovereign state is also independent or autonomous in its relations with other states at the international level (Dunne, 1999).

The traditional Realist's dominating view suggests that the fate of the state, either survival or annihilation, is determined by relative power vis-à-vis potential or actual adversaries. Inter-state violence is the central issue that states always try to avoid, while survival is the primary driving force influencing states’ behaviour. Furthermore, all states have ‘a tendency toward sameness’ to fulfil the same security function (Waltz, 1979: 127). The search for security is primarily a matter of defence against foreign coercion and invasion. In turn, states will certainly seek to maximise their power and to advance their self-interests for security in the international system (Morgenthau, 1978: 37; Baylis, 1999: 196). States see security as a derivative of power, based on the notion that actors who possess greater power reach a dominating position in obtaining security. As one extreme, military force is the power to fulfil security.

Since the state is the highest authority in international relations, the world lacks an overarching sovereign. International politics is anarchic in nature. This means that no higher authority can impose order and enforce adherent agreements between states to prevent other states from aggression towards each other. The world, with its anarchic
nature, is as a result in conflict in international politics. Hobbes described such anarchic systems as a state of nature – a war of all against all (Hobbes, 1993: 93). His *Leviathan* suggests that states are constantly living in the fear of being attacked. Such international anarchy will, however, be a continual trend, which is no ground for ‘feeling sanguine about either the past progress or the future prospects’ (Buzan, 1991: 180). On account of the nature of anarchy in international relations, states may attack each other for a variety of reasons, while the use of military force will have far-reaching effects on states and societies (Walt, 1991: 212). Thus, each state has no alternative but to depend on a self-help mechanism with whatever means they possess for their security. Consequently, war or the prospect of war defines how states behave in gaining security.

Disregarding each individual state’s unique background, such as the political system (democracy or dictatorship), culture, history, and mode of behaviour, Realists assume that the competition between states is perpetual and universal. States struggle for power and calculate their interests in terms of power (Gilpin, 1984: 290-291). Force, violence, threats, and the struggle for power among nations are at the core of the national agenda (Waltz, 1959; Morgenthau, 1978). International politics is a struggle for power between state-makers in the pursuit of their national interests (Morgenthau, 1978). With superior power, ‘the strong do what they have the power to do and the weak accept what they have to accept’ (Thucydides, 1972: 407). The driving force of the competition for power is ‘to seek to dominate other states in the system’ (Mearsheimer, 2001: 3). Consequently, states depend on self-help efforts to compete with other states in seeking to maximise power - both militarily and in economic terms - in an attempt to protect themselves as well as to gain an advantage over other
states (Morgenthau, 1978: 105). By that logic, the best strategy to ensure one’s own survival is to gain dominant power, because power generates the strength that can ensure safety, and the greatest strength is the greatest insurance of safety (Mearsheimer, 2001: xi). Thereby, states can retain security by deterring others’ attacks (Garnett, 1970: 25).

In order to achieve survival, states are considered as seeking to maximise their capacity for self-help, mainly through military power, backed by economic strength. However, self-help capabilities vary from state to state, in terms of the size of the territory and population, wealth, and military strength, as well as the development of technology (Kennedy, 1988). Every state is positioned differently in the international system in terms of power. States, concerned about being vulnerable under the self-help system, are consequently motivated to control or secure access to necessary materials and goods (Waltz, 1979: 106). This is one of the roots of the fact that international affairs are basically in conflict. Furthermore, under the perception that the more power a state gains the more secure is the state, states have soon fallen into the predicament of involvement in the arms race. Self-help effort will, therefore, raise suspicion among states and lead to a ‘security dilemma’, where the sense of insecurity is mounting and potential threat is escalating as a result (Herz, 1950: 157; Jervis, 1978). Such a security dilemma is the particular reason that makes war a constant possibility for all states (Herz, 1950; Jervis, 1978). States establish military power for either defensive or offensive purposes. This, however, increases the chance that they will be seen as a threat. Even a state that has no desire to engage in war may be seen as a threat and be attacked. In response to such aggression, states must, therefore,

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6 Waltz disagrees with such a power-maximisation theory and contends that states seek security maximisation rather than power maximisation, and power is an instrument of security (Waltz, 1979).
prepare to 'defend themselves when attacked' (Aron, 1994: 77). General insecurity would as a result become widespread, and interactions among states would resemble natural enemies fighting each other automatically and thoughtlessly (Buzan, 1991: 175).

In the Realist world, economic power also matters for security, yet only in the sense that wealthy states are more militarily capable than are poor ones. For a state which is considerably weaker than its potential enemies, the state's possible destinies are either being beaten and absorbed by the enemies in a war, or forming an alliance with a stronger third country or countries, if possible, to deter adversaries from attacking it. The latter option is part of the conception of the balance of power to prevent the threat of overall hegemony (Layne, 1993: 35). Since the struggle for dominant power would generate a 'security dilemma', which would in one way or another undermine security, the stability of the world system depends on achieving success in the balance of power. The distinctive international regulatory mechanism, i.e., the balance of power, as Waltz believed, can moderate conflict and war (Waltz, 1979: 117).

To sum up, four points have above been addressed that form the basis of the Realist perspective of security, which provides the foundations of what can be called the Realists' world of international relations. First, states, as unitary entities, are the central actors in international politics acting towards security. Second, international politics are characterised as anarchy, in which the self-help effort is the assurance for survival, i.e., security. Third, with the self-help mechanism, states try to increase their power in order to secure the objective of security. Fourth, the balance of power is the

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7 There is a little difference between traditional Realism and neo-Realism. Power is the goal of states in Realism, while power is seen as an instrument for security in neo-Realism. In other word, traditional Realism equates power with security as the goal of a state, while neo-Realism sees that power is a
mechanism that stabilises the world system. Consequently, states in the system can obtain security.

2.3.2 Maintaining National Security: Power and the Balance of Power

An initial overview of the scholarship on international politics and international relations suggests that its main theories and assumptions about power are that it is the ultimate guarantor of national security. With greater power, states possess greater freedom of choice and freedom of action to obtain security. In the Realist world, states depend on their self-help effort to struggle for power in order to survive in an anarchic world. Survival is the precondition for states to pursue whatever other goals they set. In this sense, power is the most essential element for national security as well as a ‘necessary ingredient of every political order’ (Carr, 1946: 232). Power is ‘national power’ or ‘power of nation’, the key element in political behaviour as well as central to the development international relations (Morgenthau, 1978: 5).

Power is an abstract term defined variously in terms of intended effects. For example, Howard notes that power is ‘the capacity of individuals or groups to control and organize their environment to conform to their physical requirements or their code of moral value’ (Howard, 1970: 41-42). Keohane and Nye define power as ‘the ability of an actor to get others to do something they otherwise would not do’ and to gain ‘control over [the] outcome’ (Keohane and Nye, 1989: 10). Morgenthau argues that power ‘may comprise anything that establishes and maintains control of man over man’ (Morgenthau, 1978: 9). Knorr suggests that ‘power can be used either to

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8 Very commonly today, power is used as a description of group capabilities in the context of social relations among various collectivises. For an analysis of these conceptions, see Wrong (1995: vii-xvii).
9 For similar arguments also see Dahl (1957) and Baldwin (1980: 500).
establish influence by means of coercion or, without coercive intent, to defend or change the *status quo* between actors' (Knorr, 1973: 3). Nye suggests that power is an ability 'often associated with the possession of certain resources' to achieve one's purpose or goals (Nye, 1990a: 177; 1993: 5). Pettman suggests that power mostly equates with military and strategic forces (Pettman, 1991: 1). Tellis and his colleagues assert that 'power is often treated as a synonym for rule' (Tellis *et al.*, 2000: 13). Although scholars use different approaches to interpret the concept of 'power', they all coincidentally point out that power is the strength or capability that can control a given situation so as to complete certain missions.

Power as statecraft can be categorised into 'hard' power and 'soft' power (Nye, 1993: 51-52; 2002: 4-5). Hard power is an operable power that can be used directly to command or to force other states to change, while soft power is strength that indirectly influences others. The hard command powers, such as military and economic power, depend on the formula of 'carrots and sticks' – the threat to set inducements aiming to bend the other's will and to use force. Soft power comes from setting the agenda and determining the framework to shape another's preferences, that is, through influence to persuade others to cooperate in line with one's own preference. Hard power is usually linked to command behaviour, while soft power tends to be associated with cooperative behaviour (Nye, 1990a: 182). The category of 'hard' and 'soft' power indicates that the essence of power contains at least two elements, namely, coercion and influence. Those are tools used by actors in the international political system to shape a situation in line with their own interests and security aims.\(^\text{10}\)

\(^\text{10}\) War and economic sanctions are two forms of coercion. The latter is the most frequent form of coercive means applied as statecraft. The effectiveness of using coercive or non-coercive means depends on states’ objectives and their influence on the target (Dahl, 1957: 203; Baldwin, 1979: 163). The effectiveness of economic sanctions is tied to both the threat-sender's strength and the threat-receiver's hierarchy of values (Keohane and Nye, 1989: 10; Hunter, 1991: 47).
The form of power, can be presented in a tangible terms, such as the ‘numerous and efficient military resources, and a relatively productive and efficient economy’ (Pettman, 1991: 58). Technological capability is also a crucial power. Together with military and economic capability it constitutes national power in the field of international relations (Gilpin, 1981: 13). Among those various forms of powers, military power and militarily relevant power have traditionally been considered as the most important national ‘muscle’ safeguarding national security, because military power is the strongest instrument of coercion (Mearsheimer, 1990: 5-6). It is ‘the capacity to use violence for the protection, enforcement or extension of authority’ (Howard, 1970: 46). Historically, ‘military power permitted many of [Europe’s] dynasties to keep above the great magnates of their land, and to secure political uniformity and authority’ (Kennedy, 1988: 70). In the name of national security, states have employed armed force for the solution of conflicts and the advancement of national interests in international politics (Padelford and Lincoln, 1962: 198).

On the other hand, the scholarship on international politics and international relations suggests that the main theory and assumptions about power and the creation of stability are incompatible. Thus, the ‘balance of power’ is a mechanism to maintain stability in international relations. The concept is generally employed to describe the distribution of power between states, while the logic is based on an intention to prevent any single nation from becoming sufficiently strong so as to enable it to enforce its will upon the rest.11 In a balancing situation, security is held. What states could therefore do is to try to balance the power of other states to prevent any one of them from achieving overall hegemony (Carr, 1946; Morgenthau, 1978).

11 The basic idea of balance is to create counter-balance or equilibrium. Here, ‘balance’ refers to equilibrium. For details of the various meanings of ‘balance’, see Haas (1953). For details of the various forms of balance of power, see Bull (1977: 101-106).
Given that states are differently positioned in the international system in terms of power, measures applied to defend their respective security are various. For a state with considerably weaker power than its potential enemies, the possible destinies of the state are either being beaten and absorbed by the enemies in a war, or to form an alliance with a stronger third country or countries to balance the power of its adversaries for its survival. The latter option of forming an alliance with third countries aiming for a balance of power has been exercised historically, because preventing one state emerging with predominant power is the best measure to defend itself against international conflict (Burchill, 1996: 71). Another reason is because an imbalance of power may lure an ambitious state to risk an adventure (Waltz, 1979: 132). Therefore, when one power grows hazardously strong, other states form an alliance to counter-balance it (Wight, 1978: 169). From the Realists’ viewpoint, it is natural for rational states seeking survival to form a counter-balance, because ‘nobody wants anyone else to win’ (Waltz, 1979: 126).

The mechanism of the balance of power moderates the effect of the anarchic international polity and maintains peace under the framework of such a vested compromise. Ideally, when the condition of the balance of power is sustained, the world shall be within a structure of stability. Conversely, an uneven change in the power structure may be a factor that causes war and instability in international relations. The collapse of the balance of power could also possibly lead to the change of the original world power structure, which may undermine a power state’s sphere of influence to keep stability in the world (Nye, 1993: 54). Therefore, in theory, within the balance of power structure, states in the international system will constrain themselves from being aggressive. Stability and peace can thus be maintained.
Regrettably, the balance of power is no guarantee of peace because states 'can always decide to defend a particular order by opting for disorder, that is, war' (Pettman, 1991: 66-67). This, however, links to the pessimistic 'offensive Realism' theory by viewing that the state's behaviour is affected by the nature of the anarchic system (Mearsheimer, 2001). Possession of great power inclines states to war. According to the Realist law of uneven growth, when the group or state's power increases, the group or state will be lured to try to increase its political, economic, and territorial control. It will attempt to change the international system in line with its particular set of interests in order to increase its own security (Gilpin, 1981: 94-95). States will, therefore, make efforts to develop their economies and technology as well as to strengthen their military capabilities. Such profit-driven action will change the existing balance of power and cause competition for power among states.

2.3.3 Hegemonic Decline, Power and Security

Debates about order-building in international relations constitute one of the most persistent features of the discourse of international relations. During the Cold War, the world was dominated by the superpowers, most notably with American hegemony in Central America and with Soviet hegemony in Eastern Europe. Both the US and the Soviet Union strove to maintain their respective primacy in terms of 'the usual and crude measures of power' in order to have greater capacity than rivals (Jervis, 1993: 52). For the Realist, the world could maintain stability and security because of 'hegemonic stability'. 12 Nevertheless, at the outset of the post-Cold War era, analysts were divided over what type of international order was emerging to succeed the

12 The core logic of the hegemonic stability theory is that a hegemon, which has outstanding military and economic power, creates an international order. On hegemonic stability theory, see Kindleberger (1973); Keohane (1984), and Gilpin (1987). For a test of hegemonic stability theory, see Kapstein (1990).
largely bipolar construct that shaped international relations. There is a growing body of literature speculating on a new age American ‘unipolarity’ or ‘hegemony’ (e.g., Nye, 1990c; Jervis, 1993; Huntington, 1993b; Mastanduno, 1997; Wohlforth, 1999; Bacevich, 2002).

Since the central argument of the traditional perception of security is in regard to power and the balance of power, hegemonic decline is, from the perspective of the US, a matter of national security in international politics. In the mid-1980s, Robert Keohane’s book *After Hegemony* raised debates over whether the US can maintain its position as the world hegemonic power in facing challenges from other competitors (Keohane, 1984). The debate on hegemony among scholars illustrated that their view on power structure had gradually changed from highlighting military-centred power to acknowledging the importance of economic power. Scholars shared the same view that economic power was the crucial determinant of stability in the international system. As articulated in Kennedy’s *The Rise and Fall of the Great Power*, the end of the hegemony is attributed to the fundamental inability of the dominant state to maintain economic strength to match its foreign military commitments (Kennedy, 1988). Gilpin took a similar view to that of Kennedy, and argued that hegemony had an inherent tendency to undermine itself through attempting to keep up with the continual rise in costs in overstretching its expansion. In turn, hegemony would be replaced by the rise of economic competitors, or ‘free riders’ (Gilpin, 1981: 162). Gilpin also has argued that the loss of the control of the key economic component of finance has caused, in succession, the decline of the hegemony both of the US and of the Great Britain (Gilpin, 1987).

According to Huntington, a system with ‘one superpower, no significant major powers and many minor powers’ is unipolar, while ‘one superpower and several major powers, and many minor powers’ is uni-multipolar (Huntington, 1999: 35-36).
Meanwhile, Cox has long regarded world ideology as being shaped by the dominant economic power state. With this perception, Cox explained that the US hegemonic decline was a consequence of its loss of economic leadership in the global economy since the 1960s (Cox, 1987). Some scholars echoed Cox’s view and raised their concerns over the rise of the economic power of Germany and of Japan. This led to a change in the power structure and eroded the American hegemony, which could eventually undermine the national security of the US (Moran, 1990a; 1993a; Oppenheim, 1992; Garten, 1992; Thurow, 1993). They shared the view that Germany and Japan had emerged as economic power states that might somehow threaten US economic security. In Thurow’s words, ‘[the world] contest has shifted from being a military contest to being an economic contest’, in which ‘one can remain friends and allies, yet still want to win’ (Thurow, 1993: 14; 24).

While the above scholars have identified the hegemonic decline of the US, some scholars contend that US hegemony may continue and may become even stronger by using economic criteria in demonstrating US power. For example, Nye argues that the US has not fallen behind any other power in terms of the ‘hard’ powers, both military and economic (Nye, 1990b: 155). Nye argues that the US has actually advanced its hegemony by the growth of its ‘soft’ power, generated through the universality of the US culture (Nye, 1990c: 191). Strange contests that the US has maintained its influence over the international system through economic power derived from the strength of the US economy. She claims that the ability of the US to run a deficit over the long term and its capacity in effectively controlling production and finance have proved the financial strength and the central position of the US in the international financial system (Strange, 1987: 565). Meanwhile, Gill and Law concur with Nye by viewing US power as having been diversified and extended through the establishment
of a dominant universal US culture. Although they are agreed as to a decline in many aspects of US economic power, they nevertheless argue that the US has retained a powerful economic and hegemonic position at the centre of the international economy (Gill and Law, 1988).

The debate on hegemony has illustrated how the theoretical outlooks and views have begun to agree the role of economic factors within the power structure. Economic factors have been accepted as one parameter of national power in sustaining a national security environment. In the debate, scholars try to demonstrate that the decline in the US hegemony is a consequence of its economic decline. In turn, the measure to defend the hegemony of the US depends upon its economic security. This implicitly highlights the fact that economic power not only constitutes a support towards security for military power but also forms in and of itself a security issue. Even those scholars who refuse to acknowledge the US hegemonic decline have pointed to the change of the conception of security from military-centred to an economic matter. While they have identified economic indicators to prove that US superiority has been retained, they have demonstrated unreservedly that scholarship increasingly unites in seeing economics as a crucial form of power within the international security system.

2.3.4 Economic Security as a New Security Paradigm

Although the traditional Realist security paradigm prevailed in the Cold War era, criticism calling for a broader and more comprehensive approach to security policy was pervasive (e.g., Brown, 1977; Ullman, 1983; Westing, 1986; Mathews, 1989).  

14 Most such efforts are more closely concerned with redefining the policy agendas of nation-states than with the concept of security itself. Scholars such as Brown (1977); Ullman (1983); Westing (1986); Mathews (1989); Romm (1993), and Tickner (1995) all call for redefining security with new broad visions, while Buzan (1991); Baldwin (1997); Stares (1998); Buzan et al. (1998), and Terriff et al. (1999) provide a broader concept of the framework of the security agenda in the post-Cold War epoch.
Issues dealing with norm, identities, economics and culture are also becoming more prominent and raising wider debates. Amid those debates, many analysts focused on the impact of trans-national forces on national security and the implications of economic issues, particularly after the energy crisis of the early 1970s. To some extent, the energy crisis had revealed unexpected Western vulnerabilities (Romm, 1993). The oil factor triggered, among developed countries in general, alarm that brought closer attention to the security concerns of economic issues. Economic issues became more salient and were increasingly treated as important political and broader architectural elements of both national security and the larger security order (Losman, 2001: 2). The slow collapse of the Bretton Woods monetary system between 1971 and 1973 further distinguished the security implication of economic issues (Gilpin, 1987: 134-142).

Aside from oil and monetary systems as reasons for international involvement in security concerns, some analysts asserted the need for attention to be paid to the economic instruments of national power to influence others (Moran, 1993b: 2; Neu and Wolf, 1994). Moran identified three threats to the US’s ability to employ economic power for security ends, in accordance with US values and autonomy. These were, firstly, fundamental and cumulative economic decline; secondly, loss of specific economic and technological capabilities, and thirdly, dependence on external suppliers. Peterson and Sebenius concurred with Moran by putting forward the notion that if a country fails to deal with issues such as investing in productive capacity, research and development, infrastructure, and education, this ‘may entail a

\[15\] For discussion over the triumph of liberal democracy, see Fukuyama (1992). For the culture issue, see Huntington (1993a). For discussion on the security implications of international trade and economic engagement, see Oppenheim (1992) and Garten (1992).

\[16\] For discussions of the oil shock in the 1970s, see Bergsten (1973); Krasner (1974); Varon and Kenji (1974), and Nye (1974).
progressive loss both of political will and economic capacity to take actions abroad that promote our real national security interests’ (Peterson and Sebenius, 1992: 59). They emphasise the significant role of economics in national security by noting that ‘US national security interests must include the development of policies that will increase our economic strength and domestic stability’ (Peterson and Sebenius, 1992: 58). To them, military security and economic security are mutually dependent over time. They argue that the US will lack the necessary resources to defend or sustain its various national interests and global obligations if it is economically weak. In their words, ‘countries that lose control of their economic destinies lose control over their foreign policies’ (Peterson and Sebenius, 1992: 61). In turn, as they argue, ‘perceptions of relative US economic decline could well mark a psychological turning point in others’ perception of our long-term ability to back allies and oppose enemies, of our vulnerability, and of our unreliability’ (Peterson and Sebenius, 1992: 66). In short, the core of their argument is to illustrate that US economic security is an important pillar in supporting US hegemony and national security in international relations.

Furthermore, some liberal schools of international relations contest that the world is shaped by order, in which inter-states cooperation is still possible (Gilpin, 1973; 1975a; 1987; Krasner, 1976; 1985; 1991; Keohane, 1984: 6; Gowa, 1989; Nolan, 1994).17 Through economic cooperation, the increasing interdependence of the international economy restrains the choice to go to war (Rosecrance, 1986). According to interdependence theorists, while states choose to become interdependent, there exist mutual and competitive interests between states (Keohane and Nye, 1989).

17 In contrast, some scholars argue that the ability of states to cooperate under anarchy is contested, for example, Axelrod (1984); Axelrod and Keohane (1986), and Snidal (1985; 1991).
Those mutual interests will reduce the likelihood of war because the cost of war increases, outweighing the likely gain. Thus, international politics is not always to 'kill or be killed', but 'there are large areas of economic and social interaction where cooperation (as well as conflict) occurs' (Nye, 1993: 20).18

The importance of the role of economics has started to gain a foothold within the overall agenda of national security, although the significance of military force as the measurement of the power of state still holds. Security is no longer measured narrowly by the correlation of military forces, but by success in gaining access to and control over markets, sources of capital, key technology, and natural resources. Military invasion and conquest are not the only issue that may cause danger to a nation. The consequence of failure of the nation may result from unemployment, economic decline, technological backwardness, or inexorable national decline (Moran, 1990a; 1993b; Huntington, 1993b). Consequently, the traditional security paradigm of defending a state from the predatory attacks of others is viewed as obsolete, while economic security is an emerging paradigm of security.

2.4 The Concept of National Security and Security Policies in the International System

2.4.1 The Concept of National Security

Throughout history, security has always been a core issue of individual states, and between and among states. States that have failed in their security tasks are usually those eventually to have fallen or even disappeared from the map. Hence, survival in

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18 Lipson agrees on the likelihood of states to cooperate in the realm of international trade (low politics) but not in security regimes (high politics). It is because states take different interaction strategies in dealing with security issues and economic issues (Lipson, 1984).
the international system is the core of the national security, common to all.\textsuperscript{19} Besides that, with different innate and required powers and facing different political environments, every individual state encounters different threats and vulnerabilities. Similarly to the broad concept of security, ‘no formal definition of national security has been generally accepted’ (Smoke, 1987: 301). The perception of security and the objective of security also vary from state to state. Accordingly, given a national security objective, states formulate their own security policies for their respective national core values and security interests. The aim of national security is freedom from anxiety or fear and to ensure ‘some degree of protection of value previously acquired’ so as to expand the ‘assurance of future well being’ (Wolfers, 1952: 484; Martin, 1983: 12).

With the underlying condition of anarchy in the international political system, states are the highest sovereign entities that need to nurture their respective security objectives. While a state aspires to protect the nation’s value by withstanding another’s threat, it will look not only at the enemy’s capabilities, but also to its own strength and capability to cope with the incoming menace. Military capability is the most direct power employed by a state to deal with those external threats, it faces. It is also the most frequent threat faced by a state in international interaction. Thus, the traditional perception of national security is frequently linked to military defence. Accordingly, by emphasising the supremacy of military power, Sarkesian \textit{et al.} have defined national security as ‘the confidence held by the great majority of the nation’s people that it has the military capability and effective policy to prevent adversaries from using force to prevent the pursuit of national interests’ (Sarkesian \textit{et al.}, 2002: 

\textsuperscript{19} Survival includes institutional survival, i.e., the integrity of the state, and physical survival, i.e., the welfare of the populations.
However, this idea of security has been too narrowly defined. In its broadest formulation, national security shall be so wide as to extend beyond military consideration. It shall also include political, economic, societal, and environmental factors, as Buzan has argued (Buzan, 1991). All of those security issues are 'woven together in a strong web linkage' (Buzan, 1991: 19-20). Proceeding from this context, national security can therefore be defined as the protection of the nation's core values and interests from all forms of potential or actualised threat by using tangible measures and policies. As explained earlier, the notion of core values is a fundamental and inalienable criterion within one's value structure. Here, at state level, the core value of national security concerns its survival in the international system.

2.4.2 The Cold War Security Policy

During the Cold War's bipolar system, the world drifted towards the Realist approach. The focus of international relations was almost exclusively on the contradictions and military dimensions of the balance of power between the two leading superpowers, the United States (US) and the Soviet Union (USSR), and on the proxy wars fought by them. It was an ideological and geopolitical struggle between the West and the East, or the non-Communist and the Communist (Mueller, 1992). The major source of the threat to security was the product of rivalry between the superpowers who elaborated on military-capability establishment aiming to win wars and to prevent them in the age of atomic bombs (Brodie, 1946). States depended on the bipolar balance of power to ensure their national security by 'bandwagoning' either the US or the USSR.20

Having noted the importance of power and its distribution as factors affecting security, [cite]

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20 Walt introduces the term simply to define the notion of threat. According to Walt, 'balancing is defined as allying with others against the prevailing threat; bandwagoning refers to alignment with the source of danger' (italics in the original) (Walt, 1987: 17; 21-22). In contrast, for Waltz, bandwagoning is allying with the strongest power - the one capable of establishing hegemony (Waltz, 1979: 126). He asserts that such an alliance will undermine the security of states. Here 'bandwagoning' refers only to forming an alliance with others.
both camps had in mind a preferred distribution of power that would, they felt, counter their opponents. Their attempts to gain the strategic edge of power for their respective security were the most important factor in the consequent arms race (Kahan, 1975; Ball, 1990; Jukes, 1990). Enlargement in the development of military forces continued briskly, with unprecedented deliberation of conventional as well as nuclear forces. These weapons were coming to dominate security calculations. Consequently, the Cold War era was an age of believing in retaining military means for security ends, while the enduring primacy of military security lay at the centre of the security policy. With adequate military defence forces, states could maintain security by both deterring and defending themselves against foreign coercion, attack, and invasion.

The security policies of the major powers involved a mixture of national and international elements to maintain the balance of power. The practice included military preparedness and alliances as well as the pursuit of détente and measures of arms control.\(^{21}\) Above all, military establishment for power supremacy was still at the core of security policy. Even a few years before the end of the Cold War, US President Reagan's administration in the 1980s had significantly increased defence expenditure and sought strategic parity with the USSR by embarking on a quantitative and qualitative military build-up programme (Posen and Van Evera, 1987; Kegley and Wittkopf, 1987: 584). Actors seek to alter the international system through establishing enormous destructive weaponry or economic expansion, aimed at obtaining greater power for survival and security objectives, until the marginal costs of continuing change are greater than the marginal benefits. Cost is an important element in the calculation of changing the existing structure of the balance of power.

\(^{21}\) For the concept of deterrence, see Brodie (1946); Shue (1989), and Payne (1996). For arms control and disarmament, see Howe (1984); Cox (1984); Carter (1989), and Barral (1990).
When the cost of changing the existing structure of balance of power is high, the system will be stable. Thus, the high stakes of nuclear war provided evident reason for a ‘peaceful’ Cold War. It was the ‘balance of terror’ created by the nuclear balance of power within the Cold War bipolarity that maintained world stability (Nye, 1993: 122).

On the other hand, rivalry between the US and the USSR created two militarily and economically independent blocs in an attempt to facilitate allies’ cooperation and to strengthen their economic strength and military power (Gilpin, 1973: 58-63; Spero, 1992: 23). In the bipolar world security environment, economic activities were conducted mostly within each bloc. Consequently, economic interdependence among Western Camp allies deepened, enhancing cooperation among allies as well as facilitating the economic security of allies in terms of promoting prosperity. Because of the relatively stable ‘long peace’ and active economic interaction among states in the Western alliance, as well as speedy, thriving, versatile technological innovation, in this period global economic development and economic interdependence could as a result maintain their upward tendency.\(^{22}\) Therefore, security in the Cold War period depended on deepening economic interdependence within the fixed alliance system, under the prevailing conditions of superpower rivalry and a ‘balance of terror’ created by nuclear weapons deterrence (Buzan, 1984: 606). In brief: stable political bipolarity reinforced by elemental fears of war as well as by the growing economic interdependence within each respective bloc ensured that the ‘Cold’ war never became a truly ‘hot’ one.

\(^{22}\) Gaddis has identified the Cold War period as the longest peace in history (Gaddis, 1992: 21-38).
2.4.3 The Post-Cold War Security Policy

At the end of the Cold War, the initial reaction among Western allies was that the collapse of the USSR and the Communist bloc represented a decisive victory for the military power of the US and its allies. Such an interpretation of the end of the Cold War was based on the ideology of the bipolar international system, shaped and driven as it was by military confrontation between the superpowers and among their respective military blocs and alliance systems. Thus, the security policy in the post-Cold War period remained predominantly in military terms, at least initially. The results of the Gulf War of 1990-1991 evidently confirmed the perception of national security and international security as still focused on military power (Ambrose, 1993: 396). Thus, military security concerns remained at the centre of the agenda in the minds of policymakers.

With the disintegration of the USSR, the world structure shifted from a bipolar balance of power to another state of balance of power: either unipolar or multipolar.\textsuperscript{23} Given the Realist theory of bipolarity security, shifts in power distribution among major powers were essential for determining the security environment. Thus, there were wide debates about whether the power structure in the post-Cold War era was unipolar or multipolar.\textsuperscript{24} The central argument was located in nations' behaviour and responses to the changes of the international balance-of-power system for the sake of security concerns. The 'Quite Cataclysmic' political transformations of the 1980s and 1990s dramatically affected models of national and international security (Mueller, 1995). Decision-makers and scholars had been uncertain about how to interpret the

\begin{footnotesize}
23 See n.13.
24 Scholars such as Layne (1993); Krauthammer (1990/91); Wohlfarth (1999); Ikenberry (2001), and Pfaff (2001), regard the post-Cold War era as unipolar. On the other hand, scholars such as Friedberg (1993/94); Dibb (1995), and Mearsheimer (1990; 2001) are inclined to believe the power structure is multipolar. Huntington distinguishes the power system in the contemporary world as a predominant power with some great powers (Huntington, 1999).
\end{footnotesize}
effect of major shifts in the balance of power because of the reduction in the direct military and political threats in international relations. Without imminent military rivalry as it was, the mixture of factors affecting national security was changing to include a wider range.

Newly emerging thinking about how to perceive and achieve security challenged the traditional state-centric security policy (Keohane and Nye, 1973; Booth, 1991; Myers, 1993). Since the threat of foreign attack had diminished, some non-military security issues, such as economic, environmental, and societal subjects, began to attract the attention and support of policy-makers and scholars. A growing awareness of the dangers posed by new phenomena led to a call for a wider concept of security in the security architecture to allow those emerging non-military agendas to integrate with traditional military and nuclear security contexts. Alongside other non-military security concerns, economic security began to regain attention among scholars and policy-makers. The outcome of over-distributing expenditure for military establishment in the USSR led to the structural problems of its economy, which unexpectedly brought victory for the US in the Cold War (Lebow and Stein, 1994: 369-376). The consequence of economic failure in the Warsaw Pact countries eventually led to the disintegration of the Eastern framework of the balance of power and ended the Cold War (Freedman, 1992: 739). The lesson drawn from the collapse

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25 For arguments asserting that the individual is the basic level of the security unit, see McSweeney (1999: 13). For arguments asserting that states remain the prime actor, see Ajami (1993: 2-9) and Lipschutz (1995: 2).

26 Those subjects used to be seen as challenges rather than as security concerns. Distinctions of security and challenge are made between 'high politics' and 'low politics' in international relations. National security is in the realm of high politics, while international trade and finance and a variety of societal and economic interstate transactions are referred to as low politics. For debate about the relationship between international security and the environment, see Mathews (1989); Homer-Dixon (1991); Prins (1993); Moffett (1994); Levy (1995); Kahl (1998), and Dupont (1998). They share the similar view that environmental degradation constitutes a security risk. For the opposite opinion, see Deudney (1990) and Deudney and Matthew (1999).
of the USSR provided an evident example that the economic factor was not only an economic issue but also a national security concern. It further revealed that economic power was not only a means to support military security but also a national security objective. The interrelationship between military security and economic security - and their relative importance, possibly inverted - raised new possibilities for cooperation in military and economic affairs (Garthoff, 1992; Steel, 1992).

In this period, the already changed world also showed that military power alone was ineffective in achieving or controlling security situations such as those in Somalia and Bosnia (Roberts, 1995-96: 18-19). It was because the crises in Somalia and Bosnia originated from problems of religion, ethnicity, nationalism, and economic dislocation. Those types of problems could not be solved or contained by means of military power. Besides, issues such as environmental disasters and epidemics, economic collapse, drug trafficking, the proliferation of weapons of mass destruction, and trans-national terrorism could also not be dealt with through the use of military power (Bergsten, 1992: 24). Furthermore, the high cost of the military build-up and military intervention worldwide had made some policy-makers reconsider whether military power was indeed the most suitable means of tackling new types of security problems. Even the US, the sole military superpower, was restrained in its freedom of action in military intervention and deployment, caused by the escalating economic costs of military deployment (Pfaff, 1990/91: 37). The problem of financing military strength in the international security environment illustrated the role of economic power in security policy. Thus, the search for new tools of a security policy to supplement or replace military tools developed in the minds of policy makers.
The US security policy then reflected the evolution of perceptions of security. During the Bush Administration of 1988-1992, the strategy documents still considered military-related threats as more serious. President Bush’s 1990 National Security Strategy (NSS) report bluntly stated that ‘our national security ... is grounded in realism’ (Bush, 1990). Although the strategy documents increasingly emphasised the government’s mission to enhance security against many non-traditional threats and new sources of instability, those issues had been categorised as threats to democracy and to the promotion of human and economic well-being rather than as security issues (Reagan, 1990; White House, 1991; 1992). As in the 1996 NSS, the military was still of supreme importance. Protection against military-related threats, instability, and arms control was the first priority mission (White House, 1996). In contrast, the 1997 NSS showed that the US had broadened its national security policy by including not only military forces but also effective diplomacy and economic prosperity, and by promoting democracy abroad as its security agenda (White House, 1997). The document listed many ‘new’ threats against the US perception of security. Meanwhile, the document argued that the US ‘economic and security interests were inextricably linked’ because the ‘strength of our diplomacy, our ability to maintain an unrivalled military, the attractiveness of our values abroad – all depend in part on the strength of our economy’ (White House, 1997: 14-15). It pointed out that the US had been increasing its focus on economic security and domestic concerns.

Given the perception of the significant role of economics in the security frontiers, the US formally listed this in the 1999 NSS as one of the vital national interests (White

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27 ‘The National Security Strategy of the United States of America’ was issued by the President of United States in accordance with the Goldwater-Nichols Department of Defense Reorganization Act of 1986, which mandated an annual report to Congress detailing the National Security Strategy of the US. Since 1986, 13 reports have been published; two during the second Reagan administration (1987; 1988); three by the George Bush Snr. administration (1990; 1991; 1993); six by the Clinton administration (1994-1999); and two by the current Bush Administration (2002; 2006).
House, 1999). In fact, the emphasis upon the role of economics in the realm of national security could be seen as a renewed insight into the fundamental importance of economic power as a security policy. The US had a long tradition of wielding economic power as an instrument to pursue its foreign policy objectives. Among the various economic instruments of foreign and security policy, it had continuously employed trade, tariffs, quotas, aid, embargoes, and boycotts, with varied outcomes (Hastedt, 1991: 239-247). It had utilised economic instruments of power as supplementary to and as a substitute for military power in an era when the costs and effectiveness of military power had come into doubt. It also relied heavily upon economic instruments of power to deal with specific problems. For example, the US placed a permanent economic embargo on Cuba. It intensified this economic action with the Helms-Burton Act in the 1990s (Luttwak, 1995: 117).

US security policy illustrated the post-Cold War era conceptions of security that gradually ascribed equal roles to military power and to economic power. The US concept of economic security influenced the security policy of peripheral countries worldwide. Taiwan’s policy-makers seem to have adopted this type of thinking with regard to their security policy through the exercise of economic power. It took a flexible and realistic approach to foreign policy, emphasising Taiwan’s external economic and trade relations as a feasible approach to overcome its diplomatic isolation and to uphold the national security agenda pragmatically (Lee, 1992: 196; Hughes, 1997: 130). Similarly, China asserted that a comprehensive national security strategy should embrace a military strategy as well as economic and political means. In practice, it threatened to boycott French goods in order to stop arms sales by France to Taiwan (Hu, 1995: 128-130).
2.4.4 Post-9/11 Security Policy

The terrorist attacks on the World Trade Centre in New York and the Pentagon in Washington, DC on 11 September 2001 marked the end of the 'post-Cold War era' in international relations. The new 'post-11 September era' retains some similarities with the past, yet these have been outweighed by differences. Under the shadow of the terrorist threat, the world has entered the 'new Wars' era, where the source of the security threat comes from non-state organised gangs and terrorists, as well as from weapons of mass destruction (WMD) (Kaldor, 1999: 6-7). The new international security landscape changed the concept and meaning of US national security in 2001 and its aftermath. The security agenda of the state to safeguard 'homeland security' has become a paramount concern for both government and society. The conventional perception of homeland security of protecting national territory has been given a broader definition. The new version of homeland security aims not only at protecting national territory; it also struggles against any possible enemy who holds a WMD and accommodates terrorists through preventive war rather than through diplomacy (Wu, 2004a).

In the international political environment, the war against terrorism became the key focus of national interests beginning in late September 2001, while the US-led war against terrorism and the notion of a new kind of war had become intermixed with economic expansion, globalisation, and the peaceful pursuit of US values (White House, 2002). In his first NSS issued in 2002, President Bush presented his vision of national security. The NSS called for the US to use its 'unparalleled military strength and great economic and political influence' to establish 'a balance of power that favors human freedom' and to defeat the threat posed by 'terrorists and tyrants' (White House, 2002: Introduction). The NSS clearly pointed out that the source of
national security is found in failed states and international terrorism, while measures for security should encounter emerging threats militarily and pre-emptively. It gives priority to a counterterrorism policy so as to alleviate the danger through relying heavily on proposing economic and political assistance programmes to countries that in many cases did not share America's basic values. These themes illustrated that US national security depended not only on military strength but also on the worth of its economic security and influence. It would rest on states worldwide to pursue their respective economic security in order to facilitate a peaceful global environment. As stated in the NSS, 'We want our allies to have strong economies for their own sake, for the sake of the global economy, and for the sake of global security' (White House, 2002: 18). Most importantly, the promotion of a strong world economy would be for the sake of enhancing US national security (White House, 2002: 17). The US explicitly indicated economic security as an end and a means of the national security of the US.

Furthermore, in the 2006 NSS, the US retained its security goals, set in 2002, of 'ending tyranny' completely throughout the world by means of exercising its inherent right of self-defence militarily and pre-emptively, if necessary, as well as by promoting effective democracy (White House, 2006: 3; 23). Meanwhile, the NSS also addressed the topic of WMD in general, and the Iranian and North Korean nuclear threat in particular. This showed that the traditional military threat was still at the top of security concerns. Nonetheless, economic security was another focal point of security strategy. Based on the insight that 'political progress can be jeopardized if economic progress does not keep pace', the NSS further emphasised the importance of economic security to overall international security by noting that 'effective economic development advances our national security by helping promote responsible
sovereignty, not permanent dependency' (White House, 2006: 4; 33). Meanwhile, the NSS outlined measures to achieve the goal of 'ending tyranny and promoting effective democracy' by employing non-military means, which included 'the full array of political, economic, diplomatic, and other tools at our disposal' (White House, 2006: 6).

The above review has demonstrated that the post-9/11 security perception in the US has focused on safeguarding 'homeland security' from the terrorist threat. Measures to safeguard security now rely on military security as well as on economic security, together with political, diplomatic and other feasible instruments. This has given a broader vision of the security concept than the Cold War era of military-centred security concept. Thus the concept of security post-9/11 is in general similar to the post-Cold War era, while laying equal emphasis on military and on economic security to counter emerging threats from terrorism and failed states.

2.5 Conclusion

This chapter has explored the course of the concept of security in international relations since the onset of the Cold War. In order to provide a better understanding of the concept of security, this chapter has first discussed a broad perception of security and its nature. It has revealed that the concept of security is, in general, a matter of perception. It is not always clear, significantly, whether challenges are thought to be a 'security' threat or another type of problem. Besides, with diverse interests and concerns, different actors have as a result different perceptions of security. Nevertheless, the aspiration of being free from threat remains the same. Insecurity comes from the perception of an external threat that makes the actor perceive
vulnerability, while the sense of security is that of being free from a sense of insecurity. Although it is difficult to gain absolute security, aspiration towards security is a universal value. The aim of security is to protect acquired assets free from threat by means of all possible and feasible measures. Thus, generally, security can be defined as the protection of core values from all forms of potential or actualised threat by using tangible measures and policies.

By reviewing the political theory of the security concept in international relations and security policies in the modern world, this chapter has sought to determine how the concept of security has changed in accordance with the changing international security environment. In order to set a stage for understanding the literature on security, the chapter reviewed the Realist security paradigm, because Realism has constituted the leading school of thought in international relations theory since the end of World War Two. On the other hand, the review of security policy generally followed US security policy, given that the US has been the world superpower. By examining the basic tenets of Realism, it was found that military power has traditionally been seen as the guarantor of security, and the state is the major actor to pursue security in the anarchic international relations. Power and the balance of power are two important measures constituting the Realist security concept. Thus, traditionally, national security has been referred to as military defence or military security.

However, with changes in international relations and the security environment, the concept of security has been given a broader range, especially after the end of the Cold War. New threats to security have emerged alongside the traditional security concerns of military issues to form a comprehensive security concept in international
relations. Discussion of the debate on hegemony revealed that international political theory after the Cold War has gradually become aware of the importance of the role of economic power in the determination of great power status and the order of international security. Within a smaller scope, economic power is as important as military power in achieving national security ends. Thus, alongside other aspects of non-military security concerns, economic security has been perceived as an item on the national security agenda. The policy-making community has elaborately formulated economic security objectives into comprehensive national security strategies.

By reviewing security policies in the modern world, history has told us the perception of security was still the same as is defined above. However, while the source of a threat and the core values of nations have varied over time, states have taken different measures and policies for security ends. In the Cold War era, the source of threat was evidently from the military antagonism between the Western and Eastern camps. Consequently, military security was at the core of the security agenda. Afterwards, despite the fact that military security still holds the same status in the security agendas of nations, economic security has emerged as an alternative factor in national security. The emergence of the concept of economic security after the Cold War has led to the recognition that economic power is one of the instruments to supplement or even substitute for the role of military power in dealing with post-Cold War security issues. It is also recognised that the health of the economy is on the national security agenda.

Security may not necessarily be achieved only through the force of violence. Peaceful means, such as economic engagements, can be an alternative security policy choice. On the other hand, with the progress in economic globalisation, international
economic interactions for national economic growth and prosperity, as well as the use of economic power for security ends, are practised on a daily basis. While economic security is emerging as a new paradigm within national security, the concept of economic security and the way economic security has an impact on national security and to what extent requires further detailed exploration. Therefore, based on the concept of security as illustrated in this chapter, the task of the next chapter will be to examine in full the possibilities of economic power in international relations as regards security ends and the concept of economic security.
3.1 Introduction

The preceding chapter has examined the evolution of the concept of security since the Cold War era. The chief characteristic of this change has been a move away from the pursuit of absolute military superiority over all possible rivals in security policy towards embracing economic policy as a form of security. There is also recognition that economic power has assumed central importance in dealing with security issues, especially in the post-Cold War era.¹ A number of new and re-emergent security issues have increased doubt within scholars and policy-making communities as regards the use of military power as the way forward in security policy. Meanwhile, certain events have also obliged them to reconsider formulating a pragmatic security policy in which economic power, too, plays an important role. Consequently, while states are increasingly adopting the logic of economic liberalism and the global division of labour in their pursuit of wealth, the concept of economic security has also emerged as one of the prominent issues on each national security agenda.

The aim of this chapter is to bring together academics' and practitioners' views of the relationship between economics, politics, and security so as to clarify the concept of

¹ In fact, there were many prominent scholars writing in the 1930s and 1940s who suggested that economics and security should be understood in an integrated fashion, for example, Staley (1935); Carr (1939); Earle (1943); Hirschman (1945); Viner (1948), and Dunn (1949: 86-87). Nevertheless, the link between economic and security issues was largely ignored during the Cold War era. The topic of political economy of national security has been a 'neglected area of study' in IR scholarship (Knorr and Trager, 1977: v).
economic security in international relations. Within the course of achieving this, it also aims to set out a working definition of economic security in order to apply it to the following case study of Taiwan. The chapter begins by outlining contemporary perspectives on the relationship between national security and economics in international politics. It aims both to facilitate greater understanding of the concept of economic security, and to examine the practicality of economic security for national security objectives. The chapter then moves on to consider the sources of economic power and the typology of economic power in the process of the pursuit of economic security. Next, the chapter examines the concept of economic security and economic security objectives when a state interacts with other states within the international system. The chapter continues by setting out a working definition of economic security on the basis of the above discussion in order to apply this to the case study that follows. Lastly, a conclusion will be drawn in accordance with the concept explored in the above sections.

3.2 Political Theory, Economic Power, and Security

Given that few states in history have been autarchic or self-sufficient, states must engage both politically and economically with others in the anarchic international system. To this end, states cooperate and compete with each other for their respective national interests and economic prosperity, on the one hand. They seek to protect their own interests and prosperity from external threats, on the other. Security and prosperity are the two most important objectives of states throughout history (Gilpin, 2001: 3).² Although sometimes political priorities, where national security interests

² The international economic system from 1815 to 1914 generally followed the value of free trade and gold-standard currency policies led by Great Britain. Eliminating barriers to foreign imports and balancing national current account surplus with capital outflow were the two major tasks of economic
are concerned, may diverge from economic policy, states are unable to keep politics and economic apart. On the contrary, states must strive to reconcile politics and economics such that the two policies do not conflict, but can mutually reinforce each other. Thus, the topic of the relationship between economics, politics, and national security within a state has always attracted the attention of scholars and policy-makers.  

Within this context, the relationship between economics and national security has been a subject with rich theoretical traditions. Among many theories and notions, three of the most prominent schools of thought in modern social science, namely, mercantilism, liberalism, and Marxism, have explicitly or implicitly linked economics and politics to issues that involve the economic power and problems of how states might achieve security and prosperity within the international system. While the scholarship of the three different schools of thought on international politics and international relations conventionally contradict or criticise the others’ theories and principles, they in some way demonstrate their similarity in asserting the significant role of economic power in national security, and the possibility for economic policy makers. Nevertheless, the British-dominated international system was shattered by the First World War. The problem of finance and trade emerging post-World War One undermined both the gold standard monetary system and the traditional pattern of trade. With American financiers and US foreign investment in Europe, the chronic trade deficit of Europe with, and war debts to, the US could be relieved temporarily. The problems of finding a way to reconcile national self-determination and to adjust trade and payment mechanisms were the two major problems facing economic policy makers in Europe. The onset of the Great Depression in the US aggravated those problems. US protectionism further disturbed the uneasy international economic system. As prices fell and unemployment spread, the major industrial countries scrambled to protect their respective industries by raising barriers to foreign goods, and by devaluing their currencies. Protectionism eventually spread worldwide, although liberalism dominated international relations theory from the end of the First World War until the Realist school of thought had regained the status of mainstream in international relations theory by the outbreak of World War Two. Each of the core industrial nations sought to save itself through autarchic measures of planned production at home and managed trade abroad. For a detailed discussion, see (Pollard, 1985: 5-7).

Even in the Cold War era, some writers focused on the link between economic and security issues. For example, analysis of the political economy of national security, see Knorr (1973); Knorr and Trager (1977), and Baldwin (1985). For literature on the interaction between international economic and political system, see Wallerstein (1974); Ashley (1980); Chase-Dunn (1981), and Tivey (1981).

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measures to obtain or to safeguard national security objectives.

3.2.1 Mercantilism

Mercantilism is the economic doctrine that dominated international thought between the sixteenth and eighteenth centuries. It stresses heavily the roles of economic capacity and wealth in upholding national security (Heckscher, 1955). The core of mercantilism is to pursue economic power by means of national political strength, where economic power guarantees national military and sources of strategic materials that enhance both objectives of economic growth and national security (Gilpin, 1987: 396). To reach this end, the objective of a mercantile state in domestic politics is to increase the state's wealth, while the goal in international politics is to strengthen the state's relative power vis-à-vis other states (Viner, 1948: 1). For mercantilists, gaining a market share is the highest priority task of a state, while the purpose of this task is 'to gain relative leadership through the production of collective goods that the world's states want' (Bobbitt, 2002: 283). It is through economic dominance in trade that states competed with one another to achieve wealth and power (Viner, 1948: 5). In turn, with the fruits of economic domination, states could produce effective military capabilities that produced a stable political order and reinforced existing economic advantages.4

With the concept that national wealth and power enhance national strength and security, mercantilists hold that states shall seek to retain a surplus in the international balance of trade in order to possess large reserves of gold (Knorr, 1973: 134). The philosophy behind the theory is that gold is the resource with which to pay for goods

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4 For the most important and illuminating works dealing with the issue about the emergence of great powers in international politics by means of economic domination and innovation, see Gilpin (1981); Kennedy (1988), and Modelski and Thompson (1996).
and services in international trade, as well as serving as a fund to sponsor a military build-up and warfare (Kindleberger, 1970: 60). To achieve this goal, the state formulates policies aimed at developing the state’s commercial, financial, and military resources, on the one hand, while the state simultaneously intervenes in domestic and international economies to advance its political and military objectives (Earle, 1986; Spero, 1992: 5). The mercantile state’s setting of trade barriers and the protections of its key industries reflect the most prominent propositions regarding this point. The protectionist economic policy is devised on the ground that the protection of trade and certain key industries by the state are to ensure their economic survival and ‘are necessary for national security’ (Oppenheim, 1992: 212).

In the modern world, the mercantilist doctrine has become revitalised through neo-mercantilist and Political Realist political interpretations of international relations (e.g. Gilpin, 1987; Kennedy, 1988; Kapstein, 1990). According to the Realist view, the sovereign state is the main actor that pursues power to maximise its security vis-à-vis other states in the anarchic international system. Greater power assures survival of a state, allowing it a wider range of policy options. For Realists, power generally equates to military power, the ultimate determinant of international order and the stability of the international system. However, Realists also recognise the significant role of economic power as one of the essential foundations of state power in supporting national war potential and economic prosperity (Carr, 1946: 109-113; Morgenthau, 1978: 113; Waltz, 1979: 131). As Spykman has argued, warfare ‘can be found successfully only on the basis of a rich supply of strategic raw materials and an enormous industrial output’ (Spykman, 1942: 18). Friedrich List, the nineteenth-century theorist of national political economy, has made similarly contention by saying that ‘[t]he power of creating wealth is then vastly more
important than wealth itself" (quoted in Gilpin, 1981: 125). This illustrates that Realist thought has adopted mercantilist notions emphasising the importance of national economy for national security. To this point, both neo-mercantilists and Realists consider that 'numerous and efficient military resources and a relatively productive and efficient economy' are a national source of power (Pettman, 1991: 58). Meanwhile, Realists also appreciate the utilisation of economic power as a tool, in the form of sanctions or the control of a market, to substitute for or supplement military power in pursuit of security objectives (Carr, 1946: 119-127; Gilpin, 1984: 293-295). Thus, a fundamental proposition of the Realist is that a powerful state must possess a strong economy to sustain a world role (Waltz, 1993: 50; 63). States struggle with one another through international trade to enhance their relative prosperity, which may in due course convert into military power. Such a Realist viewpoint concurs with mercantilist philosophy and has invigorated the mercantilism doctrine.

Neo-mercantilists/Realists consider that the paramount problem for every state is survival, while political and economic liberty is a secondary concern (Minowitz, 1989). In their view, a state's intervention in economic activities is natural and effective in advancing national security objectives. Through economic intervention, states can compete to augment their respective economic power through economic growth and market expansion such that they can transfer economic capability into military power for security ends (Heckscher, 1955: 35). Thus, mercantile states strive to advance economic power through the improvement of the gross national product, advanced technology, and the establishment of industries so as to facilitate the national ability to exercise independent action in world politics (Gilpin, 1987: 404). Their formulation of trading policy 'depends on control of one's currency, which is supported by strictly enforced limits on public spending, and the presence of
value-added industries that dominate the terms of trade’ (Bobbitt, 2002: 284). With those state-directed policies, the government of a state encourages exports, discourages imports, controls capital movement, and centralises currency decisions so as to foster economic independence and national stability. Specifically, the sustainability of national security relies on the enhancement of economic power to support military power. The relationship between economics and national security is evidently correlated and intertwined.

3.2.2 Liberalism

Liberalism is a philosophy of political economy that encourages competition, entrepreneurship, and trade, on the basis of comparative advantage. Liberals view the laissez faire doctrine and the international division of labour as the preferred means of achieving prosperity and security. In their eyes, market-oriented economies promise greater efficiency, growth, political interests, and social welfare than those that state-directed systems may provide. As economic activity is freed from regulation at home, the overall prosperity of a society would increase because resources can be allocated to the most profitable uses (Smith, 1776).

In the realm of domestic production, with the concept of comparative advantage, the liberal argues that states should specialise in producing and exporting those goods that make intensive use of relatively abundant local factors of production (Ricardo, 1817). In the realm of international trade, the liberal encourages a free trade system,

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5 Ricardo’s theory of comparative advantage forms the basis of modern trade theory, which greatly changed our understanding of the benefits accruing to states and their economic security from international trade. The notable Heckscher-Ohlin theorem reformulated Ricardo’s theory by noting that a country’s advantage in production is on the basis of its relative factor abundance (Södersten and Reed, 1994: 59). With the principle of comparative advantage, Ricardo demonstrated that ‘international economic exchange was not a zero-sum game but rather a positive-sum game’ (Gilpin, 2001: 79). This has changed our perception of economic security creation within inter-state economic activities.
and highlights the role of foreign investment and foreign aid for establishing prosperity and peace. From the liberal viewpoint, foreign investment brings managerial and technological skills that increase productivity. Foreign aid flowing from developed states to less-developed states is believed to help aid-recipient countries in economic development, which will, in turn, stabilise the international security environment. Thus, with the ideology of free trade and the market economy, liberalism offers a powerful argument as a way to achieve prosperity and security, the two most prominent goals of a state.

Although liberalism is a prevailing theory in the international economic system, liberalism is also concerned with national security - as is mercantilism. Scholars have debated the influence of international commerce on war and peace for thousands of years. Liberalism has long highlighted the importance of economic power as a determinant of stability in the international system (Gill and Law, 1988: 26). Philosophers such as Adam Smith, Jeremy Bentham, Immanuel Kant, Thomas Paine, Jean-Jacques Rousseau, Montesquieu, and John Stuart Mill in the eighteenth and nineteenth centuries have been united in their belief in two aspects (Brooks, 2005: 1). Firstly, enhancing international commerce makes war among states more costly. Secondly, a dynamic force of inter-state commerce will over time generate a progressively stabilising effect. Thus, in the eyes of these liberal thinkers, inter-state economic engagements will facilitate the prevailing peace by contradicting war within

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6 For debate focusing on the level of theory, see Waltz (1979) and Rosecrance (1986). Rosecrance (1986) argues that commerce promotes stability, whereas Waltz (1979: 138) advances the opposite position. For literature on empirical investigations, see McMillan (1997); Barbieri and Schneider (1999), and Mansfield and Pollins (2001). There is uniform agreement concerning how trade linkages influence security behaviour. The prevailing view is that higher levels of trade interdependence lower the likelihood of conflict. On this point, see, for example, the discussion in Mansfield and Pollins (2001). Some scholars, however, continue to express reservations about the validity of this finding, see, for example, Green, et al. (2001); Barbieri (2003), and Bennett and Stam (2004). For literature asserting that war has no significant impact on trading relationships, see Barbieri and Levy (1999).
and among states. They held the optimistic view on inter-state economic engagement as having a strong and positive effect on shaping international security relations. They believed that economic incentives to engage in hostilities would be reduced as commercial and financial flows globalise. This would pave the way for a peaceful world order among individuals and states (Kant, 1917; Angell, 1972).

In the contemporary era, liberal thinkers link economic interdependence and stability of states within the international system as the key element in setting international order and achieving world peace (e.g., Angell, 1972; Keohane and Nye, 1989; Russett, 1993). This belief in the peaceful consequences of international trade dependency is among the most significant tenets of liberalism. Meanwhile, the notion of military superiority is a zero-sum game that would seem to have no place in liberal discourse. For liberal thinkers, the issue of superiority is intimately related to the creation of domestic and international economic conditions that encourage investment and trade. By failing to create such conditions, countries will proceed to economic failure, as is witnessed in the case of the Soviet Union. In sum, liberalism offers a powerful prescriptive alternative to neo-mercantilism in the area of the utilisation of economic measures for the objective of national security, albeit through a different approach. Liberals believe that security and prosperity may be achieved by promoting free trade internationally and competition domestically.

In terms of the defence issue, liberals argue that defence spending is ‘unproductive’ to national economic vitality because it involves a trade-off between defence goods and

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7 Keohane and Nye define interdependence as ‘mutual dependence’, which involves reciprocally costly effects of transactions (Keohane and Nye, 1989: 8-9). However, the definition of interdependence is under debate. For debate, see, for example, Rosecrance and Stein (1973: 2) and Baldwin (1979: 175-177).
non-defence goods, contrary to the liberal argument of comparative advantage. However, such debate on the impact of the provisions of butter versus guns on national economic growth has demonstrated that liberals have also paid attention to the national security issue. Adam Smith held that ‘defence ... is [of] more important than opulence’ (Smith, 1776: 465). He agreed that governments use authorities to promote an industry that is necessary for the defence of the state (Smith, 1776: Book IV, Chapter 2). Adam Smith has excluded national defence from his framework because the provision of national security is the foremost goal of a state. In order to fulfil this goal, the state may have to intervene in certain instances in order to mobilise capital, labour, and natural resources. Thus, in a liberal world, national security also fundamentally depends on the government’s ability to mobilise political authority and economic resources. Adam Smith’s mercantilist approach in dealing with defence industries with regard to national security reflects that the liberal has brought economic factors directly into national security concerns.

3.2.3 Marxism

As with mercantilism and liberalism, Marxism also provides a useful function in explaining the relationship between economics, politics, and security by illustrating the source of security problems and military expenditure decisions within capitalist states. As an analytic tool and a critique of capitalism, Marxism illustrates the international economic relations of capitalist states when they pursue the achievement of wealth and power. Thus, the economic aspect is also essential to the Marxist view of international politics, which can be seen from the five fundamental tenets of

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8 Marxism is a set of theories, or a system of thought and analysis, developed by Karl Marx in the nineteenth century in response to the Western industrial revolution and the rise of industrial capitalism as the predominant economic mode. For the latest literature introducing Marx’s philosophy, see Rockmore (2002). For Marxist theory, see Kolakowski (1978). For Marxist theory on economics, see Sowell (1985) and Curtis (1997).
Marxism (Heilbroner, 1980). Firstly, the historical process is driven by changes in technology, production, and economic activity. Secondly, the relationship between workers and those who possess the means of production is conflicting and contradictory. Thirdly, capitalism will eventually self-destruct. Fourthly, society is constituted by classes, while the state is the executive committee formed by the group of the ruling class. Finally, workers will ultimately achieve ownership of all means of production as they become masters of society under the doctrine of Socialism.

Similar to neo-mercantilism, Marxist theory takes a fundamentally zero-sum view of the international system. However, the Marxist takes the opposite view of the international market system (Spero, 1992: 149). Marxism focuses upon conflict among economic classes and the competition among states for capital accumulation. Marxists view the international relations of capitalist states as competitive, conflicting, exploitative, and zero-sum in nature. The security problem for Marxism results from 'the aggressive and adventurist nature of capital [sic] and Imperialism' (Vodolazov, 1988: 53). As regards this point, Lenin maintained a stronger antipathy to capitalism by emphasising that capitalists’ economic expansion is not just imperialism, but would eventually cause war among Capitalist states (Lenin, 1939). From the viewpoint of the Marxist, the source of instability is capitalism itself, because the ruling class of the capitalist countries intends to employ military expenditures as a means of state monopoly and thus to control economic development (Parenti, 1989). It is the economic and class character of capitalism that fosters militarism and the arms race in the international environment (Vodolazov, 1988: 53).

Meanwhile, because contradictions and conflicts are common in capitalist societies, the ruling class must use force to maintain its position and to restrain the working
class. According to the observation of the Marxist, military expenditures and capitalism are necessarily related. Because defence spending decisions in capitalist economies are manipulated by the ruling classes, this gives those ruling classes leverage to use military power to achieve their special interests of securing ruling power (Faramazyan, 1981: 10). Besides, it is a trend for capitalist states to allocate excess supply to the defence sector so as to tackle the crises of under-consumption (Luxemburg, 1963: 454-467). Consequently, unless the capitalist country embraces the Socialist workers’ paradise, the capitalist arms race will lead to the destruction of the human race.

Marxism also has some much more sophisticated variants. For example, the critic Gramsci’s theory, propounded as a corrective to the historical determinism of classical Marxism, and the World System theory are both derived from Marxist thought. Basically, both Marxist-influenced analyses share a similar view as regards concentrating on economic power as one of the main force in the international system. Gramscian theory looks at hegemony in terms of class relations, as distinct from the Realist view of hegemony. The theory shows that hegemony is based on ideology, created by the dominant classes, rather than only on military force (Cox, 1987: 253; Gill and Law, 1988: 63-65; Gill, 1990: 33). However, with the debate on hegemony, Gramscian theory also unavoidably concentrates on economic power, and as such demonstrates the change of the international system from focusing on military-related power to economic-related power in dealing with security issues. Similarly, World System theory has shown how international order is shaped by the economic relations between the developed ‘core’ of Capitalist countries and the ‘periphery’ of developing

9 For broad overviews of Marxist approaches to international conflict and military strategy, see Semmel (1981) and Neumann and Hagen (1986).
countries (Wallerstein, 1984; Agnew and Corbridge, 1995: 104). This also illustrates that the pursuit of wealth and power at the systemic level is fundamental to the Marxist-influenced view of international politics.

3.3 The Sources of Economic Power

The above brief review of the three main international political theories has explained the relationship between economics and security in international relations. It has also illustrated that the utilisation of economic instruments as substitutes for or complements to military and political means for achieving national security objective has long been practised in history (Hirschman, 1980; Baldwin, 1985). The significant status of economic power within a security agenda entails important implications for national security patterns. As Waltz has pointed out, ‘without a considerable economic capability no state can hope to sustain a world role’, and ‘great power status cannot be maintained without a certain economic capacity’ (Waltz, 1993: 50; 63). Waltz’s Realist ideology of hegemony has not only illustrated the significant role of economic capacity in maintaining national status of power state but has also identified the universal value of economic capacity as a foundation of statehood. With the support of a strong economy, a state can maintain continuous expansion in military strength and political stability at home. Reciprocally, a stable political atmosphere and secure national situation helps to provide a better commercial environment to promote economic growth.

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10 See, Downs and Saunders (1998/1999: 117-120) and Saich (2001:52) for discussion about economic performance, and a government’s ruling legitimacy and political stability.
As Padelford and Lincoln have noted, ‘Strength – economic, psychological, moral, military, and political – directed to the furtherance of national interests constitutes national power’ (Padelford and Lincoln, 1962: 9). Power is the means towards security ends. States employ political and military means toward achieving political and military, as well as economic, ends. Meanwhile, they also utilise economic means to serve political and military, as well as economic, ends (Pollard, 1985; Wan, 2001).

Economic power is one of the instruments used by states to construct economic security policy aiming to achieve the objective of national security, as well as other aspects of national interests. Given that the construction of economic security is based on the existence and exercise of economic power, this section offers an analysis of the concept of economic power before addressing the concept of economic security.

3.3.1 The Sources of Economic Power

The sources of economic power are found in the components of economic power that are generally created from economic activities. Production, investment, trade, and economic aid are four economic activities directly linked to the process of the generation of economic power. Adam Smith viewed the process of economic growth as strictly endogenous that the wealth of nations was achieved through the capital accumulation on labour productivity (Eltis, 1984: 69). Torrens pointed out that production of commodities is not only important for the determination of the rate of profit, but it also provides the basis for assessing the growth potential of the economy (Torrens, 1821: 372-373). According to Keynes, investment is one of the determinants of aggregate demand that increases the productive capacity of an economy. Investment, at both macro- and micro-economic levels, generates income and boosts economic growth (Keynes, 1936). It is safe to argue that production and investment are the two most fundamental sources of wealth and the material basis for the
development of all societies.

The capability of production usually represents in terms of the gross domestic product (GDP). In the modern world, the GDP is the most direct indicator among others that can be used to define the size of a nation's capacity to generate economic instruments directly or indirectly for security policy (Neu and Wolf, 1994: 75; Tellis et al., 2000: 45-46). The improved performance of national production creates a higher GDP, and thus a higher national income. With wealth, states can provide welfare and public goods on a domestic level so as to create support and stability at home. Meanwhile, states can translate their wealth into economic, political, and military power to support national interests at the international level (Reisman, 1976: 223; Gilpin, 1981: 94-95). Accordingly, the change of production and wealth structure of a state will affect the power structure in international relations, given that national income is created by production (Friedberg, 1991; Brooks, 2005). This is especially true in large economic entities, such as the rising economic powers - China and India (Drexner, 2007). Due to China's continued economic growth, it has stimulated a 'China Threat' theory among many Western states. These arguments are developed on the ground that 'the state's mobilization of war matériel is constrained by the country's economic structure' (Barnett, 1990: 539; Shulsky, 2000). With growing economic strength, China can conduct military modernisation and arsenal expansion, and pursue a stealthy, systematic strategy to attain geo-political and economic dominance firstly in Asia and Eurasia, then possibly globally, which challenges the existing international

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11 There are serious constraints on power translation because, especially in a democratic system, the ability of the government to use amounts of capital flow is under administrative budgetary control. The GDP is not totally or directly equatable to economic power. Nevertheless, a broadly shared view regards that a larger economy is a larger economic power. GDP is a guide to the scale of economy. From this perspective, the GDP is still a valid reference as to the estimation of economic power.
power structure and balance of power of international relations.  

The third source of economic power is inter-state trade. Political economist David Ricardo illustrated the theory of comparative advantage in which he suggested that countries might better off from specialising in what they were best at producing and then trading with other nations (Ricardo, 1817). He believed that the benefits of comparative advantage are related to improved real income. Scholars in different schools of thought have put great endeavour into exploring the benefits and effects of trade for states. Trade provides the channel for access to raw materials and foreign markets, important means of the expansion of domestic production and wealth creation. The most direct effect of trade as regards influencing security is primarily through its effects on aggregate national production and its role as a key economic activity to increase the national income (Krasner, 1976: 317-318). While rising levels of trade increase a state’s military potential by raising the national income, falling levels of trade accordingly lower it. In this respect, trade is an essential component of economic power affecting national security.

According to the Realist discipline, the means of states to engage in trade is subject to national interests, whereas the effects of trade are various. In the eyes of Realists, trade is a political process with implications for power between and among states (Waltz, 1979: 106). The process of negotiation between and among states decides not only the capability of wealth creation. It also determines, firstly, the terms of trade and,

12 For discussion about China’s military power and ‘China threat’, see Timperlake and Triplett II (1999); Wortzel (1999); Gertz (2002); Yee and Storey (2002); Pillsbury (2002); Menges (2005), and DoD (2005; 2006).

secondly, a nation's power over its trading partners (Neu and Wolf, 1994: 16-17). Similarly, mercantilists see trade as a form of inter-state interaction for power, in that national intervention is necessary for gaining power over other states by dominating the terms of their mutual trade. For liberal scholars, free trade and exchange bring wealth to all states. Furthermore, they see trade as a means of encouraging cooperation and integration between and among states within a common norm and rules, such as the multilateral system of the World Trade Organization (WTO), and the bilateral agreement of the Free Trade Agreement (FTA) between states.

Despite the fact that scholars in different schools of thought hold different views on the effects of trade, they have converged on a view that a state can use its ability to manipulate its terms of trade with other states on bilateral and multilateral levels for its national economic and security interests (Gilpin, 1973). States implement economic policy as guidelines for engaging with other states. Through controlling the terms of trade, a state is enabled to employ both positive and negative inducements to other states for the purpose of influencing other states' economic and political behaviour. Trade serves as carrot to win cooperation from others for the purpose of

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14 For an analysis of integrating economic policy with a security agenda, see, for example, Pang (2007).
15 Since the mid-1980s, the virtue of free markets has been embraced by governments worldwide. An increasing number of states view economic development within the context of financial and investment globalisation. Furthermore, with unleashing new economic and political forces since the end of the Cold War, new regionalisms have emerged. The pursuit of bilateral and regional trade agreements raises questions about the wisdom of this approach to trade liberalization. For work on recent trends and shifts in trade policies, see WB (2000); Gilpin (2001), and Krishna (2005). For a critique of globalisation, see Falk (1999) and Stiglitz (2002). For an opposite opinion, see Bussmann and Schneider (2007). For general work on regionalism and multilateralism, see De Melo and Panagariya (1993) and Anderson and Blackhurst (1993). For a pro-regionalism view, see Winters (1996) and Frankel (1996). For an analysis arguing that FTAs would detract from trade liberalisation and fragment the global trading system, see Levy (1997) and Panagariya (1999). For general work on the political-economic history evolution of the WTO, see Matsushita et al. (2003) and Barton et al. (2006). For discussion about the situation and challenges of the WTO, see Wallach et al. (2004) and Sampson (2005).
16 On this point, Gilpin concluded that 'international economic relations are never purely economic' but involve profound economic and political implications (Gilpin, 2001: 82).
a state’s achieving its utmost political and security aims. Of this point, China’s African trade diplomacy provides a clear example. China signed with African countries, namely, Angola, Chad, Sudan, and Zimbabwe, certain trade and oil resources agreements during Chinese President Hu’s African states visit in April 2006 in order to secure oil resources and to find new markets for China’s factories. Nevertheless, the most important driving force for China’s aspirations to establish trade relations with African countries is to obtain their diplomatic support for the current dispute between China and Taiwan (Griffiths, 2006). The other example is China’s direct purchase of US products to alleviate US-China trade tensions, and to create a positive political atmosphere to facilitate China-US political relations during Chinese President Hu’s US visit on 20 April 2006 (AFP, 2006). Trade is, therefore, a source of economic power and an instrument of cultural and political penetration to realise not only economic interests, but also political purposes.

Economic aid is an important source for states of power to influence or to shape the respective policies of other states. A package of international economic aid is one of the common measures that applies to security policy in modern international relations (Lin, 2001b: 69). It aims at ‘convincing others that your aim is also theirs’ (Treverton and Jones, 2005: xi). The form of aid can be goods, equipment or technology (Lancaster, 2000: 10). The delivery of aid can be made directly from one government

17 The US deficit with China exploded to a record $202 billion in 2005. Therefore, the Bush administration expected Hu’s visit to bring some economic relaxation. In turn, Wu Yi, China’s Vice Premier, led a delegation of more than 200 Chinese business executives to the US on 3 April 2006, and signed 107 contracts to buy $16.2 billion-worth of US products (Crutsinger, 2006).

18 The indirect influence on the behaviour or interests of other political bodies through cultural or ideological means is what Joseph Nye termed as ‘soft power’ (Nye, 1990c).

19 Economic aid is part of foreign aid. The phenomenon of foreign aid began at the end of World War Two. It is viewed by many as an essential instrument of foreign policy (e.g., Lancaster, 2000; Tarnoff and Nowels, 2004). According to a report submitted to the US Congress, there are five major categories of foreign assistance: bilateral development aid, economic assistance supporting US political and security goals, humanitarian aid, multilateral economic contributions, and military aid (Tarnoff and Nowels, 2004: 3).
to another either bilaterally or multilaterally through international agencies, such as the United Nations or the World Bank (Lancaster, 2000: 10-11). The aim of aid can also be divided into humanitarian relief and economic development aid. The former aims to help overcome the short-term effects of natural and non-natural disasters, while the latter is designed to help with the long-term promotion of economic growth and stability (Tarnoff and Nowels, 2004: 16).20

With the activities of economic aid, a dependency relationship between donor and recipient is established. Usually, aid activities involve 'some kinds of bargain, a political/economic exchange that serves as much to reinforce authority as it does to alleviate wants' (Strange, 1994: 213). The donor state gains the ability to manoeuvre economic aid as a positive inducement by increasing aid, on the one hand, and as a negative inducement, on the other, by reducing aid. Both attempt to influence the recipient (Lancaster, 2000: 29). Through providing economic aid to other states, a donor state aims to help the societies of the world develop in way that will not menace the donor state’s security – either as a result of the recipient states’ own internal dynamics or because the recipient states are weak enough to be used as tools by others (Millikan and Rostow, 1953: 39). Such focus on economic aid as part of a political and security policy is the central theme for the donor state to employ economic power as a component in achieving its own security and political interests.

3.3.2 Explaining Use of Economic Power

Despite the terminology of power being vaguely denoted in different formulations among schools of thought in the field of international politics, national power can be

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20 For an analysis on economic aid vs. economic growth, see Burnside and Dollar (2000) and Easterly (2003).
produced indirectly, as a by-product of commercial endeavours, or it can be produced directly (Tellis et al., 2000: 91). Similarly, economic power can be produced directly or indirectly. Direct economic power is the economic ability utilised by the state 'to get others to do something they would not otherwise do' (Keohane and Nye, 1989: 11). It is to use economic resources directly as rewards and punishments through, for example, aid and sanctions (Wan, 2001: 10). The indirect economic power refers to a state's influence in international markets, economic institutions, and in other countries' economic and political policies. As Nye pointed out, the economic prowess of a country contributes not only to its wealth but also to its reputation and attractiveness (Nye, 1990c: 33). Indirect economic power is usually an auxiliary effect generated when direct economic power is practised. In this context, the two types of economic security are often compatible and thus associated.

In implementation, direct economic power is a tool of force and persuasion involving the direct utilisation of economic resources by a state in order to achieve its objectives of shaping the behaviour of other states, and gaining ascendancy in a power relationship (Wan, 2001: 10). For example, a state may use its direct economic capability to manipulate the terms of trade with other states on bilateral and multilateral levels. Economic power can also be used as coercive instrument to weaken counterparts' economic-political potential through the change of power structure and the balance of power (Knorr, 1973: 79-80). The employment of direct economic power can be through imposing positive and negative economic stimuli to

21 According to Lukes, 'exercising power' can be discussed from two perspectives. The first one is: 'the exercise of power in terms of A getting B to do something he would not otherwise do' through some concrete measures directly. The second one is: 'A does x, he gets B to do what he would not otherwise do'. B is affected indirectly by A's action x. A affects B through A's reputation of power. For a detailed discussion on 'exercising power', see Lukes (1974: 39-43).

22 Dependency theorists posit that one way economically developed countries secure dominance over developing countries is through economic penetration (Richards et al., 2001: 223).
have an impact on the behaviour of other states (Baldwin, 1985: 12-40). Positive stimuli aim to encourage cooperation and obedience between states, which is a 'carrot' to facilitate bilateral economic engagement (Knorr, 1973: 158). Measures such as aid packages and offering favourable economic privileges fall within this category. A negative stimulus, such as sanctions, aims to frustrate other states from achieving their own, possibly contrasting, wishes. It forces them to conform to the interests of the donor states, which is a 'stick' policy to punish or threaten states perceived as being weaker (Miyagawa, 1992: 7). Measures such as favourable economic privileges, imposing addition tariffs on key exports, threats to remove economic aid, and imposing a variety of economic sanctions are included in this category.23

Indirect power, which Nye called as 'co-optive or soft power', 'occurs when one country gets other countries to want what it wants' (Nye, 1990c: 31). Indirect economic power is generated by national economic power and political dominance within the development of a complex interdependence international system (Keohane and Nye, 1989). As Knorr notes, indirect economic power is 'non-coercive influence', the level of influence awarded to a state resulting from its ability to increase its choices of action towards another state (Knorr, 1973: 4). The strength of indirect economic power lies in its level of influence, where a state does not manipulate directly through its economic resources (Strange, 1994: 31). It is a power of influence acquired by a state through the size and diversity of its economic linkages. Such influence indirectly impinges upon the actions of other states by establishing the environment in which an apparently more powerful state operates, and the possible

23 David Baldwin defined such activities as 'economic statecraft' that is used to advance national policy objectives.
ranges of its behaviour. To this extent, economic cooperation and linkage are examples of the creation of indirect economic power where a state may influence and shape the choices of other states.

3.4 The Concept of Economic Security

As the preceding chapter has explored, security can be defined as the protection of core values from all forms of potential or actualised threat by means of tangible measures and policies. Among many security measures, military power has been traditionally regarded as the main defender of security. However, as in the above overview, the three different schools of thought in international politics and international relations have demonstrated their similarity in asserting the significant role of economic power in national security, and the possibility for economic measures to obtain or to safeguard national security objectives. Within this broad debate, it has been confirmed that the nature of the nexus between politics and economics has put forward the argument that national security has been and always will be embedded in the national and international economy. Economic power has been an alternative strength that can be used to counter not only the economic aspect of difficulties, but also a measure through which to foster or facilitate a security environment (Gilpin, 1987: 6-7). Thus, economics and national security have been and will continue to be intimately intertwined. As regards this point, based on the nexus of economics and politics discussed above, five perspectives on the economics-politics relationships associated with states' capabilities to utilise economic instruments of polity for security ends will be discussed in order to facilitate the formation of the concept of economic security in international relations.
The first type of perspective is the use of economic power to promote the military security agenda. As Friedberg noted, the most simple and direct way between economics and national security is the strong connection between wealth and military power (Friedberg, 1991: 265). It involves the use of economic power to build up a military capability aimed at defending vital national interests and ensuring security in all forms of conflict. It is the economic foundation for war and for security resource mobilisation (Spykman, 1942: 8; Schlesinger, 1960: 76). This type of economic security coincides with mercantilism and the classical Realist school of thought by regarding military power as security, whereas economic power is a resource supplementing military power and a physical resource to support an arsenal build-up (Barnett, 1990: 531-532). For mercantilists, the ultimate end of the accumulation of national wealth is to maximise the power of state for supporting military needs (Heckscher, 1955: 35). In practice, a state's economic potential can be used in support of its security policy by providing an economic base for the production of its respective war material and procuring weaponry abroad. Furthermore, in some cases, a state's economic wealth can also, in the interests of common security, support military aid to allies in order to allow these allies to purchase arms or to develop their own weapon production capacity (Knorr, 1973: 163-177; Neu and Wolf, 1994: 72-73).

Although economic strength is not automatically equal to military strength, it is true that a state with a strong economic potential is a state with a stronger military

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24 The military security agenda is about how states establish their military forces and their manoeuvring of such forces in response to those of other states (Buzan et al., 1998: 52). By the same token, the economic security agenda is about how states establish their economic forces and their manoeuvring of such forces in response to those of other states.

25 The liberal is not absent in this issue. For example, Adam Smith asserted that 'opulence [thus] is necessary for defence, while defence ... encourages industry and trade and is the precondition for opulence' (Reisman, 1976: 223).

26 For an analysis on states' preference for establishing self-sufficiency in arms production, see, for example, Moran (1990b); Vernon and Kapstein (1992), and Bitzinger (1994).
potential and power potential (Gilpin, 1981: 124; Neu and Wolf, 1994: 17-17; Terriff et al., 1999: 141). Therefore, economic strength is a pivotal base of national military power that determines the comparative military power of states. Given this, when a state is in a backward economic situation, budgetary pressures and the dilemma of the calculation of a trade-off between guns and butter will force the drastic scaling down of either military might or economic prosperity (Calleo, 1987; Kennedy, 1988). The collapse of the former Soviet Union provides an evident example of the casualties caused by inefficient economic measures and excessively large investment in military hardware (Kennedy, 1994: 228-249; Henderson and Robinson, 1997: 104-105). The relationship between economic performance and the establishment of a military capability creates an inextricable link between wealth and military power, as well as between economics and national security (Moran, 1990a: 80-82).27

The second perspective is the use of economic power or measure to prevent or to minimise the effects of an eventual conflict between states (Copeland, 1996). While there may be economic causes of war, at one stage, economic actions in various ways establish peace at another stage (Robbins, 1939). This perspective of economic security coincides with the liberal school of thought by focusing on the correlation between economic interdependence (trade in particular) and peace. This type of economic policy can be subdivided into two areas of activities and policy aims. The first is an economic security policy to protect against the undermining of national security through possible economic challenges. The basic objective of this type of economic security is to thwart the source of conflict that originates from economic

27 However, debate over defence spending and its impact on economic performance has illustrated rivalry between government resource allocation for the pursuit of security and prosperity. For debates about defence spending and its impact on economic performance, see Smith (1980); DeGrasse (1983); Olvey et al. (1984); Chan (1985); Weidenbaum (1989), and Kupchan (1989).
problems among states, given that economic friction or economic difficulty among states can breed domestic and international instability. In the worst-case scenario, it may possibly cause inter-state economic and even military conflict. The devastating Second World War was a vivid example originating largely in economic problems stemming from the failure to revive the international economy after the First World War (Gardner, 1969; Gilpin, 1973; Pollard, 1985). A state may attempt to use military force to solve economic vulnerabilities and political instability, as did Japan in 1930s (Barnhart, 1987; Keohane and Nye, 1989: 18; Trubowitz, 1998: 98).

The best-known example of this type of economic security policy is the US Marshall Plan initiated after the end of World War II. The Plan involved providing capital for the reconstruction of the European economies in order to prevent the spread of Communism (Strange, 1994: 104). The post-War Truman Administration's effort to reconstruct Germany and Japan and to integrate them into a multilateral system for the establishment of new international economic order has provided another example of economic power strategy for security ends (Pollard, 1985). In the present day, the current Bush Administration also holds the same belief in the liberalisation and expansion of commerce as a means to promote peace (White House, 2002; 2006). With both economic and political reasons behind its security strategy, the US has asserted, as was stated in the US national security strategy, that its national security and economic welfare rely on a strong world economy (White House, 2002: 17).

The second division concerned with protecting a state's security is to alleviate conflict and political differences between states through the establishment of trade and

28 For discussion about global changes in the economy and the global and domestic political consequence, see Gourevitch (1978; 1986); Rogowski (1987; 1989); Keohane and Milner (1996); Alt et al. (1996); Rowe (1999), and Anderton and Carter (2001).
economic interdependence. This economic security policy is based on the liberal argument that countries with a strong stake in each other's economies do not go to war (Copeland, 1996: 5). The philosophy behind this policy is that trade and economic interdependence within and among states lessens the probability of war because the benefit of trade gives states incentives to avoid war and to be more in favour of peace than of invasion (Gilpin, 1987: 31; Rosecrance, 1992; Copeland, 1996). It is because trade is a more rational option in an interdependent world. This factor diminishes the likelihood of war. South Korea's sunshine policy toward North Korea was based in part on such a view of the effects of economic interdependence (cited in Kahler, 2004: 487). The other factor is the sheer cost of war, with its emphasis on military supremacy and technological development, making war costly and non-beneficial (Rosecrance, 1986: 24-25; Keohane and Nye, 1989).

An example of this type of policy on the international scale is again found in the US, who provided economic aid and its huge available market to alliances in an attempt to facilitate cooperation among allies, as well as to consolidate collective power against the Communist bloc during the Cold War (Gilpin, 1973: 58-63; Pollard, 1985: 222). Despite the support for this economic security policy from strongly suggestive historical evidence, the basic principle is not always correct, at least in the case of the rivalry between Taiwan (the Republic of China) and China (the People's Republic of China). While Taiwan and China have massive bilateral trade amounting to as high as

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29 Such a trade-peace argument has met much debate and criticism from Realists. Realists argue that high interdependence increases rather than decreases the likelihood of war because interdependence means mutual dependence and hence vulnerability (e.g., Mearsheimer, 1992: 223; Copeland, 1996). For literature applying statistical methods to examining the trade-conflict relations and suggesting that economic and trade relations among states are correlated to war or peace, see for example Gasiorowski and Polachek (1982); Reuveny and Kang (1996), and Oneal and Russet (1997; 1999). For the opposite view of trade-conflict effects, see Goenner (2004). For literature applying game-theoretical models of conflict, see Morrow (1999).

30 For a contrasting argument, see Rowe (1999).
$76.3 billion in 2005, China has installed some 710 to 790 missiles aimed at Taiwan (TIER, 2006: 26; DoD, 2006: 3).\textsuperscript{31} Hostility and political antagonism has maintained their unchanged \textit{status quo} across the Taiwan Strait, as illustrated in Taiwan’s National Security Report and China’s defence white paper (PRC, 2004; NSC, 2006). This suggests that economic interdependence may possibly establish a certain peaceful level of environment within which the two rivals may conduct their economic engagement. However, it is an insufficient condition to thwart war, especially when the political differences between two rivals also involve a dispute over sovereignty.

The third type of perspective is the use of economic power to provide a defence against deterioration in economic welfare caused by an economic, political or military conflict with another state. This perspective of economic security is concerned with economic survival and development, as well as with economic prosperity-generating ability, when the state interacts with other states in the global economy (Friedberg, 1991: 275). It aims to resist economic and political crises arising from economic consequences imposed by other states. To this end, states elaborate economic policies to promote the growth of the economy and to prevent all sorts of economic and non-economic uncertainty, challenge, or conflict that may threaten national ‘economic interests in the face of events, developments, or actions that may threaten or block these interests’ (Neu and Wolf, 1994: 11-12). According to Marxist argument, the origin of such an economic problem results from the asymmetric economic dependence between developed and underdeveloped states. The developed countries have taken advantage of the underdeveloped states and made the poor poorer (Gilpin, 1975b: 44). On this point, mercantilists find the justification to question the value of

\textsuperscript{31} All currencies quoted in this thesis are in US$ unless otherwise specified.
trade liberalisation and interdependence (Gilpin, 1975b: 48).

The major task of such aspects of economic security policy is set to cope with the short-term challenge and the long-term agenda. The short-term task is to minimise and to prevent abrupt uncertainty that causes immediate economic vulnerabilities that may undermine continued economic well-being (Neu and Wolf, 1994: 12). This short-term economic security task is more closely associated with crisis management per se. It is concerned with taking contingent measures to tackle specific imminent challenges, such as the Asian financial crisis of 1997-1998. The sudden financial crisis exacerbated economic disparities within society, widened poverty, and deepened social inequality in Thailand, Malaysia, Indonesia, and South Korea, particularly. In Indonesia, the crisis further led to considerable political violence (Haggard, 2000). Other Asian economies, such as Australia, took a contingent policy including a flexible exchange rate as a shield to weather the crisis (Kahler, 2004: 28). The long-term economic security task is to safeguard a continuous national capability for generating prosperity (Dent, 2002: 17). Such a long-term economic security agenda is concerned with preserving economic potential and the capacity to counteract structural destabilisation. In brief, the short-term economic objective is to safeguard value previously acquired, while the long-term one is to ensure the capability to produce continuous economic growth and prosperity. Both are national economic development interests as well as being on the national political and security agenda.

The fourth perspective of economic security is a policy that initiates an economic ‘attack’ or a threat to ‘attack’ an enemy’s economy in the event of conflict. It is to forge ‘economic consequences of war’ (Cable, 2003). It aims to use economic measures in persuading a potential enemy to cease its course of aggressive
intimidation and thus nullify the position of conflict (Luttwak, 1995: 116-118; Cable, 2003). Through directly utilising economic measures as a coercive instrument to create pressure on the potential enemy, the latter may elect to abandon a course of economic, political or military action. Sanctions such as blockades of transport, an economic boycott, and embargoes are the key techniques applied in economic warfare in a bid to weaken enemies by means of cutting off or diminishing supplies (Padelford and Lincoln, 1962: 428-429; Knorr, 1973: 135-138). Other measures such as freezing financial assets, restricting access to foreign markets, or heavily taxing on certain important products can also impose upon the enemy an unbearable economic cost.

This type of economic security policy is adopted not to pursue economic benefit from an enemy, but to alter the enemy's behaviour through economic statecraft. The use of such strategic economic statecraft for political and security interests may have technical variations, but the fundamental of statecraft is coherent throughout history (Gilpin, 1981: 7). The practice of economic power as coercive instrument is to change the power structure and balance of power by means of economic measures to weaken potential or actual enemies' political or economic strength, and to force a change their behaviour (Knorr, 1973: 79-80).

The fifth type of perspective of economic security is a policy used as a non-coercive dominant economic power to ensure a state's own economic interests and security objectives. With liberal vision, this type of policy is usually employed in peacetime and involves the use of foreign economic aid, technical assistance, and preferential

32 Economic statecraft is a direct use of economic resources to advance its policy objectives (Baldwin, 1985: 13-14; Wan, 2001: 10). Baldwin defines economic statecraft as 'influence attempts relying primarily on resources which have a reasonable semblance of a market price in terms of money' (Baldwin, 1985: 13-14). According to Baldwin, economic statecraft can be categorised in several forms, namely, embargoes, boycotts, aid suspensions, export controls, direct purchases, and the provision of aid and investment guarantees.
trading arrangements, for instance, most-favoured nation status (Neu and Wolf, 1994: 74). Within a larger context, it aims to oblige other states towards behaviour that falls in line with international norms and rules so as to maintain international security interests as a whole. Its smaller scope is where the state initiating such an economic security policy aims at requiring the target-state to act in the initiative-state’s national interests. For example, Japanese Prime Minister Fukuda in 1978 pledged $1 billion in aid for five ASEAN regional projects in order to win favour among those neighbouring nations invaded by Japan during World War II (Yasutomo, 1989-1990: 492). In this regard, such economic activities are not necessarily associated with gaining economic benefit or fulfilling national economic interests (Knorr, 1973: 20). The political and security interests are the main concerns of this type of economic security.

Such economic statecraft can be practised by using a positive or a negative approach (Baldwin, 1969). With a positive approach, a country may use economic power to reward other countries and help them to realise their goals (Wright, 1955: 239). Measures such as financial aid, investment guarantees, and direct purchases are in this category, under which an economic instrument is utilised to facilitate the process of diplomacy. It can thus be referred to as economic diplomacy, which is about how states conduct their international relations by means of bilateral or multilateral economic engagements. The most noticeable example is Japan’s broadly utilising economic power to pursue an economic advantage and to formulate an international security environment it believes suitable for its own power (Hook et al., 2001; Wan,

33 The classical concept of diplomacy is the conduct that operates through diplomats for the purpose of the establishment of relations between states and other entities with standing in world politics. For a more insightful discussion about diplomacy and foreign policy, see Barston (1997); Marshall (1997), and Berridge (2002).
34 For a broader discussion about the methods and process of economic diplomacy, see Bayne et al. (2003).
Taiwan is another example of a state to practise this economic security policy, although its economic potency is far less effective in shaping international security system than are economically powerful states. Given its contested statehood with China, Taiwan frequently uses its economic power to fulfil its security agenda by cultivating diplomatic ties for its international presence and political legitimacy in the international community (Dent, 2002: 20; 248-251).

With a negative approach, a country may use economic power to punish other countries or to force them to act in accordance with its own interests (Baldwin, 1969: 430). Disruption and the provision of economic benefits from trade and financial ties are two conditions adopted by power states to achieve policy objectives (Knorr, 1973: 99-101). The major technique is to deny some sort of economic advantage to other states (Wright, 1955: 239). Supported by economic power, states can utilise measures such as terminating investment, reducing economic aid, closing important markets, or cutting supply sources in order for them to constitute a threat to rivals. For example, Japan suspended foreign aids to India and Pakistan as a punishment after their respective nuclear tests in May 1998. Japan suspended grants totalling $30 million, freezing new loans, previously allocated to India. An approximately similar amount was suspended to Pakistan. These actions demonstrated Japan's strategic security concerns (Wan, 2001: 57). Similarly, Japan also deployed economic power to withhold food aid and energy assistance from North Korea in protest at the latter's ballistic missile tests on August 1998 (Hook et al., 2001: 180-182). Such examples illustrate the fact that states may utilise economic power as a useful instrument in formulating an international security environment that it believes to be suitable for its own security agenda.
3.5 A Typology of the Objective of Economic Security

The above five types of perspective on economic security have illustrated the relationship between economic power and security policy that form a major characteristic of thinking about the economic security policy in many states. However, given that states with diverse historical backgrounds possess diverse scales of national leverage and face distinct challenges, the priority agenda of pursuing economic security interests varies from state to state (Stares, 1998: 324-325; Lee, 1999d: 41). As Lubbe observes, national economic capability and an enduring external security threat are the two key factors that determine a state’s priority of economic security objectives (quoted in Dent, 2002: 14-15). While a state recognises its enduring external security threat, it can set the national security strategy in accordance with its national economic ability.

National economic ability decides a state’s capability and strength to pursue economic and political missions (Friedberg, 1991: 275). On this point, Neu and Wolf emphasised the importance of the relative economic size of nation in international relations (Neu and Wolf, 1994: 15-19). According to the Realist ideology, the international system is where ‘the strong do what they have the power to do and the weak accept what they have to accept’ (Thucydides, 1972: 407). Thus, a state with greater economic power together with a healthy domestic economic system and adequate economic policies acquires further leverage and freedom of choice in the delineation of its national strategy, which it applies to promote economic development and to respond to external threats and temporary crises. Conversely, a state with a relatively weak economic power possesses a relatively lower level of potency and freedom of choice to programme national strategy in accordance with its best interests. This is so because it sometimes needs to make compromises and therefore to modify
its behaviour under the pressure of other, stronger, states (Terriff et al., 1999: 148).

Similarly, the capacity of national economic strength decides the course of an economic security objective to be inward-oriented or outward-oriented (Stares, 1998: 324-325; Dent, 2002: 15). According to Lee’s theory, she classifies economic security objectives into ‘radical economic security’, ‘basic economic security’, and ‘geo-economic security’ (Lee, 1999d). Each category corresponds to different levels of political and economic development as well as to security concerns and policy goals. The ‘radical economic security’ objective, as in Lee’s argument, involves states that are still in a stage of struggling for domestic political cohesion and societal stability. For those states, maintaining persistent economic growth is a matter of regime survival. Thus, an inward economic security objective of stabilising the domestic economy and promoting economic growth for the utmost aim of regime consolidation and societal stability is the central concern of those states. This inward-oriented economic security agenda focuses on tackling economic weakness so as to reinforce national cohesion and to advance ruling legitimacy (Lee, 1999d: 43).

‘Basic economic security’ objective involves states that rely predominantly on economic power as the national foundation for pursuing survival and national security at the international community. For this category of states, international trade relationship and inter-state economic engagement are significant not only for national economic performance, but also for the national power foundation: a matter of security. They also rely heavily on economic power as a bargaining counter in political transactions to expand their foreign relations and to constitute their national security framework. Thus, such an outward-oriented economic security objective focuses on guaranteeing that the channel to access the market be smooth, and on
Geo-economic security' is another type of outward-oriented economic security objective, a concept based on a confrontational model of international economic activity (Cable, 1995: 305). This type of economic security involves the international power structure and balance of power, which in turn shapes the international security structure. Gaining international primacy is the core of this type of economic security objective in the international hierarchy (Huntington, 1993b: 72). Winning commercial battles and exerting control or influence over international regimes are the main tactics for power states to sustain their superiority in the international community (Gallagher, 2005). To prevent the decline of a state's international status, power states adopt a neo-mercantilism-influenced international economic policy in aiming to obtain access to the international market, as well as to consolidate national economic leverage (Lee, 1999d: 48). Nevertheless, as Cable argued, the pursuit of geo-economic security was not necessarily confrontational. It could facilitate cooperation between and among states (Cable, 1995).

3.6 Towards a Working Definition

With the above discussion on the theoretical connotations of the nexus of economics and security, as well as the introduction of the common concept of economic security and the typology of economic security objectives, a basis has been provided for structuring the link between national economic power, on the one hand, and the pursuit of national security objectives, on the other. Given the distinctive features of national capacities and different levels of political and economic development, states
facing different security challenges and national interests will initiate different economic security agendas. Among many factors, three elements are the most important determinants closely associated with the pursuit of economic security: the source of the threat, the policy of utilising economic powers, and the core value of the states concerned as matter of national survival and interests. Circumstantially, following the definition of ‘security’ as interpreted in the foregoing chapter and the above consideration, economic security can therefore be defined as the protection of core values from all forms of potential or actualised threat by using economic power and policies. Here, ‘core value’ broadly equates with fundamental and inalienable criteria in a state’s value structure.

Within the working definition for this thesis, the ‘core value’ refers to national interests and security objectives. Based on the above analysis of the typology of economic security objectives, the core value can be subdivided into two categories: ‘the economic dimensions of security’ interests, and ‘the non-economic dimension of security’ interests (Neu and Wolf, 1994: 69). The economic dimension of a core value is focused on securing the integration of the economic system and enhancing the nation’s prosperity-generating capability (Dent, 2002: 17). According to Dent’s theory, the aspect of the integrity of an economic system is fundamentally associated with an ‘economy’s survival in the international system and thus the prevention of its structural collapse’, while the feature of prosperity-generating capabilities focuses on ‘reducing the future scope for economic security risk, vulnerabilities and threat’ as well as on maximising national welfare in the face of all aspects of economic challenges domestically and globally (Dent, 2002: 17). Such economic security requires governmental authority to formulate economic policy so as to pursue security in economic growth and in the nation’s prosperity-generating capacity. It is crucial
because the defence of a country's borders against adversaries depends not only on military capability, but also on the capability for access to supportive socio-economic resources (Barnett, 1990: 535). Thus, the economic resources for supporting a national security agenda to protect a nation against foreign adversaries are at least as important as the capability of the nation's proficiency in defence.

The non-economic dimension of the core value involves utilising economic power and policy to pursue outward-oriented and inward-oriented national interests and security agenda. For inward-oriented economic security, it aims to resist external influences from undermining the cohesion of domestic politics and the stability of the society. This includes the establishment of a defence capability to protect national territory, mobilising economic resources to resist all sorts of non-military threat in order to ensure national stability. For outward-oriented economic security, it aims to utilise economic power to achieve security objectives. Powerful states, such as the US, Japan and China, may focus on maintaining or creating their spheres of influence and hegemonic status in the international community, while other states may centre on securing their security and interests when engaging with third parties. For example, in the case of Taiwan, the outward economic security is, from the economic perspective, to obtain international markets and, politically, to gain diplomatic recognition in the international community (Lee, 2006a). However, regardless of the size of states, the objectives of economic security of every individual state converge in securing those respective national interests that states believe to be suitable and proper to their national security.
3.7 Conclusion

This chapter has explored the course of the concept of economic security in international relations. By bringing together academics’ and practitioners’ views of the relationship between economics, politics, and security, this chapter has identified the linkage between economic power and the security issue. The review of the concept of economic power, the components of economic power, the typology of economic security, and the objective of economic security have constructed a comprehensive foundation for conceptualising the notion of economic security in international politics, on the one hand. It has also confirmed how states utilise economic power and policy to protect the security of economy and to support the national security agenda within the international system, on the other. This has pinpointed the significant role of economics for national security patterns in international relations. A state may develop economic power not only to counteract economic aspects of the challenge of retaining national prosperity, but also to use it as a substitute for or complement to military and political means for achieving national security objectives.

Given that states with diverse historical backgrounds possess diverse scales of national leverage and face distinctive challenges, the priority agenda of pursuing economic security interests varies from state to state. Against this understanding and the perspective of utilising economic power for achieving national security objectives, a working definition has been put forward. Within the working definition, economic security is about how a state utilises its economic power to formulate economic security policies to pursue security ends in accordance with both its respective national economic potency, and its specific internal and external security challenges.

While the concept of economic security has been explored, the missing point is
whether a small country can also apply economic security to its national security agenda, and to what extent. The above literature review has illustrated that most of the studies into the subject of deliberately expanding economic engagement ties for economic security objectives have been limited to the policies of great power states. Meanwhile, the power politics suggest that the world economy and politics are shaped and influenced by leading powers. The size of a nation is important when it comes to settling international relations. In this context, the question of how a small country employs an economic security policy in pursuing security ends under the circumstance of facing a strong enemy is a field needing further research. Moreover, as discussed above, the paradox of economic interdependence and political antagonism between Taiwan and China has brought up the question of whether economic interdependence can be achieved through an economic security policy. These questions have important implications for providing a comprehensive notion of economic security. Therefore, based on the concept of economic security as illustrated in this chapter, the task of the next chapter will be to examine the economic security of Taiwan within the context of the rivalry between Taiwan and China in order to fill the gap of knowledge in conceptualising and understanding economic security in international relations.
CHAPTER FOUR

THE SECURITY OF TAIWAN:
DIVISION, CONFRONTATION AND CO-OPERATION IN CROSS-STRAIT RELATIONS

4.1 Introduction

Regardless of the size of a state, the pursuit of survival and security in the international system lies in the universal worth and interest of the state. According to wisdom of Realists, international relations are subject to ‘concert of powers’ (Rosecrance, 1992). While dominant powers set the rule of game in international relations, small states depend on the mechanism of balance of power by ‘bandwagoning’ with power states.1 Taiwan as a small state has followed the strategy of international politics to ‘bandwagon’ with the US for its national security since the Cold War.2 Due to the Chinese civil war and the international political reality, China has long been a threat to Taiwan’s national security. Taiwan’s struggle with China is not for hegemony. It is for survival and freedom of action. Scholars in international relations frequently refer to the rigorous relations across the Taiwan Strait as one of the potential ‘flash points’ of conflict in the world (e.g., Dreyer, 2000; Myers and Chao, 2000; Roy, 2000). For safeguarding its own national security, Taiwan is allied with the US for military security, on the one hand. It also pursues a self-help mechanism to build up national strength militarily and economically to resist Chinese

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1 On this point, see Chapter Two, n. 20.
2 Taiwan’s formal military and political ties with the US were terminated when Washington established diplomatic relations with Beijing in 1979. Nevertheless, from a political and military perspective, Taiwan remains heavily dependent on the support provided by the US.
aggression, on the other.

As outlined in Chapters Two and Three, the evolution of the concepts of security and economic security in international politics has confirmed the role of economic power in the pursuit of national security under the circumstance of respective national power and national security concerns. The current chapter aims at analysing the evolution of Taiwan’s rivalry vis-à-vis China, in which the major cross-Strait conflict has shifted from military confrontation to political antagonism and economic engagement. Within the task, the detailed overview of relations across the Taiwan Strait will lay the foundations of making it possible to examine Taiwan’s efforts, while pursuing its own economic security agenda, to utilise its economic strength to withstand China in the economic, political, and diplomatic domains.

The chapter focuses on three main sets of factors. Firstly, the crux of why the cross-Strait rivalry has been long-lasting will be addressed. This will provide the reasons for which the two sides may start to engage in economic activity within the circumstance of long-term political antagonism. Secondly, the reason why intensive and massive economic exchange and economic integration have thus far failed to resolve the cross-Strait political stalemate will be examined. To some extent, trade and economic co-operation have facilitated a thaw in the atmosphere across the Taiwan Strait. The question remains, however, why this cannot persuade China to renounce the use of force against Taiwan. Thirdly, answers are suggested for why China consistently interferes with efforts made by Taiwan for the latter to establish diplomatic relations with members of international community, and why Taiwan elects to contest with China at the international level. After all of these questions have been answered, it will be able to outline how Taiwan may implement its economic
security strategy vis-à-vis China under such complex and controversial cross-Strait relations.

The current chapter will first discuss the evolution of the cross-Strait political and military encounter. The second section will discuss cross-Strait encounter at the international level in terms of Taiwan’s diplomatic difficulties. The following section will focus on the cause of the commencement of cross-Strait economic ties, and on Taiwan’s economic policies toward China. Finally, after these discussions, a summary of the chapter’s contents is presented.

4.2 The Evolution of the Cross-Strait Political and Military Encounters

4.2.1 The Origin of the Division

The cross-Strait political rivalry is the never-ended chapter of the Chinese civil war. In 1949, the nationalist government of the Republic of China (ROC) was defeated by the Chinese Communist Party (CCP) in the Chinese civil war and was forced to retreat to Taiwan, there awaiting the opportunity to recover Mainland China back to forming part of the ROC. Soon after the Nationalist (‘Kuomintang’ in Chinese: the KMT) government resettled on Taiwan, it announced that Taiwan was under the Emergency Decree of 19 May 1949, which proclaimed that Taiwan still held the status of being embroiled in a civil war and that the CCP regime in Mainland China was a group of rebellion (Shaw, 2004: 97). With the ‘Emergency Decree’, Taiwan was under the rule of martial law and in a status of civil war with China. Consequently, contact with China was illegal.

3 For details about the Chinese civil war in the 1940s, see Westad (2003).
In October of the same year, the CCP, led by Mao Zedong, established the People's Republic of China (PRC) in Mainland China. Afterwards, the two parties started a long-term political struggle for the legitimacy and sovereignty of sole representation of the whole of China in the international diplomatic arena and, especially, in the Taiwan Strait (Geldenhuys, 1990: 421-422). The ROC denied the legitimacy of the CCP regime and asserted that the ROC remained the sole legitimate government representing all of China and all of the Chinese. Contrarily, the PRC claimed that the ROC regime ended in the Chinese Civil War. Hostility between the two has, therefore, placed the ROC (hereinafter Taiwan) and the PRC (hereinafter China) in an indefinite struggle in maintaining diplomatic relations with foreign countries (Kao, 1993a: 33). Both Taiwan and China stood firmly on the 'One China' principle in defending their respective legitimacy as the sole rightful government of all China, claiming that the other was an illegitimate rebel group. The contest of sovereignty, which Taiwan and China will never concede to the other side, is clearly the crux of the confrontation between the two.

At the international level, both parties contested the representation of the 'China Seat' in the United Nations (UN) as well as contending the obtaining of diplomatic recognition from the UN's member states. The Third-World countries, especially in Africa, formed the target area where Taiwan and China competed for influence by deploying foreign aid intensively and continuously (Wei, 1982). Despite the fact that the number of Taiwan's diplomatic allies increased slower than did China's, Taiwan was able to take a legal position in the international community with the support of

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5 This point can be verified by the fact that neither the ROC nor the PRC ever accepted the suggestion of two seats for the two Chinas in the UN before 1971, when the ROC held UN membership.
the US before 1970 (Hughes, 1997: 17). In the Taiwan Strait, political antagonism and military confrontation made the constant scenario that reflected the relationship between Taiwan and China. All cross-Strait culture and trade exchanges were terminated for about forty years from 1949.

4.2.2 The Development of Cross-Strait Political Rivalry

The development of cross-Strait rivalry had been shaped by the international political environment as well as by the dynamic of domestic political and economic progression. The history of cross-Strait relations between 1949 and 2004 can be subdivided into five periods when viewed in terms of the tension of military confrontation, the succession of Taiwan’s head of state, and China’s political policies vis-à-vis Taiwan.

(a) 1949-1965: Rigid Military Antagonism

In the 1950s, the fundamental policy in China under Mao Zedong towards Taiwan was ‘bloodshed Taiwan’ by a superior military power (Dittmer, 1996: 29). On the other side of the Strait, the basic national agenda of the KMT administration under the leadership of Chiang Kai-Shek was determined to pursue reclaiming the Mainland for the ROC. Consequently, each side strove to establish military strength in an attempt to resist the other. In the 1950s, the Chinese People’s Liberation Army (PLA) began to launch a full-scale assault on Taiwan (Lee, 1999a: 17-18). The first crisis happened between 1954 and 1955, when China began large-scale shelling of the islands of Kinmen on 3 September 1954. The second confrontation happened in August 1958 when China once again launched military aggression by shelling the islands of Kinmen and Matsu, aiming to take over Taiwan by force. Both military conflicts
ceased under the military intervention of the US. With the US military arrangement, Taiwan was under the defence umbrella of the US. Nevertheless, the US also forced Taiwan to promise to use peaceful means towards future Chinese unification, i.e., to give up using aggressive military means to recovery mainland China (Lee, 1999a: 19). Under such circumstances, the two separate political entities ruling Taiwan and China respectively became an inevitable reality.

The existence of cross-Strait antagonism was part of the Cold War legacy. China’s policy towards Taiwan was shaped by its relations with the Soviet Union (USSR) and the US in the context of the Cold War balance of power. China’s agenda regarding Taiwan had shifted back and forth between ‘bloodshed Taiwan’ and ‘peacefully liberated Taiwan’. The occurrence and the easing of the two Taiwan Strait crises in the 1950s were evident examples of this. The first Taiwan Strait Crisis ended under US military involvement as well as through the absence of USSR involvement. Because China-Soviet relations had deteriorated, the Chinese elites realised that they would need to face confrontation with the US yet while lacking the backing of the USSR. With its security concerns, China withdrew from applying aggressive military deployment to resolve the ‘Taiwan issue’, which ended the first military confrontation in the Taiwan Strait (Lee, 1999a: 19). In the aftermath, in April 1955, Chinese Premier

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6 In the first crisis, the US and the ROC issued the Sino-American Mutual Defence Treaty on 2 December 1954. In the second crisis, on 23 October 1958, the US and the ROC governments issued a joint communiqué reaffirming solidarity between the two countries.

7 For US policy regarding Taiwan and China from the 1940s through the Cold War to the current day, see Herschensohn (2007). For Taipei-Washington-Beijing relations and their impact on cross-Strait relations, see Wei (2002). For US policy regarding Taiwan’s agenda of the recovery of mainland China, see Chen (2004b).

8 Originally, the US decided to cease its involvement in the Chinese civil war and stopped providing military aid to the KMT. The outbreak of the Korean War on 25 June 1950 brought the US back into the rivalry in the Taiwan Strait (Ditmer, 1996: 29; Clough, 1996: 104; Dickson, 1997: 47). The Soviet threat during the Cold War era was another reason for Taiwan and China to become involved in US power diplomacy (Clough, 1996: 104-105).

9 For discussion about triangular relations among Washington, Moscow, and Beijing, as well as the Cold War rivalry, see Lee (1999c).
Zhou Enlai publicised two alternative choices for Chinese people towards resolving the ‘Taiwan issue’: by resorting to war, or by peaceful means (TAO, 1993). However, this proposal was undermined after the outbreak of a quarrel between China and the US over the commencement of the Great Leap Forward in China in 1957. To demonstrate its strength, China’s approach to Taiwan became aggressive. Mao ordered on 23 August 1958 the launch of heavy bombing of Taiwan’s offshore islands, Kinmen and Matsu.

Against the background of civil war, Taiwan’s national security strategy at this stage consisted, basically, in striving for military superiority to recover Mainland China for the ROC. From Taiwan’s standpoint, maintaining great military strength and a large arsenal had not only carried out its national goal, but had also provided crucial protection for safeguarding the inhabitants of Taiwan. However, on the basis of the US Cold-War strategy, the US restrained Taiwan from using military means to ‘recover Mainland China’. The KMT government had, under such a circumstance, gradually put greater weight on setting long-term survival strategies by carrying out economic development plans through state-planned arrangements, although the original national objectives of ‘recovery of the Chinese mainland from rebellion’ and ‘anti-Communism and national revival’ were still Taiwan’s highest priorities among its guidelines regarding the battle against China (Kau, 1996: 51). Taiwan Island was no more merely a military base for short-term shelter, but a long-term basis for national revival. Economic development was critical for support of military build-up to defend the security of Taiwan, and also for enhancing the legitimacy and popularity of the ruling party and state (Kau, 1996: 51). This long-term national agenda has proved an effective economic security strategy in the light of the way Taiwan has

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10 For explanation and evaluation of Taiwan’s defence forces and infrastructure, see Cole (2006).
extended its connections and relations with countries: without diplomatic relations, yet through business and cultural links.

(b) 1966-1979: Political Resistance and Diplomatic Rivalry

After 1958, there were still some minor sea battles and military tensions between the two sides of the Taiwan Strait. Nevertheless, China’s tactics of showing a united front had moved to the stage of the ‘peaceful liberation’ of Taiwan. The frequency of direct military clashes decreased slowly after 1965. Four major reasons were perceived to attribute to the result. Firstly, deteriorating relations with the USSR gave a warning signal to Chinese leaders, who realised that China had to face the US alone if any conflict broke out (Lee, 1999a: 19). Secondly, China from 1966 plunged into the Cultural Revolution for ten years. The internal political struggle absorbed all of its resources and left it little energy to battle with Taiwan (Henckaerts, 1996: 281). Thirdly, China meant to present an illusion to the world that China’s attitude had become benign. It aimed to change the Western world’s perception of cross-Strait issues to the detriment of Taiwan. This helped China to escape from diplomatic isolation by gaining diplomatic recognition (see Table 4.1). Fourthly, the international détente provided China with a good opportunity to sever connections with the Soviet Union and to reduce tension in its relations with the US, both of which offered China the opportunity to reach the Western community (Hickey, 1992; Kao, 1994a: 57).
Table 4.1  
Diplomatic Establishment of the PRC: 1949-2004

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Note: Figure represents newly established diplomatic ties in the respective year.

Although no major direct military clash occurred between Taiwan and China in this period, a series of challenges in its foreign affairs served to restrict Taiwan's international status. The change in the international relations among power states altered the balance in the Taiwan-China rivalry. The international political environment was in favour of China in the light of the Cold War strategy of 'alliance with China to contain the Soviet Union', which had brought Taiwan's international situation into difficulty (Kao, 1994a: 59). Moreover, the US desperately wanted to disentangle itself from the Vietnam War (Lee, 1999a: 19; Tsai, 2003b: 62-63). Consequently, the US national adviser Henry Kissinger visited China secretly between 9 and 11 July 1971, seeking Chinese cooperation. The US, in the aftermath of the contact, abandoned its opposition to the PRC's bid for UN membership. In the end, the ROC's 'China Seat' and its permanent membership of the Security Council in the UN had been replaced by that of the PRC in October 1971 (Kao, 1993a: 37). On 28 February 1972, US President Nixon visited China and signed the Shanghai Communiqué with China, which thus established the foundation for the normalisation of Sino-US relations in the future. The consequence of the development in US-China relations devastated Taiwan's international status and foreign relations by triggering a
series of diplomatic chain reactions. A series of diplomatic setbacks dragged Taiwan into disadvantage in the diplomatic battle. The country has continuously faced rigorous challenges ever since. Taiwan engaged in a losing battle with China for diplomatic recognition acutely related to Taiwan's international existence and national survival (Shaw, 2006).

On 1 January 1979, the US formally switched recognition from Taiwan to China. Taiwan experienced a further devastating diplomatic blow after the UN incident. In the Sino-US 'Joint Communique on the Establishment of Diplomatic Relations', the US proclaimed that it retained an interest in the peaceful resolution of the Taiwan issue and would maintain cultural, commercial and other unofficial relations with Taiwan (USA, 1979a). Strategically, due to the long-term alliance between Taiwan and the US, the US put the Taiwan Relations Act (TRA) into effect on the same day in 1979 when the US and China established diplomatic relations.\(^\text{11}\) In the TRA, the US assured Taiwan that it would put effort into ensuring peace and security in the Western Pacific area and to maintain substantial relations, such as commercial and cultural exchange, with Taiwan (USA, 1979b). Meanwhile, according to the TRA, the US would also help Taiwan to establish the necessary defensive weapons in order to give Taiwan a stronger power of deterrent and the means to survive if deterrence failed.\(^\text{12}\) Because of the TRA and the status of the US of world political leader, the US has incessantly been involved in the cross-Strait rivalry.

\(^{11}\) The TRA was advanced by the US Congress and supported by the executive branch as a critical instrumental tool to maintaining peace, security, and stability in the Taiwan Strait from its enactment in 1979.

\(^{12}\) China has continuously sought measures to repudiate the idea of the TRA. On 17 August 1982, China and the US under the Reagan administration signed the joint Communiqué, which tried to establish limits on US arms sales to Taiwan. For a detailed discussion, see Harding (1992: 383-385). The full text of the 1982 China-US Joint Communiqué, see USA (1982). For discussion on the development of the cross-Strait arms race, see Swaine (1996) and Shlapak (2000).
Having established diplomatic ties with the US, China moved its intimidating stance toward Taiwan subtly towards tactics of a united front for ‘peaceful unification’ by using the lure of economic collaboration and popular contacts to win political cooperation from Taiwan (Dittmer, 1996: 32). Such movements fell within China’s political and economic calculations. From China’s perspective, it was not necessary to deploy military forces subsequently to liberate Taiwan, because Taiwan’s largest supporter, the US, had already shifted over to its side. This peaceful campaign towards Taiwan could also fulfil China’s objective of economic reform as decided in 1978.13 China also believed that closer economic ties could foster a good foundation for future political talks. Thus, the aim of Chinese unification would be reached eventually. Consequently, China officially announced on 1 January 1979 the cessation of the bombing of Taiwan’s offshore islands, Kinmen and Matsu (NPC, 1979). In the same document, China also proposed that the two sides engage with each other through ‘Three Links and Four Exchanges’.14

However, Taiwan did not respond to China’s proposal, but continued to devote itself to economic development. Taiwan perceived that the economy was critical not only for the support of its military build-up, but also as a tool to link Taiwan to the world. From the KMT government’s perspective, a prosperous economy and a strong army were a guarantee of national security (Eberstadt, 1992: 83). Taiwan also realised that economic engagement was an alternative measure to maintain international connection under the circumstance of its inferior diplomatic position. Because both Taiwan and China held the inflexible principle of ‘non-coexistence’ with each other,

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13 China decided to promote general economic reform as a higher priority by postponing the modernisation of the PLA (Swaine, 1996: 161-162). For China’s Open-Door policy and implementation, see Galbraith et al. (2000).
14 The Three Links are: direct post, trade, and transportation. The Four Exchanges are: the exchanges of relatives and tourists, scientists, cultural groups and performances, and athletic teams.
other countries of the world were bound to choose between maintaining diplomatic
ties with either Taiwan or China. Both Taiwan and China competed in gaining
diplomatic recognition from newly independent states, as well as in luring away the
other’s diplomatic allies. Many countries, while the majority were influenced by the
US-China diplomatic relations and shifted their recognition to China, also tried to find
a balance between political relations with China, on the one hand, and economic ties
with Taiwan, on the other. For example, Japan and the US retained their economic
links with Taiwan after they had severed diplomatic relations with Taiwan.15
Consequently, Taiwan’s national security was dependent on its economic capability in
the diplomatic arena in the context of competition with China. The so-called ‘informal
diplomacy’ supported by economic power became Taiwan’s instrument to breaking
through international isolation (Wu, 1996a; Möller, 1996). Taiwan’s economic
security is not only in pursuit of economic prosperity in the economic domain, but
also of the creation of diplomatic relations in the international arena. Consequently,
economic measures played a significant role in the cross-Strait diplomatic rivalry.

(c) 1980-1987: Pragmatic Economic Engagement but Inflexible Diplomatic Struggle
In this period China adopted both soft and tough policies in dealing with Taiwan in
the bilateral contacts across the Taiwan Strait and in the international arena. At the
international level, China continued its foreign affairs policy to isolate Taiwan by
launching a series of diplomatic offensives. China warned states around the world not
to establish official relations with Taiwan so as not to risk their opportunities to gain
access to the Chinese market (Lee, 1999a: 20). This was China’s economic security
strategy to achieve its political interests. At the bilateral level, China adopted more

15 For long-term research into the evolution of diplomatic relations of the ROC, see Kao (1993a; 1994a).
benign tactics by inviting Taiwanese businesses to invest in China in order to facilitate
its ‘Open Door’ economic policy and also towards the objective of future unification.
In September 1981, Ye Jianying, chairman of the Standing Committee of the National
People’s Congress, elaborated a nine-point proposal calling for the CCP and the KMT
to hold talks on a reciprocal basis. In his statement, he reiterated the ‘three links’ and
‘four exchanges’ proposal and also suggested ‘three upholdings’ to Taiwan for
allowing Taiwan, as a Special Administrative Region, to retain its own local economic
and political arrangement when Taiwan and China entered into unification (Ye,
1981).16 Nevertheless, Taiwan steadfastly retained a ‘no contact, no negotiation, and
no concession’ policy in response to China’s sequential proposals (Kao, 1994a: 24;
Lee, 1999a: 21). Taiwan also continued to forbid businesses and the population from
contact with China. Consequently, economic exchanges between Taiwan and China
were essentially non-existent at the beginning of this period.

From the political perspective, the government in Taiwan encountered both internal
and external challenges during this period. Domestically, Taiwan was in the process of
a new wave of democratisation.17 The ruling KMT faced rising challenges from
opposition parties that sought political reform at the domestic level. The newly
founded Democratic Progressive Party (DPP) bravely challenged the KMT’s
‘recovery of China to the ROC’ and pledged to establish a new ‘Republic of Taiwan’
under a new constitution to be achieved through a peaceful and democratic process
(Kau, 1996: 62; Tsai, 2003b: 69).18 Internationally, Taiwan continuously encountered
China in the diplomatic tug-of-war. Under the pressure of the fear of isolation in the

16 The Three Upholdings are an unchanged social system, an economic system, and local and
provincial administration.
17 For discussion about Taiwan’s democratisation and its impact on cross-Strait relations, see Kuan
(1992); Kau (1996); Garver (1997); Robinson and Moon (1999), and Lee and Chang (2004).
18 For the literature discussion on the growth of the DPP and its anti-unification efforts and the Taiwan
movement, see Wu (1994).
international arena and the pressure of political reform at the domestic level, the KMT élite was forced to rethink its overall policy toward China (Kao, 1994a: 31). This let in July 1987 to the lifting of the Emergency Decree, which offered a legal foundation for pragmatic diplomacy and lifting of the ban, thus allowing in November 1987 Taiwanese residents to visit relatives in Mainland China.

From the economic perspective, both Taiwan and China endeavoured for improvement in their respective economies during this period. Taiwan was emerging as a newly industrialised country. It experienced industrial transformation during this period (Yu, 1998). Taiwan was in 1987 the eleventh-largest exporter and the fifteenth-largest trading state in the world (Kao, 1994a: 33). In the same period, China focused on ‘Open Door’ policies aiming to restore an economic structure from the ten-year Cultural Revolution (Galbraith et al., 2000). The Chinese political élite perceived that a successful, modernised and booming economy could facilitate the best chance for unification (Sheng, 2001: 17). It believed that pulling Taiwan into the economic domain while keeping Taiwan more diplomatically isolated would force Taiwan to enter into negotiations for unification, or at least to maintain the status quo. To this end, China launched a series of preferential measures to attract Taiwanese investment and to build closer links with Taiwan (Chia and Lee, 1993). As a result, economic ties between the two were becoming closer, but political confrontation in the international arena became even more rigid and inflexible.

(d) 1988-1999: ‘Hot’ Economic Exchange versus ‘Cold’ Political Deadlock

In order to cope with the emerging tide of democratisation domestically and to extricate itself from a disadvantageous diplomatic position internationally, Taiwan began at the end of 1980s to adopt a more flexible foreign policy in dealing with
diplomatic affairs and relations with China, especially after the beginning of the Lee Teng-hui Administration (Wu, 1994: 127). Taiwan had shifted its foreign policy from strong confrontational non-co-existence with the Chinese Communist to a more flexible and realistic pragmatic approach (Lee, 1992: 196; 282-283). The original ‘zero-sum’ ideology-bound foreign policy had been adjusted pragmatically (Hughes, 1997: 130). The main objective was to gain ‘substantive diplomacy’ by emphasising its external trade and cultural ties through informal representative offices in countries with which it had no official ties, under the circumstance of severe diplomatic rivalry with China. Besides, Taiwan’s pragmatic strategy of an economic security policy by which Taiwan uses various tools at its disposal, primarily financial, also aimed to search for new diplomatic allies and to consolidate relations with existing formal diplomatic ties, also seeking international support for its re-admission to various international bodies (Clough, 1993: 104). It is Taiwan’s effort to utilise economic leverage to achieve its national security objectives in the international system. With such pragmatic foreign policies, Taiwan retained the flexibility to tolerate various countries’ maintenance of their ‘dual recognition’ of both Taiwan and China. This in turn allowed Taiwan and China to co-exist in the international community (Kao, 1994a: 74; Dent, 2002: 249).

On 30 April 1991, Taiwanese President Lee Teng-hui announced suspension of the ‘Period of National Mobilisation for Suppression of the Communist Rebellion’, effective on the next day. With this political arrangement, Taiwan pragmatically accepted the CCP government as a political entity in Mainland China and formally abandoned claims to sovereignty over China (Shaw, 2004: 105). Taiwan’s domestic policies from the mid-1990s onwards propelled the country towards asserting its international status and, furthermore, to challenging the ‘One China’ policy. Taiwan’s
political system and power structure gradually relegated the remote goal of unification with mainland China to the back burner, for it to be replaced after five constitutional amendments by the concept ‘Taiwan first’ (Swaine and Mulvenon, 2001: 45). As part of its national security agenda, Taiwan conducted domestic democratic reform and adjusted its foreign affairs policy. Taiwan’s first-ever direct presidential election, held in 1996, for example, was one of the results of constitutional amendments. From Taiwan’s viewpoint, it displayed the evidence of Taiwan’s democratisation and sovereignty.

Taiwan’s constitutional amendment was, to China, cause for suspicion. China regarded Taiwan’s political arrangement as a movement to create a structure of ‘two Chinas’ or ‘one China one Taiwan’ for ‘Taiwan independence’, which undermined China’s national security (CPC, 2001: 86; Interviewee: E9). In response, China proposed a ‘one country, two systems’ formula under the framework of the ‘One China’ principle. The fragility of the Taiwan-China ties was, due to the lack of mutual trust, always under serious challenge from the political persistence of either side. The atmosphere between the two remained in general much more moderate for at least eight years until 1995, which saw the outbreak of the Taiwan Strait Missile Crisis.

Ironically, while the political aspect of relations was still rigorous, the cross-Strait economic exchanges grew speedily (see Tables 4.2 and 4.3). Massive economic exchange between the two countries failed to prevent China from deploying military

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19 China has persistently proposed such a statement in several official documents, for example, ‘The One-China Principle and the Taiwan Issue’ (TAO, 2000a) and ‘Jiang Zemin’s Eight-Point Proposal’ (Jiang, 1995).

20 For studies on the improvement of the relationship across the Taiwan Strait, see Clough (1993); Khanna (1995); Shambaugh (1995), and Leng (1996).
exercises and missile tests in the Taiwan Strait in 1995, 1996, and 1999. The juxtaposition of ‘hot’ economic exchange with ‘cold’ political deadlock gave a true portrayal of the situation across the Taiwan Strait. In this period, three political events were significant to the development of cross-Strait relations. These events illustrated the key to the cross-Strait rivalry as focusing on Taiwan’s sovereignty. Within the events, Taiwan and China each adjusted their approach towards the other. The former had sought to strengthen its national security by pragmatically pursuing its right as an independent state to international participation, a policy perceived by China as a plan towards Taiwan’s independence. China had shifted its policy priorities from seeking unification to preventing Taiwan’s independence (McDevitt, 2006: 84). Nevertheless, at the most fundamental level, there had still been no changes in the two sides’ positions. Taiwan insisted its sovereignty and legitimacy as an independent state, while China persisted in pursuing the ‘One China’ principle by asserting that Taiwan was part of China.
<table>
<thead>
<tr>
<th>Period</th>
<th>Approved by Ministry of Economic Affairs, ROC</th>
<th>Official Data from Mainland China</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Cases</td>
<td>Amount</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1992</td>
<td>264</td>
<td>246.99</td>
</tr>
<tr>
<td>1993*</td>
<td>1,262</td>
<td>1,140.37</td>
</tr>
<tr>
<td></td>
<td>(8,067)</td>
<td>(2028.05)</td>
</tr>
<tr>
<td>1994</td>
<td>934</td>
<td>962.21</td>
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<tr>
<td>1995</td>
<td>490</td>
<td>1,092.71</td>
</tr>
<tr>
<td>1996</td>
<td>383</td>
<td>1,229.24</td>
</tr>
<tr>
<td>1997*</td>
<td>728</td>
<td>1,614.54</td>
</tr>
<tr>
<td></td>
<td>(7,997)</td>
<td>(2,719.77)</td>
</tr>
<tr>
<td>1998*</td>
<td>641</td>
<td>1,519.21</td>
</tr>
<tr>
<td></td>
<td>(643)</td>
<td>(515.41)</td>
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<td>1999</td>
<td>488</td>
<td>1,252.78</td>
</tr>
<tr>
<td>2000</td>
<td>840</td>
<td>2,607.14</td>
</tr>
<tr>
<td>2001</td>
<td>1,186</td>
<td>2,784.15</td>
</tr>
<tr>
<td>2002*</td>
<td>1,490</td>
<td>3,858.76</td>
</tr>
<tr>
<td></td>
<td>(3,950)</td>
<td>(2,864.30)</td>
</tr>
<tr>
<td>2003*</td>
<td>1,837</td>
<td>4,594.99</td>
</tr>
<tr>
<td></td>
<td>(8,268)</td>
<td>(3,103.80)</td>
</tr>
<tr>
<td>2004</td>
<td>2,004</td>
<td>6,940.66</td>
</tr>
<tr>
<td>Accumulated</td>
<td>33,155*</td>
<td>41,249.23*</td>
</tr>
</tbody>
</table>

**Table 4.2** Taiwan’s Investment in China: 1992-2004

**Unit:** US$ million; %

Note: Accumulated amount includes data before 1992 that are not listed in this table.

*: includes the number of registrations of previously unregistered investments.

(): figures in the bracket represent the cases or amount for registration of previously unregistered investments, which is in accordance with the revision of the ‘Statutes Governing Relations between the People of Taiwan Area and Mainland Area’ on 14 May 1997.

### Table 4.3 Comparison of Estimates of Indirect Trade between Taiwan and China: 1989-2004

<table>
<thead>
<tr>
<th>Year</th>
<th>Hong Kong Export</th>
<th>Hong Kong Import</th>
<th>Taiwan Customs Export</th>
<th>Taiwan Customs Import</th>
<th>China Customs Export</th>
<th>China Customs Import</th>
<th>MAC(^1) Export</th>
<th>MAC(^1) Import</th>
<th>Trade Balance with the World</th>
<th>Trade Balance with the World</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989</td>
<td>28.97</td>
<td>5.87</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>33.32</td>
<td>5.87</td>
<td>27.45</td>
<td>140.39</td>
</tr>
<tr>
<td>1991</td>
<td>46.67</td>
<td>11.26</td>
<td>0.001</td>
<td>5.98</td>
<td>36.39</td>
<td>5.95</td>
<td>74.94</td>
<td>11.26</td>
<td>63.68</td>
<td>133.18</td>
</tr>
<tr>
<td>1992</td>
<td>62.88</td>
<td>11.19</td>
<td>0.01</td>
<td>7.47</td>
<td>58.81</td>
<td>6.98</td>
<td>105.48</td>
<td>11.19</td>
<td>94.29</td>
<td>94.64</td>
</tr>
<tr>
<td>1993</td>
<td>75.85</td>
<td>11.04</td>
<td>0.16</td>
<td>10.16</td>
<td>129.33</td>
<td>14.62</td>
<td>139.93</td>
<td>11.04</td>
<td>128.89</td>
<td>80.30</td>
</tr>
<tr>
<td>1994</td>
<td>85.17</td>
<td>12.92</td>
<td>1.32</td>
<td>18.59</td>
<td>140.85</td>
<td>22.42</td>
<td>160.23</td>
<td>18.59</td>
<td>141.64</td>
<td>77.00</td>
</tr>
<tr>
<td>1995</td>
<td>98.83</td>
<td>15.74</td>
<td>3.77</td>
<td>30.91</td>
<td>147.84</td>
<td>30.98</td>
<td>194.34</td>
<td>30.91</td>
<td>163.43</td>
<td>81.09</td>
</tr>
<tr>
<td>1996</td>
<td>97.18</td>
<td>15.82</td>
<td>6.23</td>
<td>30.60</td>
<td>161.82</td>
<td>28.03</td>
<td>207.27</td>
<td>30.60</td>
<td>176.67</td>
<td>135.72</td>
</tr>
<tr>
<td>1997</td>
<td>97.15</td>
<td>17.44</td>
<td>6.27</td>
<td>39.15</td>
<td>164.42</td>
<td>33.97</td>
<td>224.55</td>
<td>39.15</td>
<td>185.40</td>
<td>76.56</td>
</tr>
<tr>
<td>1998</td>
<td>83.64</td>
<td>16.55</td>
<td>8.35</td>
<td>41.11</td>
<td>166.30</td>
<td>38.70</td>
<td>198.41</td>
<td>41.11</td>
<td>157.30</td>
<td>59.17</td>
</tr>
<tr>
<td>1999</td>
<td>81.75</td>
<td>16.28</td>
<td>25.37</td>
<td>45.22</td>
<td>195.38</td>
<td>39.52</td>
<td>213.13</td>
<td>45.22</td>
<td>167.91</td>
<td>109.40</td>
</tr>
<tr>
<td>2000</td>
<td>95.93</td>
<td>19.81</td>
<td>42.18</td>
<td>62.23</td>
<td>254.97</td>
<td>49.95</td>
<td>250.10</td>
<td>62.23</td>
<td>187.87</td>
<td>83.10</td>
</tr>
<tr>
<td>2001</td>
<td>88.12</td>
<td>16.93</td>
<td>47.45</td>
<td>59.02</td>
<td>273.39</td>
<td>50.00</td>
<td>219.46</td>
<td>59.02</td>
<td>160.44</td>
<td>156.59</td>
</tr>
<tr>
<td>2002</td>
<td>103.12</td>
<td>17.08</td>
<td>99.45</td>
<td>79.48</td>
<td>380.63</td>
<td>65.86</td>
<td>294.65</td>
<td>79.48</td>
<td>215.17</td>
<td>180.67</td>
</tr>
<tr>
<td>2003</td>
<td>117.89</td>
<td>21.61</td>
<td>214.17</td>
<td>109.61</td>
<td>493.62</td>
<td>90.05</td>
<td>353.58</td>
<td>109.62</td>
<td>243.96</td>
<td>169.31</td>
</tr>
<tr>
<td>2004</td>
<td>147.62</td>
<td>24.85</td>
<td>340.20</td>
<td>166.79</td>
<td>647.79</td>
<td>135.45</td>
<td>449.60</td>
<td>166.79</td>
<td>282.81</td>
<td>61.25</td>
</tr>
</tbody>
</table>

Note: 1. The MAC sets a formula to estimate cross-Strait export figures, which has been widely accepted and referenced. For details of the MAC's calculation formulation, see TIER (2005b: 26).

2. Exports indicates amount of exportation from Taiwan to China, while imports indicates amount of importation from China to Taiwan.


(i) The Historical Koo-Wang Talks in 1993 and their Aftermath

In January 1991, Taiwan formally established the Mainland Affairs Council (MAC) as the statutory administrative agency under the Executive Yuan. It was the equivalent of China's Taiwan Affairs Office (TAO) that, under the State Council, had been set up in October 1988. The MAC was designed to be the architect of Taiwan's Mainland policy, guided by the President's ideas and under the supervision of the Premier. Under the consideration of avoiding any official-level direct contact and adherence to the principle of legitimacy, two semi-official bodies were established for bilateral talks. The MAC set up the Straits Exchange Foundation (SEF) in February 1991 and China's TAO established a counterpart organisation, the Association for Relations Across the Taiwan Straits (ARATS), as corresponding 'windows' for cross-Strait...
negotiations, in December 1991. The ARATS was designed to promote direct three links and future unification on the basis of the ‘One China’ principle, while the SEF aimed to facilitate cross-Strait non-governmental contact and exchange (Lee, 1999a: 22).

Several working meetings were held. They produced in 1992 agreement on a variety of specific issues and problems on an *ad hoc* basis. The historical high-rank cross-Strait non-politically-involved Koo-Wang Talks in Singapore on 27 to 29 April 1993 were the inauguration of the delicate Taipei-Beijing negotiations. Although the talks were defined as unofficial consultations and signed only four agreements covering communications across the Strait, the symbolical significance of the meeting was perceived as a historical breakthrough (Su, 2003: 21-27; Yang, 2003). By 1995, an atmosphere of appeasement in the Taiwan Strait had led to a noticeable overall extension of the cross-Strait relations. Not only was there immense growth regarding the ‘soft’ issues, such as in the non-political sphere of economic and cultural exchange, but also in the ‘tough’ issues, the acute military confrontation and diplomatic struggle, had relations became placid (Su, 2003: 28). Both sides had reached a rapprochement by temporarily laying aside the most difficult ‘One China’ principle in 1992. With this arrangement, each side had tried not to intimidate the other, in an attempt to foster a beneficial atmosphere for the possibility of future dialogue with no constrictions as to the topic.

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21 For example, agreement on official document authentication and on registered mail.

22 The 1992 event became a controversial debate between Taiwan and China from 2000, when Chen Shui-bian was elected ROC president. Both Taiwan and China adhered to their own respective views of the 1992 event. China persisted in the view that SEF and ARATS had reached a consensus in 1992 over the principle of ‘One China’, namely, the ‘1992 Consensus’. Taiwan’s DPP government, however, insisted that SEF and ARATS had discussed the issue of ‘One China’ yet achieved no consensus, and there was thus no so-called ‘1992 consensus’. According to Interviewee E9, if China agreed to resume ARATS-SEF dialogue without Taiwan’s acceptance of the ‘1992 consensus’, China would fall into a situation of recognition of ‘one country on each side of the Taiwan Strait’, an item not on China’s agenda.
(ii) President Lee’s US Trip and the 1995/96 Missile Crisis

President Lee Teng-hui’s 1995 trip to Cornell University in the US on 8 to 11 June triggered China’s anger. Soon after Lee’s speech at Cornell University, China responded with a series of sharp criticisms published by its mouth-piece Renmin Ribao (People’s Daily News), and announced the suspension of the second round of Koo-Wang talks, which had been scheduled for 20 July 1995. China also embarked on all-embracing efforts to interfere with Taiwan’s international engagements (Sheng, 2001: 28). Moreover, China took extreme measures, launching military exercises and missile tests near Taiwan, and mobilising a gathering of troops in Fujian Province between July 1995 and March 1996 (Sheng, 2001: 28-32; Lee, 1999a: 47-51). These military manoeuvres were China’s effort to demonstrate that the PLA was capable of and determined to defend national unity. It aimed to prevent Taiwan from moving further away from unification (Shulsky, 2000: 41). It was also China’s intention to send the message to the US and the rest of the world that China would do whatever it could to sustain the ‘One China’ principle and to reject foreign interference. In this context, it was evident that the key to the cross-Strait rivalry hinged around a sovereign right. China feared that the gradual acceptance by the international community of Taiwan as an independent state would drive Taiwan far away from unification (Nathan, 1996: 88). This illustrates the reason why Taiwan has always and without exception been confronted with fierce diplomatic battles vis-à-vis China.

China perceived that the US played the ‘Taiwan card’ against China and in support of Lee’s strategy of ‘creeping independence’ from China (Sheng, 2001: 65-66; Swaine,

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China believed that the US was the major figure in deciding Taiwan's direction towards independence (Sheng, 2001: 71). In contrast, Taiwan regarded Lee's 'private' US visit was a landmark diplomatic breakthrough because Lee was the first incumbent president to visit the US, especially under the circumstance of Taiwan's lack of official diplomatic relations with the country. For Lee himself, the US trip was a triumph of pragmatic diplomacy, one that would bring him to the point of winning the first-ever popularly elected president in 1996 (Lee, 1999a: 34). Clearly, Taiwan's domestic political calculations, foreign affairs, and cross-Strait rivalry were inextricably entangled.

In 1996, China once again conducted military exercises near Taiwan, and launched several ballistic missiles over the island. The sabre-rattling actions were taken in response to the possible re-election of President Lee Teng-hui. China's military demonstration eventually ceased after the military involvement of the US. The whole event began when the US granted a visa to Lee and ended with the massive military deployment on the part of China, Taiwan, and the US. Afterwards, the unfavourable international situation and the China factor began to generate negative impacts on Taiwan (Su, 2003). In the Taiwan Strait, it was not until 1997 that the two sides resumed unofficial exchanges through informal meetings between the personnel of the two sides' unofficial representative organizations. Direct SEF-ARATS contacts resumed in April 1998, and the SEF Chairman Koo Chen-fu visited the Mainland in October 1998 (Harding, 2004: 188).

24 For this point, several Chinese scholars agreed with the point that the US is an important external factor shaping the cross-Strait relations (Interviewees: A1, E9, and H3). However, Interviewee A5 said that the US did not manipulate cross-Strait relations. Nevertheless, Chen Shui-bian was dominated by the US.
25 The US sent the aircraft carrier Nimitz through the Taiwan Strait on 19 December 1995. Also, on 11 March 1996, the United States, under the then President, Clinton, sent the Nimitz and another aircraft carrier towards the Taiwan Strait. For a comprehensive analysis of the process of US involvement, see Ross (2000).
(iii) ‘Special State-to-State Relationship’

Originally, SEF and ARATS agreed to further dialogue on political, economic, and other issues, and Wang agreed to make a visit to Taiwan after Koo’s 1998 China trip. However, the arranged visit was cancelled following statements made by President Lee’s ‘special state-to-state’ theory over cross-Strait relations on 9 July 1999. Lee interpreted the situation as being that the cross-Strait relations should be conducted as ‘state-to-state’ or at least as ‘special state-to-state relations’ (Lee, 1999b). Adhering to the strict notion of sovereignty, ARATS immediately rejected Lee’s statement and suspended talks between ARATS and SEF. The two sides have since then never been able to organise other Koo-Wang Talks successfully. The two semi-official intermediary agencies found themselves in a condition of ‘malfunction’ after the ‘special state-to-state theory’ event of 1999 (GIO, 2003). The cross-Strait dialogue since then has been suspended sine die.26

Once again, tension rose and the two sides fell into a repetitive war of words by condemning each other in speech and in writing. China blamed Lee as having ‘betrayed the One-China Principle’ and wishing to ‘promote a separatist policy’ for Taiwan independence (TAO, 2000a). In response, China mobilised all propaganda units to attack Lee’s statement severely. Beginning on 16 July 1999, the Xinhua News Agency ran a series of criticisms of President Lee. On 1 August 1999, the Liberation Army Daily alleged in its editorial that war was not far away (Su, 2003: 99-100; 119-122). Meanwhile, China took coercive action again by sending more than 100 sorties of jet fighters over the virtual middle line of the Taiwan Strait within three weeks after Lee’s two-state theory. In addition to mobilising conventional forces,

26 The Koo-Wang Talks also became real history because the two major figures, Mr. Koo and Mr. Wang, who represented two counterparts, passed away in January and in December 2005, respectively.
China test-fired a long-range intercontinental ballistic missile (ICBM) capable of reaching the US homeland (Su, 2003: 99-100).

According to the former Chairman of MAC, Su Chi, the two sides have secretly conducted negotiations several times through the private sector and secret envoys in order to find a possible solution for mutual talks (Su, 2003: 10-15). Nevertheless, SEF-ARATS talks were suspended. Political motivation was the core factor, among many other elements, that terminated mutual talk between the countries. Although the massive economic engagement and cultural exchange had to some extent relieved the acute tension across the Taiwan Strait, the strong political rhetoric and stance from both sides had devastated the possibility of resuming peaceful dialogue. Regrettably, the standstill relationship across the Taiwan Strait remained, and the bombardment with harsh language of one by the other became the *modus operandi*. The lack of mutual trust and politically-oriented cross-Strait mindset between China and Taiwan annihilated the slim consensus that was established in the former half of the 1990s.

(e) 2000-2004: Moving without Progress

According to the insightful observations and sharp comments made by Su Chi, Lee’s theory of ‘special state-to-state relations’ and China’s overreaction through its high-profile, harsh propaganda and threat of military exercise contributed to the triumph of Chen Shui-bian, candidate of the pro-independence DPP, in the presidential election in March 2000 – a factor lying beyond China’s calculation (Su, 2003: 122). China’s attitude towards the DPP was deep mistrust.27 It perceived that the DPP’s self-interest was to pursue independence, the national security issue to

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27 This idea was confirmed by author’s interview with Chinese scholars and officials during her field trip to China in June 2004 (Interviewee: A2).
which China would never become reconciled (Shaw, 2003: 179-182).\(^{28}\) This can be observed from China’s prompt statement on the Taiwan election of 18 March 2000. On the very same day when Chen was elected, China’s TAO issued a statement to reiterate that China’s firm stance on the ‘One China’ principle is ‘to safeguard the sovereignty and territorial integrity of the motherland’. In the same statement, showing its profound suspicion, China emphasised that Chen should not change Taiwan’s *status quo* and would pay careful attention to ‘listen[ing] what the new leader in Taiwan says and watch[ing] what he does’ (TAO, 2000b). Although Chen Shui-bian officially addressed the ‘Four No’s Plus One’ policy on cross-Strait relations when he was sworn into office as the tenth president of the ROC on 20 May 2000, the subtle wording in his inauguration speech failed either to convince China or to alleviate China’s concerns (MAC, 2004c: 1-7).\(^{29}\)

It continues to be China’s view that Taiwan is steadily drifting farther away from national unification. China, with a sense of urgency, adjusted some aspects of its strategy toward Taiwan (Yu, 1999a: 46). Politically, China forged a strategy to isolate and marginalise Chen and the DPP in then cross-Strait policy arena in order to weaken Chen’s position and DPP’s administration (Bush, 2003: 67-73). China closed the negotiation window with Chen and his DPP government and insisted that the two sides could resume talks only when Taiwan accepted the ‘One China’ principle (Tsai, 2003b: 75-76). In the diplomatic arena, China strove to accelerate Taiwan’s diplomatic isolation. The number of Taiwan’s allies dropped from 29 in 2000 to 25 in

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\(^{28}\) Interviewees A1 and H1 mentioned to the author during an interview that Chinese leaders would never allow Taiwan independence because no one can take such a historic responsibility.

\(^{29}\) The ‘Four No’s Plus One’ policy on cross-Strait relations was: not declaring independence, not changing the national title, not pushing forth the inclusion of the so-called ‘state-to-state’ description in the Constitution, not promoting a referendum to change the *status quo* with regard to the question of independence or unification, and not abolishing the National Reunification Council or the Guidelines for National Unification.
Economically, China enhances Taiwan’s economic dependency on China as a market-place for investment and trade. In 2003, with total exports amounting $35.4 billion and imports amounting $11 billion, China for the first time surpassed Japan and the US to become Taiwan’s largest trading partner in terms of both imports and exports. Militarily, China has continuously deployed along its south-eastern coast missiles targeted at Taiwan. The number of short-range ballistic missiles (SRBMs) pointing towards Taiwan from China increased to around 650 to 730 by late 2004, according to the US Department of Defense. The deployment continues to expand at an average rate of about 100 missiles per year (DoD, 2005: 4). Briefly, China’s strategy vis-à-vis Taiwan can be described as ‘economic absorption where feasible, diplomatic blockade where necessary, and military invasion only as a last resort’ (Chang, 2003: 129).

Similarly, Taiwan did not trust China. The key to the difference between Taiwan and China lay in their respective interpretations of ‘One China’. While China insisted that Taiwan’s acceptance of the ‘One China’ principle as a prerequisite for cross-Strait talks, Taiwan was unwilling to accept China’s proposal because Taiwan perceived that Taiwan’s acceptance of the ‘One China’ principle was in actual terms making fundamental concessions towards the national stance (Bush, 2003: 64; Tsai, 2003b: 73). Thus, no dialogue occurred in President Chen’s first term of presidency. The media became the only mechanism for the two sides to ‘talk’ to each other. Not only were mutual mistrust and misunderstanding fuelled, but the already uncomfortable cross-Strait hostility also worsened. For example, in response to Taiwan parliament’s

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30 Cross-Strait diplomatic rivalry will be discussed in Chapter Six.
31 Cross-Strait economic exchange will be discussed in Chapter Eight.
32 According to 2002 US military report, China has over 300 SRBMs that can strike Taiwan (DoD, 2002: 51).
passing of a bill in 2003 allowing a ‘defensive referendum’ on sovereignty in the event of an attack by China, Chinese army officers told the media during an interview that they would do anything to prevent Taiwan from declaring independence, including going to war. Major General Peng Guangqian of the Chinese Academy of Military Sciences threatened war with Taiwan if Taiwan pushed towards independence, even to the extent of boycotting the Beijing Olympic Games in 2008 and rising consequences for economic prosperity (Xinhua, 2003a). As interviewee G3 observed, such abnormal ‘communication’ through subjective speculation would cause miscalculation and thus possible military confrontation across the Taiwan Strait.

In this period, the fundamental positions of either side of the Taiwan Strait had seen no changes. China reiterated the same pre-conditions for the resumption of cross-Strait talks, namely, that Taiwan must recognise the ‘One China’ principle, the 1992 consensus, and oppose independence (Hu, 2005). On the other side of the Taiwan Strait, Taiwan still insisted that China should recognise Taiwan as a co-equal government and should not impose any pre-conditions for resuming cross-Strait dialogue. Mistrust between Taiwan and China increased. China was deeply distrusted by Chen and his DPP confederates. In order to negate Taiwan’s DPP administration and Chen’s authority in Taiwan, China intended to embrace and encourage Taiwan’s opposition parties for negotiation cross-Strait issues with China. Consequently, Chen needed to create issues to maintain his own and the DPP’s political leverage in Taiwan, which pressed the DPP and Chen progressively towards China’s perception of ‘Taiwan independence’. Throughout the whole of President Chen’s first term of Presidency, there was no engaging in cross-Strait ‘official’ negotiations. The relationship between Taiwan and China was stagnant.
4.3 The Diplomatic Tug-of-War

Adhering to the ‘One China’ principle, China has sought to discredit Taiwan by isolating it at a global level by adopting whatever measures were available. The theory behind China’s action lies in the principle of state sovereignty in international relations. China perceives that the recognition of a state or a government has been commonly regarded as crucial for the sovereignty and legitimacy of that state. With international recognition, then, Taiwan will become an independent sovereign state, to be treated equally in the international arena. To negate Taiwan’s sovereignty and independent status, China argued that Taiwan should not be permitted to join the UN and ‘has no right to represent China in the international community, nor can it establish diplomatic ties or enter into relations of an official nature with foreign countries’ (TAO, 1993). China’s strategy is to squeeze Taiwan’s place within the international community by negating Taiwan’s external political legitimacy such that this will force Taiwan to surrender to China’s will (Nathan, 1996: 91).

On the basis of the same theory yet in contrast to China’s assertion, Taiwan has elaborated the means of claiming its legitimacy and the identification of its democracy in the international community (Yu and Longenecker, 1994). Given that the ability to practise diplomacy is one of the defining elements of a state, as is widely accepted under international law, Taiwan makes its best endeavours in practising diplomacy to prove its existence within international society and to claim its independent sovereign statehood.\(^3\) For Taiwan, international recognition and official diplomatic ties are

\(^3\) Widely accepted in international law, the ‘Montevideo Convention on the Rights and Duties of States’ provides the classic definition of the state. Article 1 of the Convention holds that ‘[t]he state as a person of international law should possess the following qualifications: (a) a permanent population; (b) a defined territory; (c) government; and (d) capacity to enter into relations with the other states’ (cited in Chiu, 1995a: 249). Also, Article 3 states that ‘[t]he political existence of the state is independent of recognition by the other states’. The full text of the ‘Montevideo Convention on the Rights and Duties of States’ can be accessed on website: http://www.molossia.org/montevideo.html.
valid symbols of legitimacy in the international arena. Security is the vital driving force through which Taiwan pursues international participation (Hsieh, 1996: 103). Taiwan realises that international recognition is not solely for the purpose of increasing the number of diplomatic partners, but for its own national security (Swaine and Mulvenon, 2001: 9). Without international recognition, no international voice will support Taiwan in the event of China's aggression. To some extent, Taiwan's national security depends on its own defence strength in resisting the Chinese PLA in the event of war between them. Nevertheless, world opinion can to a greater or lesser degree restrain China's behaviour. Taiwan's national security must build under the international system. According to the wisdom of international relations, countries must join in a balance of power for their respective security.

4.4 The Mechanism of Cross-Strait Trade and Investment

4.4.1 Initiation and Rationale

Since the ROC central government retreated to Taiwan in 1949, there has been no economic interaction between China and Taiwan, except for some small-scale and illegal smuggling deals that occurred in the coastal area (Lin, 1999c). The deadlock changed when China issued ‘A Message to Compatriots in Taiwan’, which on 1 January 1979 called for ‘Three Links and Four Exchanges’ with Taiwan. Although Taiwan did not respond to China's proposal, the possibility of the establishment of economic ties came into existence. There were several clear objectives in this strategy, in which political interests and economic factors were the two major driving forces behind China's attitude in the cross-Strait economic exchange.
First of all, as part of its unification strategy, Chinese political leaders had long pledged to use economic engagement as a vehicle to facilitate future Chinese unification with Taiwan (Chang, 1993: 4-5; Wheeler, 1996: 82). They believed that closer economic ties would pull Taiwan closer into China’s orbit and improve longer-term prospects for unification (Sheng, 2001: 17). Secondly, China wanted to show the world its peaceful attitude towards cross-Strait relations so as to satisfy the spirit of peaceful resolution in the communique that China signed with the US (Chang, 2002: 33). Thirdly, China perceived that a peaceful cross-Strait economic relationship could serve as a model to attract worldwide investors (Chang, 2002: 33). Fourthly, after the detrimental effects of the ten-year Cultural Revolution between 1966 and 1976, China’s economic foundations were on the verge of bankruptcy, and needed immediate reform (Yang and Wei, 1995: 319). Taiwan’s capital, technology, and well-established international economic connections with the world were what China needed, as these could help to facilitate its own economic reform (Tanner, 2007: 37).

Against such an economic and political backdrop, China initiated many preferential incentives to attract Taiwanese and Hong Kong investments, such as the first four Special Economic Zones (SEZs), intending to upgrade its industrial capacity by attracting technology from abroad (Cheng et al., 1995: 117; Henley et al., 1999; Linda and Tuan, 2001). China also proposed in 1980 to award exclusive permission for Taiwanese businesses to export duty-free to China (Naughton, 1997: 84). With this arrangement, Taiwan’s exports enjoyed less rigid import controls, in comparison with goods imported into China from other foreign suppliers (Wheeler, 1996: 82).

With the firm stance of ‘non-co-existence’ with the ‘rebel group’, Taiwan soon denied China’s proposal with ‘Three No’s’ for reasons of national security and the lack of
mutual trust (Kao, 1994a: 24; Naughton, 1997: 84; Shaw, 2003: 6)\(^{34}\). From Taiwan’s viewpoint, China’s proposal formed part of its united-front tactical and political deception through which China attempted to use economic exchange to facilitate future unification (Chang, 1993: 4-5). Taiwan was convinced that China’s initiatives to open contacts were motivated by the political objective of unification rather than for economic objectives (Jia and Shirk, 1996: 141). In this regard, Taiwan’s attitude toward establishing economic ties with China was hesitant.

This resistance altered in the early 1980s, when Taiwan experienced economic progress and political democratisation, as well as the aspiration to take a pragmatic approach to pursue Taiwan’s international place and to gain recognition in the international arena. Similarly to China’s decision-making, political concerns and economic interests provided the momentum for Taiwan’s strategy. Firstly, leaders in Taiwan believed that a growing network of economic exchange between Taiwan and China would render China a more stable and predictable entity, which would in turn contribute to Taiwan’s security by lowering the risk of armed conflict and promoting a more pluralist form of government in China (Wheeler, 1996: 83). Secondly, under the pressure of domestic political reform and increasing social movements, the government in Taiwan adjusted its foreign policy as well as its Mainland policy so as to meet the population’s aspirations to ‘reach outside’ into the world and to liberalise regulations to allow Taiwanese residents to visit relatives in Mainland China (Tanner, 2007: 37).\(^{35}\) Thirdly, in the 1980s Taiwan experienced a transformation in the domestic economic structure, accompanied by economic difficulties with respect to

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\(^{34}\) The former ROC President Chiang Ching-kuo introduced ‘the Three No’s’ policy on 4 April 1979 in response to China’s ‘three links and four exchanges’. ‘Three No’s’ refers to: no contact, no negotiation, and no concession. The full context of the ‘Three No’s’ can be accessed on: http://www.mac.gov.tw/big5/rpir136.htm, (accessed: 13/1/2006).

\(^{35}\) According to Hsiao’s research, there were 17 different social movements to emerge in Taiwan in the 1980s (Hsiao, 1990).
inflation in the costs of labour and land (Clough, 1993: 44). This economic issue had pressured the political élite in Taiwan into reconsidering the possibility of de-regulating economic relations with China to resolve economic problems and to promote economic security, on the one hand, while maintaining Taiwan's long-term position in protest the CCP, on the other. Finally, under the economic and political calculations, Taiwan was confident about taking a more open approach in dealing with China because Taiwan was in a relatively superior position in terms of its economic structure and economic performance, which could give Taiwan the leverage to dominate the direction of any economic exchange. Besides, the military threat of containment from China was generally not impossible, but had stabilised. Consequently, Taiwan gradually adopted an attitude of non-interference, allowing small amounts of exports to China since 1985 (Clough, 1993: 43).

4.4.2 Evolution and Arrangement

In the 1980s Taiwan experienced a domestic economic transformation. Between 1975 and 1985 the nominal wage rate in Taiwanese manufacturing increased at 13.7 per cent (Naughton, 1997: 87). Furthermore, foreign exchange reserves increased from $23 billion to $77 billion between 1985 and 1987, which eventually caused the New Taiwan Dollar to appreciate by 40 per cent against the US dollar in 1986 in comparison with the exchange rate in 1985 (Naughton, 1997: 88-90). With political and economic considerations, Taiwan’s stance with regard to cross-Strait low-politics engagement changed from reluctance to liberalisation. In 1985, Taiwan for the first time responded to China’s initiatives by announcing ‘New Three No’s’, which was a non-interference principle over indirect exports to China (Clough, 1993: 43; Lin, 1997: 115).
This political breakthrough officially commenced the cross-Strait economic relations, albeit in an abnormal, indirect structure. Taiwanese companies can invest in China only indirectly through subsidiaries or companies in Hong Kong.

Afterwards, Taiwan began a series of political and economic reforms regards engagement with China, which had profound impacts on Taiwan's economic and political development. The removal of the Emergency Decree in July 1987, a fundamental legal movement for cross-Strait engagement, was the real watershed in cross-Strait relations. The de-regulation in November 1987 of the earlier ban on allowing Taiwanese citizens to visit China ignited the new era of cross-Strait people-to-people 'diplomacy'. People from Taiwan had made 33,885,252 trips to mainland China to visit relatives, travel, conduct business, and engage in social exchanges and business or academic research between 1987 and 2004. Over the same period, only 1,127,732 Chinese mainlanders visited Taiwan, in which only six per cent of visits were for business purposes, and three per cent for tourism (TIER, 2005b: 39-40). Unquestionably, the asymmetric amount of Taiwanese visitors to China had boosted China's tourism and contributed considerably to China's economic development.

The de-regulation in 1987 of the controls on foreign exchange and the control of individual remittance to Mainland China were the two most determinant economic policies in Taiwan. They led to a rapid increase in outward investment to China (Lin, 1997: 175; Naughton, 1997: 102)37. Furthermore, in October 1989 Taiwan officially

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36 'New Three No's' principle of exporting Taiwanese commodities to China refers to: no direct trade with China, no contact with Chinese officials, and no interference in transit trading.
37 According to the new regulations, the remittances amount of capital below $5 million no longer needed the approval of the Central Bank in Taiwan.
lifted the ban on investment in China, although direct investment was still prohibited
(Chiu, 1995b: 148). Cross-Strait investment was promoted positively when Taiwan
deregulated the ‘Taiwan taking orders and mainland exporting goods’ business
mechanism in December 1991 (Huang, 2004: 104). This business arrangement
between Taiwan-invested enterprises in China (TIEs) and parent enterprises in Taiwan
couraged the establishment of overseas manufacturing bases and offshore
production, as well as the system of division of labour. Such investments were
primarily attracted by China’s cheap labour and the potential local market.
Consequently, the economic interdependence between Taiwan and China increased in
the content of investments, division of labour, intra-industry trade, and inter-industry
cooporation.

The ‘Regulations Governing the Approval of Investment or Technical Cooperation in
Mainland China’ (Regulations) issued in 1993 was the investment principle applied to
regulate Taiwanese investment in China (Chen, 1994a: 53-56). The government’s
principle over investment to China shifted from that of ‘not allowing direct
investment and no interference in indirect engagement’ to that of ‘restraining direct
investment and controlling indirect investment’ (Lin, 1997: 175). With this policy
reform, many Taiwanese investors have consequently shifted their attention to China
and from other ASEAN countries. China quickly became Taiwan’s top outward
investment destination, accordingly. It was interesting to note that Taiwan’s unilateral
and progressively liberated economic relations with China were in line with its own
economic interests on the basis of pursuing the economic aspect of economic security,
which in turn has accelerated the progress of economic integration with China.
However, under national security concerns, Taiwan had to initiate constrained
economic policies to mediate intensive economic linkage with China and thus to
avoid excessive economic dependence on China.

China responded to Taiwan’s unilateral economic policies, with respect to economic arrangements with China, both actively and unilaterally. To grasp opportunities released by the Taiwanese government and to attract more Taiwanese foreign direct investment (FDI), the Chinese government promulgated several regulations and laws especially designed for Taiwanese investors. In July 1988 China’s State Council promulgated the ‘Provisions of the State Council Concerning the Encouragement of Investments by Compatriots from Taiwan’ by offering special preference to Taiwanese investors unilaterally. The preferential incentives provided Taiwanese businesses with certain privileges including tax holidays, duty-free imports, land use rights, the transfer and inheritance of properties, permission to purchase bonds, and special areas designated exclusively for Taiwanese investments (PRC, 1988). With this preferential arrangement, Taiwanese investors enjoy better business treatment than other foreign investors (Cheng et al., 1995: 118). Such preferential treatment attracted as much as $0.5 billion to Taiwan’s FDI in 1988, which accounted for five times the total accumulated by Taiwanese investment in previous years (Lin, 1997: 185).

Furthermore, in order to attract Taiwanese export-oriented labour-intensive industries, the Chinese government in May 1989 assigned two investment zones, in Xiamen and Fuzhou, to develop labour-intensive industries and to improve exports (Sutter, 2002: 524). In 1994, the National People’s Congress of China adopted the ‘Law to Protect Investments by Taiwan Compatriots’ (Chen, 1994a: 53-56). This was the first law issued in China that applies to guarantee and protect Taiwanese investors’ rights and property, although not many Taiwanese investors believed that they were really under
the protection of the law.\textsuperscript{38} Four years later, in December 1999, China’s State Council issued the ‘Rules for the Implementation of the Law of the People’s Republic of China on Protection of Investments by Taiwan Compatriots’, aiming to soothe Taiwanese investors through legalisation procedures so as to encourage investment by Taiwanese businesspeople (PRC, 1999). China’s efforts to attract Taiwanese investment were evident.

4.4.3. Taiwan’s Economic Policy \textit{vis-à-vis} China


Due to hostility across the Strait after 1994, the Taiwanese government encouraged businessmen to ‘Go South’ to invest in other Asian countries rather than in China (Sheng, 2001: 102-103; Tanner, 2007: 45-47). Taiwan perceived that China had continuously used economic engagement and enhanced its strategic military capabilities and diplomatic pressure as major elements of its policy towards Taiwan. It feared that if Taiwanese foreign investment were allowed to flow unrestricted into China, Taiwan could become dependent upon China and eventually be forced into a \textit{de facto} unification under China’s economic containment. Thus, at the National Assembly on 14 August 1996, President Lee Teng-hui initiated a cautious economic policy of ‘No Haste, Be Patient, steady progress over a long term’, which aimed to redirect Taiwan’s soaring investment in China to avoid too much dependence on the Chinese market, as this would undermine Taiwan’s economic security in the context of economic growth and prosperity (Sheng, 2001: 137-138).

\textsuperscript{38} This conclusion was drawn from the author’s field trip after interviewing Taiwanese businesspeople in China in 2004 (Interviewees: E3, E8, and G1).
The NHBP economic approach was a product of political and economic considerations aimed at preserving Taiwan’s national security and economic security in the context of economic competitiveness. From the political perspective, the NHBP policy aimed to tackle China’s statecraft of ‘exploiting business to press politics’ and ‘utilising the public to urge the official’ to prevent Taiwan from being driven passively to the negotiation table (MAC, 1998a: 568). From the economic perspective, the policy aimed to prevent Taiwan from a form of industrial ‘hollowing out’ by constraining its investment in high technology areas in China and therefore ‘retaining business roots’ in Taiwan. From the government’s perspective, scrutiny into major investment into the high-tech industry was an attempt to prevent such investments from being hijacked by China and Taiwan from becoming a ‘political puppets’ of China (Nystedt, 2001). It was believed that to slow down the China investment fever displayed by local businesses could prevent Taiwan from over-dependence on China, and this could safeguard Taiwan’s economic security.

The policy had been embodied in May 1997 by the stipulation of new regulations governing investment in terms of the level of risk. The policy includes: first, no restriction on investment to areas outside China. Second, the differential management towards investment to China, such as (a) no restriction on labour-intensive industry (if lower than $50 million); (b) the special arrangement and assessment for those domestically-oriented investments (if higher than $50 million); (c) bans on all investment in China’s infrastructure; and (d) to formulate some policies to control the externalities due to the investment in China (such as the law of political contribution) (Hsia, 2006: 89). In brief, the investment policy discouraged projects that were greater than $50 million in value, involved higher technology, or were aimed at developing the Chinese infrastructure. It aimed at preventing Taiwan’s core industries, especially
the backbone high-tech industries, from relocating to China and thus causing a 'hollowing out' effect on the country's industry and capital.

With the self-constrained economic policy, a top-down itemised list to regulate economic transactions and investment with China had been set. All projects of investment and technical cooperation in China were subject to the Regulations and under the approval of the Investment Commission (IC). The IC checked both the project amount and items of investment in accordance with a top-down list set by the Ministry of Economic Affairs (MOEA). By September 1999, a total of 6,658 items had been classified as permitted. Only 342 items were prohibited from investing in China (Chiu, 2000: 131-133). In comparison, 3,900 items in 1993 and 2,500 items in 1990 were permitted to invest in China (Lin, 1997: 175-176). The permitted investment categories were enlarged. From this point, it was clear that the policy was not intended to control or terminate economic relations with China, but gradually to open these up in line with Taiwan's economic capacity and preference for economic security ends.

Although the investment policy had little impact on small- and medium-sized enterprises (SMEs) in Taiwan, the government had required firms to register in advance their potential investment in China. For those violators who failed to follow the rules, penalties with fines of up to NT$15 million and a maximum jail term of five years was set, according to 'Statutes Governing Relations between the People of Taiwan Area and Mainland Area' (Statutes). To some extent, these penalty measures had confirmed the fact that Taiwanese companies and investors had long been finding ways to manoeuvre around Taiwan's ban on direct engagement with China. Before the regulation of the penalty came into effect, the Taiwanese government had granted
businesspeople an opportunity to register their previously unregistered investments, in the form of temporary amnesty, according to the revision of the Statutes on 14 May 1997. As a result, the official number of new outward FDI cases in 1997 and 1998 were biased upwards (see Table 4.2). However, measures for the mandatory registration of investments in China have had little effect on companies who skirt the law by setting up holding companies and transferring investment money directly from overseas accounts into China.

Overall, this policy had a very short-term effect on halting Taiwanese investment in China. In 1996 the total number of approved investment cases to China decreased for 21.8 per cent, but the total amount of investment increased by 12.5 per cent compared to the same period in the previous year (see Table 4.2). Businesspeople followed their own rules in making investment directions. Thus this economic policy did not significantly slow down their pace of investment in China. After the 1998 Asian financial crisis, the 'Go South' investment policies were generally less attractive. Taiwanese investment in China grew speedily in 1999 with a year-on-year growth rate of 13.2 per cent, according to China's statistics (see Table 4.2). Moreover, the policy had little effect on cross-Strait trade exchange either, which retained an upward tendency. From 1991 to 2000, the total amount of two-way cross-Strait trading had reached $206.97 billion, according to MAC's estimation. In 2000 alone, cross-Strait trading reached $31.23 billion (see Table 4.3).

The NHBP economic policy governing investment in China had not only failed to constrain outflow investment to China as it had been designed to do, but also met with much complaint from business circles when China gradually became a popular destination for investment. Given the NHBP investment policy and its cap of $50
million on any single investment in China, Taiwanese business conglomerates faced considerable difficulties over capital funding in Taiwan when they intended to expand the scale of their investment in the Chinese market. Gradually, many business people called for the government to relax its investment policy towards China as soon as possible so as to enable them to make meaningful investments in China (CNA, 2000; GIO, 2001e). Furthermore, many powerful business leaders in both traditional and advanced high-tech industries called for the government to de-regulate three direct links (TDL) and to self-constrain economic policies in order to boost Taiwan's economy. For example, Wang Yung-Ching (Chairman of the Formosa Plastics Group), Tsai Wan-Tsai (Founder and Chairman of the Fubon Group), Ho Show Chung (Chairman and CEO of the Yuen Foong Yu Group) and Chiao Ting Piao (Founder and Honorary Chairman of the Walsin Lihwa Corporation) paid a visit to the Presidential Residence to suggest that President Chen review the NHBP economic policies; the deputation aimed to call for government relaxation of mainland economic polices (Jian, 2000; Lin, 2000b).

(b) ‘Proactive Opening with Effective Management’

The NHBP self-constraint policy lasted for five years before Taiwan removed the cap of $50 million on individual investments to China in 2001. Three imminent reasons pressured the Taiwanese government to adopt a more open policy toward China. Firstly, Taiwan had fallen into political uncertainty brought about by the stunning results of the change in ruling parties in 2000. Political friction between the ruling DPP government and opposition parties spiralled, which stripped economic confidence in the country. Because of the political uncertainties, the Taiwan stock market plunged by 47.68 per cent during the period between Chen’s inauguration on 20 May 2000 and 30 October 2000 (Lin, 2001a: 21). Real estate prices declined, and
domestic banks held huge amount of overdue loans. A massively wave of capital was flowing out of Taiwan and into China (Hsu and Tang, 2001a). All of those economic pressures forced the inexperienced, newly-formed government to adjust its economic polices toward China.

Secondly, World Trade Organization (WTO) entry was another reason for Taiwan to adjust its NHBP policy (Peng and Wang, 2003: 139-151; Liu, 2004: 1). After both Taiwan and China were included in the WTO trade system, the cross-Strait economic and trade policies were subject to WTO institutions. Given that WTO rules are against both member states’ discriminating against specific countries, and the applicability of clauses allowing the exclusion of certain countries from the principle of treating all member states on an equal mutually beneficial basis, the NHBP policy is incompatible with the spirit of the WTO.

Thirdly, the relaxation of restrictions on the economic policy served a political purpose (Lyne, 2001). The openness of the management economic policy towards China was announced to take effect coincidentally just before Taiwan’s election of legislators held on 1 December 2001. Given Taiwan’s sluggish economic performance and record unemployment in 2001, the ruling DPP utilised this cross-Strait economic policy to boost the public’s economic expectations and to gain support from business sectors in an attempt to win the parliamentary election. This campaign strategy has proved to be a success when the DPP won 87 seats and became the majority party in Taiwan’s Legislative Yuan. The victory reinforced President Chen’s pragmatism in manoeuvring economic issues for political ends.

The idea of ‘Proactive Opening with Effective Management’ (POEM) to guide the development of the cross-Strait economic engagement was first initiated in Present Chen’s 2001 New Year message. Nevertheless, the new POEM economic policy, which decided to liberalise the ‘westbound’ investments to China, was publicised officially after the Economic Development Advisory Conference (EDAC), concluded on 27 August 2001 (Chen, 2001d). The POEM policy was a general consensus of the EDAC, which emerged between the government and the business community, for a phased liberalisation of cross-Strait trade and investment. Among many suggestions concluded in the EDAC, 36 items were regarding cross-Strait economic ties that had constituted the important frame of reference for programming cross-Strait economic policies (Shaw, 2003: 80-83).

The POEM approach to cross-Strait economic relations focused on improving the scrutiny of capital from China and on regulating the import of mainland commodity goods, especially agricultural, energy and strategic imports (Leng, 2002: 265). In order to comply with WTO commitments, the cross-Strait direct trade had been legitimised. However, indirect shipment (i.e., where the goods are transported through a third territory) is still mandatory. A top-down list of import/export products and items of investment was replaced by a new and negative list, listing only those items that were not allowed to invest in China and those were prohibited to be transacted. For imports from China, two requirements were essential criteria for allowing their import into Taiwan. Firstly, imports may not endanger national security. Secondly, imports may not have any serious negative impact on related

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40 For a conclusion report regarding cross-Strait matters issued by the cross-Strait working group of EDAC, see MAC (2004c: 25-28).
41 Trading activities between the Taiwan Area and Mainland Area can be executed in a direct manner, whereby the buyers or the sellers can be the traders in the Mainland Area.
42 Article 8, Regulations Governing Permission of Trade Between Taiwan Area and Mainland Area, (Amended on Aug 26, 2003).
domestic industries. According to such criteria, increasing amounts of Chinese products were allowed to be imported into Taiwan. For example, by the end of February 2005, only 2,384 items of Chinese products, or a share of 21.7 per cent of total Chinese commodities, were in the list of negated imports (BOFT, 2005).

For investment in China, the POEM approach includes several new sets of measures designed to resolve the anxiety of industrial ‘hollowing-out’ and to promote continuous industrial upgrading (Hsia, 2006: 92-93). Firstly, investment or technical cooperation projects in China carried out by individuals and organisations or other institutions of Taiwan were classified into two categories: general, and prohibited. Secondly, Taiwanese entrepreneurs were allowed to make investment in China, except in those industries that might undermine Taiwan’s national security. Thirdly, the $50 million ceiling on individual investment in China was scrapped. It was replaced by a new formula that depended on the status and business scale of investors. However, a singular investment of over $50 million was continuously under review for approval by the IC on a case-by-case basis. Fourthly, there was no need for an investment project in China of under $20 million to be subject to permission by the IC, although it still needed compulsory registration. Fifthly, a negative list of investments in China, issued by the MOEA, included 436 items of agricultural products and 102 other manufacturing investments that had been put onto a negative list. Sixthly,

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43 The new cap of total accumulated investment amount into China is subject to a company’s total pay-in capital, which was no more than 40 per cent of the company’s total net asset value. Companies with a net worth of below NT$5 billion can invest up to 40 per cent of that amount in China. The limit is 30 per cent for companies with a net worth of up to NT$10 billion. For individual investors and SMEs, the accumulated amount of investment is $80 million (MAC, 2004c: 42).
44 If they did not register before conducting investment, investors (companies or individuals) would be suffer a penalty, in line with Article 86 in the revision of the Statutes amended on 1 March 2004.
45 Originally, there were only 231 items of agriculture on the list with permission, while 13 items and 1,268 items were on the lists of prohibition and of special reviewing projects, respectively. According to the new regulations, 1,076 items and 436 items had been placed in ‘general’ and ‘prohibition’ categories respectively (Han, 2002).
Taiwan-based banks and financial institutions such as security companies and insurances companies were allowed to invest in China. Seventhly, under the new provisions, international financial institutions with branches handling financial exchanges between the two sides could exchange directly.\(^46\) Finally, some investment categories of high-tech projects, such as semi-conductors, and infrastructure, such as the construction industry, have gradually been liberalised.

In summary, such openness in management policy showed the government's efforts to boost a slumping economy and to adjust existing economic regulations in order for them to correspond to those required for Taiwan's accession to the WTO in 2002. The government hoped that to relax restrictions \textit{vis-à-vis} China would help to restore the economic health of many ailing Taiwanese firms. Meanwhile, from the political perspective, Taiwanese political leaders also realised that it was impossible to stop the rising trend of Taiwanese investment in China. A relatively loosening policy towards China may help them to win political support from the business community. Furthermore, the DPP government needed to create issues that would push China to arrange ARATS to return to the negotiation table with SEF in order for them to discuss precisely these economic-related subjects. Therefore, the reason for Taiwan to adjust its economic policy towards China was under complicated political and economic considerations that lay within the capacity of Taiwan's own leverage and movement.

In comparison to the backdrop of the two economic policies when the Taiwanese government formulated them, the NHBP approach was released in the wake of

\(^{46}\) The revision of 'Measures Governing Banking Sector's Correspondence between the Taiwan Area and the Mainland Area' was approved by the Executive Yuan (ROC) on 30 May 2001.
political tension across the Taiwan Strait. China deployed six waves of military exercises and missile tests in the Taiwan Strait during the period of 1995 to 1996. Diplomatically, China took more rigid measures to suppress Taiwan’s international engagements and sovereignty at that time. Against such a background, the NHBP economic policy was in nature one of retrenchment (Hsia, 2006). The POEM economic approach was relatively slack in terms of regulations over the ceiling of the amount permitted in investment in China and the trading categories. The policy was formulated while Taiwan was in the stage of changing its ruling regime from the KMT to the DPP and, simultaneously, in the process of gaining access to the WTO economic regime. Furthermore, China’s attitude towards the DPP was in fluctuation, which gave President Chen the political space to pursue benign political as well as economic relations with China. The principle of national security and the priority of sustainable economic development are, however, still at the core of the economic policy. The government in Taiwan formulated towards China economic policies lying within Taiwan’s capacity to exert economic sovereignty under its freedom of choice and freedom of action.

4.5 Conclusion

This chapter has introduced Taiwan’s security within the context of cross-Strait rivalry from the perspectives of political, military, diplomatic, and economic factors. Within the introduction, the chapter has illustrated the case of how a small country (Taiwan) engaged for reasons of its own national security with an obvious power state (China). A careful review confirmed that the way in which Taiwan has pursued national security concurred with the evolution of the concept of security in international relations. Taiwan relied on the international balance of power, generally from the US,
and its self-help defence capability, as well as an economic security strategy. Despite the fact that military security still holds an important status in the security agendas of nations, Taiwan realised that security might not necessarily be achieved only through the force of violence. Peaceful means, such as economic engagements, can be an alternative security policy choice. Meanwhile, the health of the economy is also crucial to the national security agenda. Given Taiwan’s disadvantaged international status, sustaining Taiwan’s national economic strength is crucial not only to helping ensure continued economic growth and, therefore, society’s welfare. It is also a key to Taiwan’s external manoeuvrability, and towards helping counter the country’s relative political and security weaknesses generated by China’s diplomatic moves intended to isolate Taiwan internationally.

Fundamentally, Taiwan’s security problem is largely as a result of rivalry between Taiwan and China within the context of the issue of sovereignty: the utmost objective of national security. The cross-Strait rivalry originated with the Chinese civil war. Both Taiwan and China have struggled for their respective legal identity and sovereignty ever since. Taiwan’s legal identity and sovereignty is what Taiwan strove to uphold, while China endeavoured to negate it. This issue has not only caused the outbreak of cross-Strait military confrontation. It has also trapped the two parties in an apparently unending diplomatic tug-of-war. China has adhered to the ‘One China’ principle and persistently striven for unification with Taiwan by taking all possible measures to isolate Taiwan from the international community. In a form of defensive action, Taiwan has formulated a policy of ‘pragmatic diplomacy’ by which Taiwan uses various tools at its disposal, primarily financial, to generate greater international support and influence. This economic security policy has helped Taiwan develop its diplomatic relations with the rest of the world in order for it to maintain its de facto
In the economic domain, the two sides of the Taiwan Strait have reached flourished in both progress and advantage, despite the fact that economic ties are subject to political constraints. The motivation for them to enter into an economic engagement came through careful economic and political considerations, aimed at achieving the utmost objective of national security. The strong political ideology and the national security agenda have dominated the development of the cross-Strait economic engagement. Given that national security concerns had been emphasised, the cross-Strait economic and trade linkage were the product of a political manoeuvre on the basis of a division of China. The major objective of Taiwan’s self-constraining NHBP and POEM economic policies were to safeguard Taiwan’s economic interests and to defend its national security.

The economic integration between Taiwan and China was encouraged by both governments’ economic policies, yet suppressed by unrest and cross-Strait political hostility. The fundamental reason for these is found in Taiwan’s legal identity and sovereignty, constituting Taiwan’s national security. Therefore, the cross-Strait economic significance has not been strong enough to persuade China to renounce the use of force towards Taiwan, nor could China’s aggressive suppression of Taiwan’s international position be changed. This reason provides the final verdict that the intensive and massive economic exchange between Taiwan and China is in itself insufficient to prevent military confrontation. Economic integration will never be an adequate condition for thwarting aggression. On the other hand, although political interference has been a crucial factor and has hindered the normal economic exchange between Taiwan and China, the pursuit of the economic dimension of security has
remained the most fundamental motive for the progress of cross-Strait economic integration. This has provided an answer to why economic relations can indeed develop in the context of political hostility. Upon this foundation, economic measures become an important element utilised by Taiwan in its pursuit of national security in the context of rivalry with China.

Within the introduction of cross-Strait rivalry, the chapter has demonstrated Taiwan's effort to utilise economic power within its capacity to pursue its national security agenda within the context of cross-Strait relations. On this point, it has confirmed that a small state could also formulate economic security policies with which it could pursue security ends in accordance with both its respective national economic potency, and its specific internal and external security challenges. However, the gap in our knowledge about to what extent and with what limitations Taiwan can successfully employ an economic security policy while facing China's hostility in both international and domestic level requires further research. The growing economic ties with China have provided Taiwan with a ground on which to formulate economic security policy, on the one hand, while it has also complicated Taiwan's security environment. In this respect, the economic dimension of a security agenda is also crucial to Taiwan's survival. Given the above concerns, a case study of Taiwan's economic security will be discussed in the following chapters in order to supplement the current level of knowledge of how Taiwan pursues economic security within the context of cross-Strait antagonism.
CHAPTER FIVE

METHODOLOGY

5.1 Research Hypothesis and Research Method

The aim of this research is to examine the concept and the development of economic security within the realm of international relations, as well as to argue that economic security is an important means through which a state may achieve its national security agenda. To attain this specific research objective, the current research was designed so as to choose Taiwan as the case study through which to explore and verify the concept explored in the previous literature review chapters. Against the background of the notion of economic security as submitted in Chapter Three, the following case study argues that economic security is a form of protective barrier that Taiwan has erected in the pursuit of Taiwan’s national security agenda in the context of cross-Strait antagonism. Nevertheless, as analysed in Chapter Four, Taiwan’s security is deeply and extensively subject to its relations vis-à-vis China with respect to political, diplomatic, and economic factors, given the long-lasting political hostility and potential military confrontation as well as the speedy growth of economic ties between Taiwan and China. Moreover, providing that immense and intensive cross-Strait economic ties have thus far failed to persuade China to renounce the use of force towards Taiwan, nor could China’s aggressive suppression of Taiwan’s international position be changed, the task for Taiwan to pursue national security through economic security policies is disputed. Against such a paradox, the case study aims to examine how and to what extent Taiwan can apply economic security policies and measures while it faces relative political and security weaknesses generated by
China’s diplomatic moves to isolate Taiwan internationally.

Against this background, this case study intends to address three categories of questions. Firstly, how large is the cost to Taiwan of pursuing economic security vis-à-vis China, and what is Taiwan’s capability to afford the cost? Secondly, what factors would contribute to or undermine Taiwan’s efforts in practising economic security, and to what extent? Thirdly, do cross-Strait economic ties strengthen or weaken Taiwan’s economic security with respect to its economic performance, and to what extent?

The case study focuses specifically on the relations between Taiwan and China as the background against which to distinguish Taiwan’s national security concern vis-à-vis China, and to explore how Taiwan utilises economic security measures in fulfilling its respective national security agenda. The research period is set between 2000 and 2004, during Chen Shui-bian’s first term of Presidency. The case study will adopt the qualitative research approach in order to construct an understanding from the experiences, meaning, and significance of the events. The narrative format is developed to present related events in an unfolding account with the relevant acts of the protagonists. Quantitative records and qualitative materials including diaries, archives, documents, oral history, and anecdotes will be used as supporting material in the research. An investigation of the documentary evidence and the historical research approach will be adopted as the major technique for analysis.¹ The value of the historical research approach rests in the fact that it can contribute to understanding the current cross-Strait relations by examining the past events in which these originated.

¹ Historical research is a ‘process of systematically searching for data to answer questions about a past phenomenon for the purpose of gaining a better understanding of present institutions, practices, trends, and issues’ (Gall et al., 2003: 514).
This background to cross-Strait relations constitutes the knowledge necessary to the fulfilment of the research aims.

5.2 The Research Design for the Case Study

With the given definition of economic security and the aforementioned hypotheses, this case study examines Taiwan's economic security vis-à-vis China from three perspectives. Firstly, it analyses how Taiwan has employed economic power to construct its national security within the international system. This section discusses the extent to which Taiwan has successfully utilised economic measures for economic security ends in the diplomatic arena. It also aims to explore the effectiveness and limitations of Taiwan's effort towards economic security vis-à-vis China. Secondly, it examines how Taiwan has utilised economic measures to resist China's political and economic influence. This section concentrates on the extent to which China has utilised politics and military force to influence Taiwan's security and interests. Taiwan's utilisation of economic measures to resist China is also carefully analysed. Thirdly, from an economic perspective, it examines whether Taiwan's economic security objectives, in the context of its capability of sustaining economic prosperity, have been enhanced when it has engaged in economic exchange with China, given the uneasy situation of cross-Strait political hostility. This section focuses on cross-Strait economic exchange and on issues that raise concerns.

The research period focuses on that between 2000 and 2004 for three significant reasons. Firstly, in 2000 the pro-independence Democratic Progressive Party (DPP) won the Presidential election and Taiwan entered a new political age. The change in Taiwan's political atmosphere has to a certain degree affected cross-Strait relations.
Such a political background provides a motivating point for the research. Secondly, in 2001, Taiwan experienced for the first time since 1952 negative economic growth (of -2.2%). The impact on Taiwan's economic development of the cross-Strait economic linkage has become essential to surveying the extent of its economic security. Thirdly, China and Taiwan both entered into the World Trade Organization (WTO), in November 2001 and January 2002, respectively. Taiwan and China should, in theory, construct their economic engagement in accordance with the norms and regulations set by the WTO trade regime. Bilateral economic interaction within the international institutions can offer valuable information towards gaining an understanding of the extent to which international institutions and norms can facilitate the fact of political rivalry leading ultimately towards cooperation. Since this research is based on the belief that security may not necessarily be achieved only through the forces of violence, the cross-Strait political-economic contradiction in this period provides a solid framework within which to explore the author's specific research aims.

The research examines the economic and political implications of Taiwan's economic security in the context of cross-Strait political and economic engagement. It is a qualitative study that depends on documentary evidence rather than on statistical models. Given cross-Strait political hostility over a period of years, many government documents issued by either Taiwan or China regarding the other party generally contain each government's rhetoric and propaganda. Therefore, field work and qualitative interviews are adopted as part of the research method to collect information for the research. To collect information and data on cross-Strait relations and Taiwanese investment in China in the context of Taiwan's economic security, interviews were arranged with Taiwanese scholars and officials, Taiwanese businesspeople in China, Taiwanese professionals in China, Chinese scholars and
Chinese officials. The qualitative interview focuses on collecting primary data from the perspective of each interviewee and on verifying selected secondary information. Moreover, a field trip to China and Taiwan provided the author with the opportunity to experience and to observe research targets personally and directly.

Furthermore, this research has also drawn on bodies of literature, such as previous academic research articles, government statements, news reports, and also publications of academics in the Chinese language in order to achieve a comprehensive understanding of the specific research topics. Although some Western academics might regard most of the Chinese sources as part of Beijing's propaganda tools, it is equally important to note that these Chinese publications are significant in that they can provide the Western reader with insights into the Chinese mindset. Bodies of literature were carefully classified, sorted, analysed, cross-referred, and utilised.

5.3 Interview Design and Implementation

To collect information and data the author conducted field trips to China and to Taiwan between June and August of 2004. The purpose of the field trip was four-fold. Firstly, conducting interviews was the primary task of the field trip. In China, the author conducted interviews with Chinese scholars, Chinese officials (incumbent and retired) in charge of Taiwan affairs, and Taiwanese businesspeople in China. In Taiwan, the author interviewed scholars, officials, and businesspeople with investments in China. Secondly, the field trip helped towards acquiring a better understanding of the actual situation and environment of China as well as of Taiwan. The field trip to China helped the author to fill the gap between real life in China, and
the perceptions and impressions gained from books and the media. Although the short period in which eight Chinese cities were visited was sufficient for the author to gain only a superficial notion of circumstances in those cities, the field trip nevertheless assisted the author to establish a well-founded and first-hand concept of cross-Strait relations, rather than only through others’ report, in whatever form. The field trip to Taiwan provided a fresh view on Taiwan’s politico-economic developments. Thirdly, during the field trip to China and Taiwan, the author collected many Chinese books and articles, including China’s official statements, Taiwan’s official statements, and newspaper and journal articles, none of which are available in the United Kingdom. Consequently, the three-month field work was fruitful. Fourthly, the crux of cross-Strait relations and Taiwan’s economic security is closely related to China’s policy towards Taiwan, as well as to investments of Taiwan-invested enterprises (TIEs) in China. Thus, personal visits to TIEs in China helped the author to grasp some insider knowledge of how TIEs function in their businesses in China.

The purpose of conducting interviews is generally to satisfy three objectives. Firstly, it is an effort to collect first-hand information from a number of individuals. A list of questions has already been designed in advance. The author collected interviewees’ ideas and opinions with regard to those questions. Secondly, interviewing is an effort to verify second-hand information. Extant bodies of literature and news reports are all second-hand information. In some cases, conflicting arguments have appeared in various articles. Besides, unintentional personal sentiments or designated purposes may have been melded into arguments, and this may cause distortion of the facts. Furthermore, given the political hostility across the Strait, some media information has only illustrated a one-sided opinion or is designed to smear the counterpart on the other side of the Strait. Consequently, interviews can help to clarify the above issues.
Thirdly, because the identities of the interviewees ranged among Chinese scholars, Chinese officials, Taiwanese scholars, Taiwanese officials, and Taiwanese businesspeople in China, the opinions of all of these regarding certain specific questions or aspects of questions can be submitted to cross-referral.

The method of selecting the interviewees followed two principles. First of all, interviewees must have been involved in the development the concept of Taiwan’s economic security. For example, scholars’ research expertise is related to cross-Strait engagements, while officials are or were in charge of cross-Strait affairs. Business representatives are those who have investments or who themselves work in China. Secondly, due to the fact that China is a very large country with a huge territory, it was impossible to visit many cities within a short period of time. Therefore, some cities significant for their relevance and where many Taiwanese businesses have gathered were arbitrarily chosen as those to be visited. Consequently, the author visited Beijing, Jinan, Zhenjiang, Nanjing, Shanghai, Hangzhou, Ningbo, and Chengdu. Beijing is the capital city of China, while Shanghai is China’s financial centre. Jinan is one of the cities included in the Bohai Rim Economic Circle (the economic area encircling Bohai Bay) that has attracted considerable Taiwanese, as well as Korean investment. Chengdu is one of the cities in China’s Great West, located almost in the middle of China geographically. It has attracted many new investments in more recent years since the start of the Chinese government’s economic incentives for international and domestic companies to move there through

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2 Although the author tried to establish a field trip to some cities in the Pearl River Delta, two reasons made my trip impossible. Firstly, none of the picked TIEs accepted the request to be interviewed by the author. It seemed that those TIEs had a far stronger reluctance to agree to be interviewed after Taiwan’s Presidential election. Secondly, health considerations formed another reason. Due to the fact that Severe Acute Respiratory Syndrome (SARS) originated in that area, a trip to certain cities constituted too high a risk.

3 The Bohai Rim Economic Circle is believed to become a new economic engine for the country in the near future.
its 'Go West' initiative. The other cities are included in the Yangtze River Delta, which has attracted almost half of Taiwan's total authorized investment.

The decision-making regarding the selection of the interviewees was the most difficult element of the entire design of the interview process. Firstly, it was impossible to conduct a large-scale interviewing because of the factors of time and budgetary limitations. Secondly, given China's political control, it was impossible to conduct a general survey without the government's permission. Besides, such a large scale of survey as many have been desirable was highly likely to be viewed as an intelligence effort conducted for the purposes of espionage in China. This may have created for security problems both the interviewees and the author. Thirdly, many TIEs in China were unwilling to participate in interviews because they preferred to maintain a low profile, especially after Taiwan's 2004 Presidential election. The TIEs had fears, probably not unfounded, that an inaccurate interpretation of the opinions expressed their interview would possibly endanger their personal security and may, too, undermine their business interests in China. Fourthly, some scholars in major think-tanks and universities in China may agree to be interviewed only when their respective administration offices afford permissions. Such considerations served to fill the interview arrangements and travel plans with uncertainty.

Given the difficulties illustrated above, the author first collected members' address books issued by the Association of Taiwanese Investment Enterprises in China,

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4 Steven Mosher was one of the first Western anthropologists to be allowed unrestricted study in a rural village in south-east China. He was, however, listed as a persona non grata and expelled by the Chinese government after he revealed China's one-birth policy and documented the attendant horrors in 1983 (Zagoria and Despard, 1983/84: 474).

5 For example, American scholar of Chinese origin Lee Sha-min was declared guilty and expelled by the Chinese government. China accused Lee of prying for intelligence information (RMB, 2001).

6 On this point, Interviewee 13 warned the author of such a situation before the author proceeded to China.
located in the cities that were selected. The author then randomly picked TIEs and wrote letters to them requesting interviews. When the list of interviewees of TIEs was confirmed, the author then started to contact scholars and officials. The interview list was finalised after intensive contact through letters, emails, and telephone calls. In spite of the fact that some interviewees cancelled interview arrangements at the last minute after the author had already arrived the city where they were located, the author conducted a total of 43 interviews in China. It was worth noting that several interview arrangements were under the assistance of local-level government officials in the Taiwan Affairs Office (TAO). As one Taiwanese businessman told the author during the interview, he would not have accepted my invitation to interview had arrangements not been made through the local TAO (Interviewee: G1). In addition, some interviews with scholars and TIEs were attended by the assistants of Chinese officials. In Taiwan, the interview arrangement was much easier, yet the author conducted only seven interviews in Taiwan. The reason for only arranging fewer interviews in Taiwan was because Taiwan’s government policy was relatively transparent and the accessibility to government information was very high. Furthermore, the ultimate aim of interviewing Taiwanese officials and scholars was for the collection of information that was used for purpose of analysis.

As designed, each interview was conducted by the asking of a list of the ten prepared questions (see Appendix I). For their various respective reasons, some interviewees preferred to answer questions selectively. Also, some preferred only to tell the author their own viewpoints, yet not adhere to the question list. Some of interviewees could not realistically offer comments on certain questions or else they felt reluctant to answer because the list of questions covered economic and political issues. The author

7 Those assistants also made notes, as did the author.
also perceived that most of the Taiwanese businesspeople located in China showed
greater unwillingness to discuss any political issues. Some of them clearly pointed out
that they were ‘grilled’ by both governments, although their ultimate aim in China
was that of profit-making.\(^8\) Combining all of those limitations, some interviews
remained incomplete. The author had no intention of using individuals’ viewpoints to
generalise from each interview questions, thus opinion collected from all interviews
were as a result both inspirational and educational. The greatest harvest of journey
was to discover that political issues are too sensitive to discuss in China. In contrast,
economic issues were widely accepted as long as no political issues were involved.
This finding reveals that cross-Strait economic interaction is a possible channel for
Taiwan and China to manoeuvre towards negotiation.

Ten questions were designed as an interview guide in accordance with research aims,
the literature, research hypotheses, the interviewer’s personal knowledge, and
preliminary conversations in the research area. Those questions were designed on the
ground of the given cross-Strait political rivalry and high level of economic
engagement. It aims to discover the gap between the perceptions of Taiwanese
businesspeople in China and those of Chinese interviewees in order to examine the
research hypotheses.

According to the aforementioned interview design and implementation, there were in
total 43 interviews held in China, and seven interviews held in Taiwan (see Appendix
II). In this research the name of those interviewees will be withheld because the vast

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\(^8\) They mentioned that almost all of their phone calls were monitored by the Chinese authorities. For
safety reasons, it would be better not to discuss any political issues or to criticise the Chinese
government. Besides, it would be better for the interviewees not to reveal personal political preferences.
Some interviewees also pointed out that they felt extremely hurt because the Taiwanese government did
not appreciate their economic contribution; it regarded them as rebels.
majority of interviewees wished to remain anonymously. Therefore, each interviewee is given an identifying code. The reason for so doing was also under the advice of Interviewee 15. He suggested that the author withhold the identities of all interviewees in China, including Taiwanese businesspeople. The reason for keeping interviewees' real identities confidential is for the sake of the protection of the interviewees' personal security. As Interviewee 15 mentioned, despite the fact that the interviewees' opinions involved no national security information, their opinions and viewpoints could still possibly cause them trouble in the future. The reason behind his theory was the cross-Strait political stalemate. Scholar David Shambaugh held similar security considerations. He, too, withheld the name of his interviewees in order to protect his sources. (Shambaugh, 2004: xxviii).
CHAPTER SIX
THE ROLE OF ECONOMIC SECURITY IN THE
BATTLE OF DIPLOMACY

6.1 Introduction

This chapter will explore the role of economic security in the battle of diplomacy between Taiwan and China, evaluating the dynamics of Taiwan's effort in utilising economic power as a measure for its pursuit of security ends in the diplomatic arena. As was argued in Chapter Three, economic security is one of the elements in any comprehensive national security framework. This chapter examines the way in which Taiwan employs economic leverage through diplomacy in international society in the setting up of the security structure that it pursues. The aim of the present chapter is to explore how Taiwan has utilised economic power to implement its economic security strategy for the maintenance of formal diplomacy, admittance to international organisations, and the establishment of Free Trade Agreements (FTAs) within the environment of interference from China. The chapter will centre on how and at what cost Taiwan's DPP (Democratic Progressive Party) government has executed its economic security policy in the international domain to consolidate Taiwan's national security agenda. Meanwhile, the research will also examine the success and failure of Taiwan's economic security agenda, as well as its scope, durability, and implications.

The chapter will start by outlining Taiwan's international status in terms of its formal diplomatic relations and participation in international organisations. Within the discussion, Taiwan's foreign affairs agenda and objectives will also be addressed.
Following, in order to examine the extent of Taiwan’s economic security with regard to China in the battle of diplomacy, an investigation of how Taiwan uses economic power to support its diplomatic struggle vis-à-vis China will be discussed. It will focus on the economic costs that Taiwan has borne in obtaining new diplomatic ties, as well as on those states that have amended their diplomatic recognition from that of Taiwan to that of China. It aims to demonstrate that Taiwan has depended on economic power to achieve political objectives. Next, the chapter will move on to how Taiwan uses its economic power to support head-of-state diplomacy for the purposes of securing current diplomatic relations and gaining the support of allies for its national interests, such as gaining membership of the United Nations (UN) and admittance to the FTA and some other interests. Lastly, a conclusion will be drawn in accordance with the concept explored in the above sections. It will raise attention to Taiwan’s economic security policy in the diplomatic domain, and to pinpoint the challenges that Taiwan faces in the future.

6.2 The Role of Economic Power in the Diplomatic Arena

The Republic of China (ROC; hereinafter Taiwan) has been constantly engaged in a struggle with the People’s Republic of China (PRC; hereinafter China) to maintain its security and survival since its withdrawal to Taiwan Island in 1949. Although major military conflict has diminished since 1958, the struggle across the Taiwan Strait has been continuously underway in the political, diplomatic, and economic domains. Taiwan’s diplomatic position began to decompose when the world entered into the age of détente between the US and the Soviet Union obtaining since the 1960s (Hickey, 1992). The change within the international relations among major states in turn altered the balance of Taiwan-China rivalry. Such a situation further deteriorated
when the membership of Taiwan, the ROC, of the UN was substituted by that of China in October 1971. The decision of the US of 1979 no longer to recognise the ROC was the other factor that further undermined Taiwan's international status. Because of these two major events, many states switched their diplomatic recognition to China. As a result Taiwan's diplomatic allies dwindled dramatically from 68 in 1969 to 22 in 1978. In comparison, China's diplomatic partners had increased from 85 in 1972 to 116 in 1978 (Kao, 1994a: 56-58).

Taiwan's withdrawal from the UN affected not only its formal diplomatic relations with the rest of the world, but also its participation in international organisations. Without UN membership, Taiwan was in the 1980s forced to relinquish all its memberships of international organisations related to the UN, because China pressurised those institutions to act in line with the 'One China' principle (Hsieh, 1996: 68-69).\(^1\) Taiwan's memberships of international governmental organisations, including the United Nations Educational, Scientific and Cultural Organization, the World Health Organization (WHO), and the Food and Agriculture Organization, were replaced by China. At the end of 1979, Taiwan could maintain only four memberships of UN specialised agencies, namely, the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD), the International Finance Committee (IFC), and the International Development Association (IDA). However, all of those memberships were stripped in the 1980s (Hsieh, 1996: 69).

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\(^1\) Taiwan is one of the few states without UN membership. The other state is the Holy See. However, the Holy See holds UN non-member-state permanent observer status. Palestine is not a state yet, but it has held a status in the UN as an entity maintaining a permanent observer mission at UN headquarters, see UN website, 'United Nations Member States', http://www.un.org/members/list.shtml, (accessed: 4/1/2007).
While Taiwan was expelled toward diplomatic isolation in the international arena, the state experienced a period of rapid social and political change domestically. Simultaneously, Taiwan emerged as a newly industrialised economy in the international economic system. Taiwan’s total world trade volume registered as $3 billion in 1970, but $30.8 billion in 1979 (CEPD, 2005: 212). Since the 1980s Taiwan has, furthermore, been an emerging global investor and active international trader, making Taiwan ‘too big to ignore’ in the international economic arena (NYT, 1990).

According to statistical data, Taiwan was the third largest foreign exchange reserves holder in the world in 2004, after China and Japan (MOEA, 2006). Its gross national product reached $316.7 billion in 2004, the twentieth largest economy in the world (CEPD, 2005: 17). Meanwhile, according to the World Trade Organization (WTO) statistics, Taiwan’s international trade ranked in fifteenth place among both exports and imports in 2004, with an exports value of $182.4 billion and an imports value of $168.4 billion (WTO, 2005: 21). Through the momentum of economic and trade exchange, Taiwan has been able to establish diplomatic relations and unofficial substantive relations with many countries world-wide (Swaine and Mulvenon, 2001: 31). Taiwan’s economic power has produced a powerful foundation for the country to practise pragmatic diplomacy in pursuit of national security ends (Simon and Kau, 1992).

Appreciating Taiwan’s economic capability, many countries took measures by separating ‘politics’ and ‘economics’ into two distinct issues in seeking their respective balance in relations between Taiwan and China. While maintaining diplomatic relations with China, a large number of states have established trade offices or similar institutions in Taiwan. Meanwhile, they have also allowed Taiwan to establish offices in their respective countries to conduct ‘official things unofficially’
Moreover, Taiwan’s economic success in 1970s and 1980s drew much attention from Third World countries. They took advantage of Taiwan’s international aid projects, on the one hand, and also hoped to use Taiwan’s economic success as a model to develop their own, on the other (Hsieh, 1996: 70). Taiwan has introduced investment and aid to friendly countries, while those countries respond to Taiwan’s political requests. Such developments encouraged Taiwan to take more ‘flexible’ and ‘pragmatic’ strategic measures to break through its status of isolation internationally. The prime objective of such an economic security practice is to safeguard Taiwan’s national security on the global stage against China’s diplomatic containment.

The measure of economic engagement provides appropriate channels for Taiwan to connect itself with the outside world and to develop economic and trade relations for economic interests, as well as to maintain unofficial political relations and to conduct national consular affairs, such as the issuing of visas. Without economic and trade competency, it is less likely that other non-diplomatically related countries would be interested in the establishment of substantive relations with Taiwan (Chen, 2000b: 32). Taiwan can, through such pragmatic economic diplomacy, shake off its total isolation from the international community and instead become an integrated part of it.

Such a concept of ‘pragmatic diplomacy’ for pursuing substantive relations with the outside world is achieved through the realistic approach of emphasising external trade and cultural ties with states, yet without diplomatic relations. Consequently, Taiwan

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2 The perception of ‘pragmatic diplomacy’ has raised hotly debate in Taiwan’s academia in the 1990s. For an analysis on the situation through the rationale of pragmatic diplomacy, see Chao (1993); Chen (1990); Rei (1993); Lin (1996), and Lin (2000e). For literature discussing the notion of pragmatic diplomacy from the perspective of international law, see Chang (1990) and Bau (1992). From the political economy perspective, see Teng (1998). From international strategy and security, see Wong
has also adjusted its strong political ideology of 'no co-existence' with the Chinese Communists by adopting a more flexible and realistic foreign policy in the international arena, especially from the time Lee Deng-hui took administration office in 1988 (Chen, 2002). The original 'zero-sum' ideology-bound foreign policy has been adjusted pragmatically (Hughes, 1997: 130). Taiwan retained the flexibility to allow countries that intended to engage with Taiwan to choose whether or not they wanted to maintain their relations with China (Kao, 1994a: 74). In a display of such a pragmatic and flexible attitude coupled with generous offers of foreign aid, Taiwan was able to convince a number of small countries that had already maintained diplomatic ties with China, including Grenada (1988), Belize (1989), the Bahamas (1989), Guinea Bissau (1990), Lesotho (1990), and Nicaragua (1990), to accept dual recognition for both Taiwan and China between 1988 and 1990 (Lin, 1993: 773; Yahuda, 1998: 280-295).

Given that the ability to practise diplomacy is one of the defining elements of a state, as is widely accepted in international law, Taiwan makes its best endeavours in practising diplomacy to prove its existence in international society, and to claim its independent sovereign statehood (MOFA, 2006a: 15). Such a foreign policy objective is due to Taiwan's diplomatic dilemma: of its isolated situation yet its desire for a diplomatic breakthrough into the international political arena. From Taiwan's perspective, international recognition and official diplomatic ties are a delicate symbol of legitimacy in the international arena (MOFA, 2004a; 2006a: 15). To resolve the issue of Taiwan's diplomatic survival in the global community, the ruling Taiwanese leaders have to contend with their counterparts in China (MOFA, 2004a; 2006a).


3 See Chapter Four n. 33.
Security is the vital driving force for Taiwan’s pursuit of international participation (Hsieh, 1996: 103). To this end, Taiwan has little choice but to adopt alternative unorthodoxies in diplomacy to break its international isolation and to play an increasingly active role in the international arena (Wang, 1990). With economic success, political democratisation, and social stability, Taiwan is able to pursue its economic security policy for national security objectives at the international level. The practice of the economic security policy has allowed Taiwan to maintain diplomatic relations with 25 states as of 2005, and to sustain the \textit{de facto} status of an independent sovereign state in the international community (see Table 6.1).  

However, from China’s perspective, Taiwan’s efforts to establish official diplomatic ties are seen as an attempt to breach the so-called ‘One China’ policy and hence threaten China’s sovereignty (Jiang, 1995). China claims that Taiwan is part of China and thus has no independent right to establish foreign relations with other countries (CPC, 2001: 233). Thus, China has constantly tried to use various tactics to shake Taiwan’s existing diplomatic relationships and to oppose Taiwan’s participation in international activities, aiming to isolate Taiwan and to negate Taiwan’s statehood in the international area (Lee, 1990: 77). In this regard, China has requested its diplomatic partners, especially those states who had ever established diplomatic relations with Taiwan (for example, Tonga), to proclaim their recognition of ‘the Government of the People’s Republic of China as the sole legal government representing the entire Chinese people’ in a Joint Communiqué on the establishment of diplomatic relations (e.g., MFAPRC, 1998). In order to thwart Taiwan’s efforts to take any possible measures to prove its existence on the international stage, China has made public its ‘Three Alls’ diplomatic strategy - to ‘take all’ of Taiwan’s diplomatic

\footnote{For a list of Taiwan’s current diplomatic allies, see Table 6.4.}
allies, 'block all' of Taiwan’s international channels, and 'squander all' of Taiwan’s bargaining chips for dealing with China on an equal footing – formulated toward Taiwan in 1998 (NSC, 2006: 49; MOFA, 2006a: 8).

Table 6.1 Number of Diplomatic Allies of the ROC, 1999-2005

<table>
<thead>
<tr>
<th>Area/Year</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Pacific</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>4</td>
<td>5</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>Africa</td>
<td>8</td>
<td>8</td>
<td>8</td>
<td>8</td>
<td>7</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td>Europe</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Central and South America</td>
<td>14</td>
<td>14</td>
<td>14</td>
<td>14</td>
<td>13</td>
<td>13</td>
<td>12</td>
</tr>
<tr>
<td>Total</td>
<td>29</td>
<td>29</td>
<td>28</td>
<td>27</td>
<td>27</td>
<td>26</td>
<td>25</td>
</tr>
</tbody>
</table>


Given China’s attempts at suppression and the international political realities, the major aim of Taiwan’s employment of economic strength, coupled with orthodox diplomacy, has been to expand the horizon of international space for the country, as well as to avoid being marginalised in the international community. Taiwan maintains its economic relations with almost all of the members of the international community, including not only those states possessing diplomatic ties with Taiwan, but also those without diplomatic relations. Given Taiwan’s unique international position as a relatively rich economy holding few formal diplomatic relations with other countries, Taiwan depends upon economic instruments to keep in touch with the outside world and to build up its national security architecture in pursuit of national security, prosperity, and stability in the international arena. Utilising economic aid and bilateral economic engagement form one of the powerful pivotal strategies for Taiwan to sustain its existing diplomatic ties and to develop possible unofficial diplomatic relations with other non-diplomatically related countries (Wu, 1995; 1996a; 1996b; 1997a; 1997b).

5 According to ROC foreign policy guidelines, the protection of national sovereignty, and existence and development in the international community are the ultimate missions of foreign affairs. For details, see MOFA (2004a).
Möller, 1996). Taiwan has utilised economic prowess as a key foreign policy instrument to befriend its allies so as to win friendship and support for Taiwan’s legitimate existence in the world politics, as well as to gain support for Taiwan’s re-admission to international bodies (Wu, 1995: 26; Hickey, 1997; Chan, 1997: 39-40; Lin, 1999a: 64). Economic measures such as helping allies to establish Export Processing Zones (EPZs) and providing generous official development assistance (ODA) for humanitarian aid (in addition to providing covert aid through confidential operations) are all performed for the purpose of consolidating foreign relations.6

Like most industrialised countries, Taiwan is a donor of aid for the purposes of economic development, military security, disaster relief, and rehabilitation. The competition between Taiwan and China for international recognition has led the two rivals to offer extensive foreign aid to Third World countries. Taiwan has operated an economic security policy through a variety of economic aid packages both overtly and covertly. Publicly, Taiwan in 1996 established the International Cooperation and Development Fund (Taiwan ICDF) as Taiwan’s official authority and the principal body to oversee Taiwan’s cooperative overseas development programmes.7 However, the history of Taiwan’s Official Development Assistance (ODA) can be traced back to 1959 when Taiwan sent an agricultural team to South Vietnam. Similarly to other states, Taiwan’s ODA also maintains a special agenda: to ‘strengthen [Taiwan’s] international cooperation and enhance foreign relations by promoting economic development, social progress and human well-being in partner nations around the

6 For literature discussion of Taiwan’s ODA, see Lin (1999a; 1999b).
7 Taiwan’s foreign aid programme rests in the decision-making process of the MOFA and the Ministry of Economic Affairs (MOEA). The two implementing arms are the Committee of International Technical Cooperation (CITC), and the International Economic Cooperation and Development Fund (IECDF). In order to consolidate the CITC and the IECDF, the Taiwan ICDF was established in 1996 as a single window for Taiwan ODA programme. It carries out ODA in accordance with Taiwan’s diplomatic strategies and acts on behalf of Taiwan’s government in its international development work (ICDF, 2005: 12-14).
The Taiwan-China diplomatic tug-of-war is a war of attrition. The two rivals employ massive economic resources, such as financial loans and financial aid, as powerful weapons to sustain existing diplomatic ties, on the one hand, and to weaken their adversary's diplomatic relationships with other countries, on the other (BBC, 2005b). The fluctuating statistic of Taiwan's official diplomatic allies reveals the consequence of the cross-Strait diplomatic tug-of-war in the international arena. Taiwan lost ten diplomatic allies and established seven new diplomatic ties during the 1990s, while it dropped three diplomatic links and established or re-established diplomatic relations with two countries between 2000 and 2004 (see Tables 6.2 and 6.3). Several states continue switching their official relations between Taiwan and China (see Table 6.3). This situation has demonstrated the harshness of the diplomatic battle across the Taiwan Strait.

Table 6.2 Countries Establish Diplomatic Ties with the ROC: 1990-2005

<table>
<thead>
<tr>
<th>Year</th>
<th>Name of Countries</th>
<th>Current Relation (Year of establishment relations – Year of termination relations)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>Democratic Republic of Sao Tome and Principe</td>
<td>Allies (1997-)</td>
</tr>
<tr>
<td>1999</td>
<td>Republic of Palau</td>
<td>Allies (1999-)</td>
</tr>
<tr>
<td>1999</td>
<td>The Former Yugoslav Republic of Macedonia</td>
<td>Severed relations (1999-2001)</td>
</tr>
<tr>
<td>2003</td>
<td>Kiribati</td>
<td>Allies (2003-)</td>
</tr>
</tbody>
</table>

Source: Edited by the author in accordance with information provided in the various editions of The Foreign Relations Yearbook, ROC, issued by the Ministry of Foreign Affairs (ROC). Those yearbooks can be accessed on website: http://www.mofa.gov.tw/.
Table 6.3 Countries Severed Diplomatic Ties with the ROC: 1990-2006

<table>
<thead>
<tr>
<th>Year</th>
<th>Country Name</th>
<th>Year of establishment relations – Year of termination relations</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>Kingdom of Saudi Arabia</td>
<td>1932-1990</td>
</tr>
<tr>
<td>1997</td>
<td>Saint Lucia</td>
<td>1984-1997</td>
</tr>
<tr>
<td>1998</td>
<td>Kingdom of Tonga</td>
<td>1972-1998</td>
</tr>
<tr>
<td>2004</td>
<td>Commonwealth of Dominica</td>
<td>1983-2004</td>
</tr>
<tr>
<td>2005</td>
<td>Grenada</td>
<td>1989-2005</td>
</tr>
</tbody>
</table>

Source: The same as table 6.2.

Since 1971, Taiwan’s prime economic security applying to its foreign policy is two-fold: to win friendship and support for its legitimate existence in world politics, and for its re-admission to membership of international bodies (Chan, 1997: 39-40; Lin, 1999a: 64). Although employing an economic security policy through economic aid as diplomatic tool is not without its defects, the fact means that the economic factor has contributed to preventing Taiwan from being totally isolated in the international arena (Hsieh, 1996: 99). With international recognition and the ability to practise diplomacy, Taiwan can maintain its capacity as an independent sovereign state in the management of its foreign affairs. On this point, it is clear that an economic security policy in the diplomatic arena is the foundation of national security in Taiwan’s case. This also explains why Taiwan elaborates upon the expansion and maintenance of official diplomatic ties with foreign countries, despite the high level of cost and the difficulties this entails.
6.3 The Battle of Diplomacy vis-à-vis China: 2000-2005

Based on pragmatic diplomacy and what it has defined to be national interests, three axes constitute the objectives of Taiwan’s foreign affairs, which are closely related to national survival and security. These are: firstly, the reinforcement and expansion of the recognition and legal status of Taiwan; secondly, its admission or re-admission to international bodies, both non-governmental organisations (NGOs) and intergovernmental organisations (IGOs), such as the UN and the WHO; and thirdly, participation in bilateral and multilateral free trade dialogues to join the World Trade Organization (WTO) and to sign FTAs with economic partners (MOFA, 2001). Such diplomatic objectives of national interest remain Taiwan’s general foreign policies in the twenty-first century, although the country has experienced for the first time in its history the transfer of power from one political party to another (MOFA, 2006a).

In 2000, Chen Shui-bian, the major opposition Presidential candidate supported by the DPP, won the Presidential campaign in Taiwan. To some extent, this was a significant step forward in the history of democratisation in Taiwan. Nonetheless, because the DPP is fundamentally opposed to unification with China, the political rivalry between Taiwan and China is as a result more severe than ever before. In this regard, the Chinese leadership has taken more aggressive action in an attempt to counteract Taiwan’s economic security policy in the diplomatic domain in order to avoid nurturing a Taiwan independence movement. The new DPP Administration has continuously struggled with China in the international arena for Taiwan’s ‘international space’ and diplomatic recognition. When President Chen Shui-bian began his first term of Presidency in 2000, Taiwan had 29 diplomatic allies (see Table 6.1). Nevertheless, five years later, in 2005, Taiwan could maintain only 25 diplomatic partnerships. During this period, Taiwan lost six recognitions; it gained
one new establishment with Kiribati in 2003 and one re-establishment of diplomatic relations with Nauru in 2005, even though Taiwan elaborately consolidated relations with existing diplomatic nations through measures such as state visits, humanitarian aid, international aid projects, economic cooperation, etc (see Tables 6.2 and 6.3). In the same period, Taiwan has also signed a joint communiqué to establish full diplomatic relations with Vanuatu in November 2004. Nevertheless, due to Vanuatu’s domestic political disagreement, the ROC-Vanuatu relations were maintained for one month only.

Although China and Taiwan have multi-billion-dollar trade relations, political ties have been largely frozen. The diplomatic war is persistently and hotly being fought between the two sides. China has tried aggressively to woo Taiwan’s diplomatic allies with money. Similarly, Taiwan also has regularly offered aid and support to gain greater diplomatic recognition from third parties. Both counterparts regularly accuse each other of using ‘dollar diplomacy’ to ‘buy’ influence and to shape allies’ political preference by pouring huge amounts of money into some of the smallest and weakest countries in the world in terms of their economic performance. For Taiwan, the prime motivation for maintaining existing diplomatic relations with existing diplomatic partners are for political purposes rather than for economic interests. The bilateral trading statistics have clearly revealed this intention. According to Table 6.4, bilateral international trade between Taiwan and its diplomatic partners is very small. Among the 25 allies, Panama was the top importer of Taiwan-made products in comparison with its other allies. However, Panama ranked as only the fiftieth largest export destination of Taiwan in 2005.8 For Taiwan, economic interests are important, yet

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they are not the core of this domain of the economic security policy. The prime objective of economic security is to sustain existing diplomatic allies and their support for re-entrance into international organisations, as well as to develop new diplomatic relations. On the contrary, China conceived the notion that ensuring a completely isolated Taiwan would be a strategy serving to strip Taiwan of its assertion of statehood (CPC, 2001: 250-252).

Table 6.4  Bilateral International Trade between Taiwan and Diplomatic Allies

<table>
<thead>
<tr>
<th>Name of Country</th>
<th>The Country's International Trade</th>
<th>Bilateral Trade with Taiwan</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total Export</td>
<td>Total Import</td>
</tr>
<tr>
<td>Burkina Faso (1)</td>
<td>431,000</td>
<td>1336,000</td>
</tr>
<tr>
<td>Gambia (1)</td>
<td>140,300</td>
<td>197,000</td>
</tr>
<tr>
<td>Malawi (2)</td>
<td>510,400</td>
<td>1,022,000</td>
</tr>
<tr>
<td>Swaziland (1)</td>
<td>1,783,510</td>
<td>1,503,820</td>
</tr>
<tr>
<td>Sao Tome and Principe (2)</td>
<td>8,000</td>
<td>38,000</td>
</tr>
<tr>
<td>Holy See</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Solomon Islands (1)</td>
<td>171,000</td>
<td>159,000</td>
</tr>
<tr>
<td>Tuvalu (1)</td>
<td>2,100</td>
<td>12,000</td>
</tr>
<tr>
<td>Nauru (1)</td>
<td>640</td>
<td>19,800</td>
</tr>
<tr>
<td>Kiribati(1)</td>
<td>17,000</td>
<td>62,000</td>
</tr>
<tr>
<td>Marshall Islands (3)</td>
<td>46,000</td>
<td>96,000</td>
</tr>
<tr>
<td>Palau (1)</td>
<td>5,882</td>
<td>107,300</td>
</tr>
<tr>
<td>Belize (1)</td>
<td>205,070</td>
<td>514,110</td>
</tr>
<tr>
<td>Dominican Republic (2)</td>
<td>6,132,500</td>
<td>9,613,900</td>
</tr>
<tr>
<td>Guatemala (2)</td>
<td>5,380,820</td>
<td>10,492,560</td>
</tr>
<tr>
<td>Paraguay (2)</td>
<td>1,687,820</td>
<td>3,251,420</td>
</tr>
<tr>
<td>St. Vincent and the Grenadines (1)</td>
<td>34,000</td>
<td>200,000</td>
</tr>
<tr>
<td>Costa Rica (2)</td>
<td>7,021,000</td>
<td>9,806,700</td>
</tr>
<tr>
<td>El Salvador (2)</td>
<td>3,390,000</td>
<td>6,766,000</td>
</tr>
<tr>
<td>Haiti (2)</td>
<td>390,700</td>
<td>1,471,000</td>
</tr>
<tr>
<td>Nicaragua (1)</td>
<td>857,900</td>
<td>2,595,000</td>
</tr>
<tr>
<td>Saint Christopher and Nevis (3)</td>
<td>77,000</td>
<td>195,000</td>
</tr>
<tr>
<td>Honduras (2)</td>
<td>1,694,600</td>
<td>4,483,500</td>
</tr>
<tr>
<td>Republic of Panama (2)</td>
<td>963,770</td>
<td>4,155,290</td>
</tr>
</tbody>
</table>

Note: Because the availability of information is different in every state, above figures are collected from different years. There are three different year-combinations for 'The Country's International Trade' and 'Bilateral Trade with Taiwan'. (1): stands for 2004/2005; (2): 2005/2005; (3): 2003/2005.

6.3.1 Economic Security Deployment for Gaining New Alliances

As Taiwan’s Foreign Minister Tien Hung-mou outlined in 2000, the government would use democratic and economic achievements as the axes upon which to base the achievement of the objectives of a national general diplomatic policy (Tien, 2000). States establish diplomatic relations on the basis of mutual interests and their respective national agendas. In Taiwan’s case, the establishment of diplomatic relations with foreign states brings more political implications than economic significance. During the period of 2000 to 2005, Taiwan successfully established diplomatic relations with Kiribati and resumed diplomatic ties with Nauru. Given that these two states have far lower GDPs in terms of purchasing power parity (PPP) than does Taiwan, Taiwan provides economic aid to them while they recognise Taiwan’s statehood and in return support Taiwan’s applications for re-admission to the UN and WHO.9 The economic security effort for the establishment of diplomatic ties with those states is not for economic interests, but for political objectives.

(1) Kiribati

Kiribati is the first positive result that the DPP regime has reached in the diplomatic tug-of-war vis-à-vis China. On 7 November 2003, soon after Kiribati’s President Anote Tong came to power, he decided to accept the proposal of ‘dual recognition’ over the ‘two Chinas’ and established relations with Taiwan. President Tong announced publicly that economic development was Kiribati’s priority, thus he hoped to keep relations with Taiwan and China for the sake of Kiribati’s economic development (SIFY, 2003). Under its rigid ‘One China’ policy, China refused to allow ‘two Chinas’. It announced the cessation of diplomatic relations with Kiribati

9 According to World Factbook issued by the CIA, the GDP per capita in terms of PPP of Kiribati, Nauru and Taiwan are estimated as $2,700 (2004 est.), $5,000 (2005 est.), and $29,000 (2006 est.), respectively (CIA, 2007).
immediately and definitely. Chinese ex-Ambassador Ma Shuxue in Kiribati accused Taiwan of using 'dollar diplomacy' to alienate relations between China and Kiribati. He also criticised Kiribati for failing to appreciate China's having benefited Kiribati financially, through unconditional loans, free economic and technical assistance, help with expanding an international airport and building a sports stadium, and debt relief to the value of RMB50 million ($6.04 million) (Goodenough, 2003). Ma has implicitly pointed out that Taiwan provided more generous financial aid in order to manipulate the diplomatic switch in allegiance.

Officially and publicly, Taiwan's Foreign Minister Chien reiterated that Taiwan would not enter into a competition of dollar diplomacy with China, but that Taiwan would nevertheless carry out cooperative programmes to aid Kiribati in the spheres of agriculture, fisheries, health, and education, when he made the announcement of ROC-Kiribati diplomatic relations on 7 November 2003 in Taipei (Lin, 2003a). According to Chien, one of the reasons for Kiribati to decide to embrace Taiwan was that China failed to 'make good on many of its promises of aid' (Lin, 2003a). This comment had revealed that Taiwan must have promised to provide economic aid to Kiribati, at least as much as China had promised to Kiribati, although no official figure was published showing how much foreign assistance Taiwan had in fact promised Kiribati. According to the ROC-Kiribati Memorandum of Understanding on Cooperation (MUC) signed on 5 November 2003, Taiwan agreed to provide a A$10-million interest-free loan to Kiribati every year during the period of 2004 to 2007, and an A$50-million special fund to help Kiribati to accomplish the on-going construction that had originally been sponsored by China (Kan et al., 2004: 62). Furthermore, according to China's official media Xinhua News Agency reports, Taiwan had granted A$1.2 million to the Kiribati ruling party and $100,000 to the
incumbent president secretly during Kiribati’s presidential campaign (ETT, 2003). Regarding this political accusation, Taiwan’s Premier Yu and Foreign Minister issued an immediate denial and asserted that Taiwan would not conduct vicious ‘dollar diplomacy’ with China (ETT, 2004).

In response to an accusation by a US newspaper - the Baltimore Sun, in November 2003 – Richard Shih, spokesman of ROC Ministry of Foreign Affairs (MOFA), issued a denial that the establishment of Taiwan-Kiribati diplomatic ties was a result of ‘chequebook diplomacy’ by providing presidential candidate financial assistance during the campaign or that Taiwan might offer $8 million in aid to Kiribati annually (THL, 2004). Furthermore, the MOFA spokesman also said that there was no agreement on a fixed aid amount inked into the MUC signed by the two sides on the establishment of diplomatic ties. Taiwan promised to provide Kiribati with assistance only after a careful evaluation of Kiribati’s needs and Taiwan’s own budget resources. Nevertheless, given Taiwan’s frequent utilisation of economic aid in the battle of diplomacy vis-à-vis China, most of the reports sceptically assumed that Taiwan must have promised a certain level of economic aid package to Kiribati for the establishment of their bilateral diplomatic ties (Johnson, 2005).

(2) The Republic of Nauru
Taiwan and Nauru first became allies in 1980. However, this friendship was tested twelve years later when Nauru switched ties to China on the same day when President Chen took over DPP chairmanship on 21 July 2002. It was reported that China offered $130 million in financial aid for the diplomatic shift (MAC, 2005d: 41). A couple of years later, Taiwan resumed diplomatic ties with Nauru on 14 May 2005. The decision to resume Taiwan-Nauru ties was made when President Chen conducted a diplomatic
mission to visit three allies in the South Pacific: the Marshall Islands, Kiribati, and Tuvalu in May 2005 (GIO, 2006). For the resumption of diplomatic relations, Taiwan agreed to set up a series of economic assistance programmes, which included exchanges and co-operation in various fields, such as cultural activities, education, agriculture, fishery, aquaculture, tourism, and health care, in Nauru.

The re-establishment of Taiwan-Nauru ties was accomplished soon after Ludwig Scotty was elected the new President of Nauru. It is not difficult to imagine how much determination Taiwan’s diplomats must suffer whenever allies are in the time of a presidential election or election for new prime ministers, because a new government means that relations between Taiwan and the country may possibly be under a challenge. Given this understanding, generous economic aid acts as a powerful catalyst for the establishment of diplomatic relations, yet changes in allies’ domestic political situations and political-party rivalry are equally important in the tug-of-war between Taiwan and China. In 2006, the MOFA (ROC) confirmed that Taiwan legitimately donated $13 million to enable Nauru to buy back Air Nauru's sole aircraft, seized by Australia in 2005 after Nauru failed to pay its loans to the US Import-Export Bank, and to cover the country’s debt (CP, 2006a). Because the occasion of Taiwan-Nauru' resumption of relations coincided with Nauru’s difficulty in debt, it was reasonable to doubt that the $13 million was part of the aid package for diplomatic relations. In addition, Taiwan donated around $3.5 million to help over 200 Kiribati people and over 100 people from Tuvalu, who were stranded in Nauru, to return to their respective home countries. Taiwan’s donation covered those workers’ back pay and their return trips home. The above two donations cost Taiwan $16.5 million, worth over one-half of Nauru’s then total foreign debt.
From above context, it is evident that the cross-Strait rivalry has offered a competitive environment in which third parties may bargain with both Taiwan and China (Lin, 2001b: 71; Shaw, 2006). For countries in need such as Nauru, there is no moral element right or wrong in its shifting its diplomatic ties for better financial aid. From Nauru’s perspective, it matters little who becomes the donor of economic aid as long as Nauru can indeed obtain foreign aid to help its national survival and remain in line with its own national interests. In the case of ‘dollar diplomacy’ between Taiwan and China over Nauru, the result has confirmed Knorr’s argument that there is no guarantee for a success through a large granting of aid (Knorr, 1973: 180). Furthermore, this has also demonstrated Taiwan’s difficulty in the development of new diplomatic allies through its economic security policy.

6.3.2 Economic Security for Maintaining Relations with Allies

(1) The Former Yugoslav Republic of Macedonia (Macedonia)

The Taiwan-Macedonia relationship was built on shaky foundations in the first place since the two forged official ties in January 1999. Because Macedonia was in an enduring unstable political situation, the Macedonian government gained no accord over the establishment of diplomatic relations with Taiwan. Therefore, the civil war between ethnic Albanians and Slavs in Macedonia, as well as China’s permanent membership of the UN Security Council, became the last straw, breaking the diplomatic ties between Taiwan and Macedonia.10 China’s veto right in the UN affords China the privilege to negotiate with the international community (Kao, 1993b: 111-112). In contrast, it is Taiwan’s ‘Achilles’ heel’, beyond Taiwan’s ability to overcome.

10 Due to the civil war, Macedonia urgently needed help from UN peace-keeping troops. China, which sits on the United Nation’s Security Council, has been pressuring Macedonia by threatening to veto any proposed troop deployments (TT, 2001b).
It was reported that Taiwan had promised to provide some $1 billion-worth of aid, loans, and investments to Macedonia as a pre-condition when the two sides launched talks in 1999 (BBC, 1999). The establishment of diplomatic ties with Macedonia served not only a political symbolic purpose, but also had economic significance. Taiwan hoped its ties with Macedonia would open a gateway to Europe (Hsu, 2001b). According to reports quoted by the ROC embassy in Macedonia, Taiwan has engaged with Macedonia for eleven aid projects worth over $100 million, which included $60 million in loans, a road-building project worth $20 million, a project in the infrastructure worth $20.5 million, and $12 million in loans to the Macedonian government for an enterprise-loan fund (UDN, 2001a). Taiwan helped Macedonia to build the Taiwan Commercial Centre (TCC) and the Skopje Free Economic Zone (SFEZ). The former project was managed by the overseas investment company, while the latter was operated by the Skopje Development Management Company – a joint investment between the Taiwan ICDF and Taiwan’s China Development Industrial Bank (UDN, 2001b).

However, massive economic ties and generous financial aid did not guarantee the stability of Taiwan-Macedonia diplomatic relations. The diplomatic ties were terminated at the time when President Chen was setting sail on his voyage of a head-of-state diplomatic tour to Central America and the US gave him high-level treatment when he transited in New York in 2001. China revealed its engagement with Macedonia so as to frustrate President Chen’s pleasure. Although Foreign Minister Tien Hung-mao have done his utmost in an effort to salvage diplomatic ties with Macedonia by cutting short his Latin American trip in order to fly to Macedonia, Taiwan could not change the fact that Macedonia moved closer to links with China (GIO, 2001b).
When Taiwan took initiative measures at the beginning of the termination of Taiwan-Macedonia ties, the TCC decided to continue operating. However, the SFEZ project was terminated on 18 July 2001 when the two countries ceased relations (THL, 2001a). To protect Taiwan's possessions, the MOFA (ROC) demanded that Macedonia return the $12 million cash loans (THL, 2001b). However, Taiwan failed to claim back the loan from Macedonia, according to Taiwan's legislator Lai Shyh-bao (Xinhua, 2006). Regarding other aspects of the economic aid package, Taiwan also transferred its technical mission then stationed in Macedonia to Guatemala (GIO, 2001c). All other cooperation projects between Taiwan and Macedonia were terminated immediately. In this case, Taiwan lost not only an ally and a huge amount of money, already invested in Macedonia as either grants or investment, but also a gateway to Europe for economic and political connections.

(2) The Republic of Liberia

It was reported that Taiwan has been active in Liberian politics for a number of years by contributing about one million dollars to Charles Taylor's 1997 presidential campaign. This was the reason why Liberia resumed relations with Taiwan soon after Taylor came to power (Dukuly, 2003). As Taylor regime's leading foreign partner, Taiwan carried out several agricultural projects, as well as imported thousands of tonnes of staples and rice from Liberia. Taiwan also gave Liberia $1 million for the refurbishing the building of the Ministry of Foreign Affairs, and provided equipment and funds for the capital's power supply. Furthermore, Taiwan has dispatched doctors and specialists to serve people in the rural areas of Liberia, and also sent an agricultural mission stationed in Liberia to help develop the agricultural sector.
Nevertheless, the Taiwan-Liberia diplomatic ties was challenged, since Liberia fell into civil war and its then President Taylor, a close ally of Taiwan, was exiled into Nigeria in August 2003 (Chen, 2003a). The Liberian transitional government kept on sending messages to Taiwan that the country desperately needed cash for its tattered economy in the midst of international isolation. Liberia also emphasised that it might otherwise soon end its recognition of Taiwan to embrace China in exchange for cash (BBC, 2003). Although Taiwan kept a most cautious eye on the progress of bilateral relations between Taiwan and the Liberian transitional government, Liberia decided to shift its diplomatic ties from Taiwan to China in October 2003 in exchange for China’s economic aid and UN peace-keeping employment in Liberia. This diplomatic setback once again proved that even though Taiwan could afford to provide the war-torn Liberia financial support for its tattered economy, Taiwan’s economic security measures to sustain relations with Liberia were defeated by China’s leverage of the veto power in the UN Security Council. Furthermore, while China has emerged as new economic power, Taiwan’s economic security policy in the battle of diplomacy has become a costly but a competition that Taiwan has no guarantee of winning.

(3) The Commonwealth of Dominica

In March 2004, Dominica’s new Prime Minister Skerrit, who took power in the January of the year, visited China and announced in a joint communiqué Dominica’s decision to enter into diplomatic relations with China. Taiwan suggested that such a political arrangement between China and Dominica was an act intended to shame President Chen after he won his second-term presidential election (Chen, 2004c). In the China-Dominica political arrangement, China granted the economically straitened Dominica $4 million immediately as part of a five-year aid package worth $111 million (CP, 2004a; SEF, 2006: 20). To justify his decision, Skerrit claimed that the
Taiwan-Dominica diplomatic ties had been entered into under a policy ‘based on mistaken historical assumptions’ by accepting proposals of ‘dual recognition’ for China and Taiwan in 1983 (BBC, 2005a). He also admitted that China’s assistance was vital for the decision of diplomatic establishment with China, ‘which is a major player in international diplomacy’ (BBC, 2004).

Since Skerrit took office, he had pressed Taiwan for $58 million in aid - far more than the original amount that Taiwan had agreed to provide for the bilateral cooperation projects (Chen, 2004c). Dominica had also requested Taiwan to up-grade its representation from a consulate to a full embassy. In negotiation processes, Skerrit had occasionally threatened to switch diplomatic allegiance to China if Taiwan failed to satisfy his demands. In response to Skerrit’s requests, Taiwan had promised to provide partial grants and partial loan for building a stadium through Taiwan’s ODA procedures, and agreed to consider the proposal of the embassy up-grade (CP, 2004a). Taiwan continued to provide Dominica with economic aid as scheduled, and ended by being shocked at Skerrit’s sudden embracing of China. Just two months before Dominica broke relations with Taiwan, Taiwan had in January 2004 presented $60,000-worth of computer systems to Dominica as part of on-going educational assistance for developing technology and human resources (Charles, 2004). Taiwan had also given $9 million to Dominica for the purpose of stabilising bilateral relations two weeks before Dominica changed sides (CNN, 2005). Nevertheless, Taiwan’s failure to accede to Skerrit’s blackmail gave China the opportunity to woo Dominica away from Taiwan.

For about 20 years, Dominica benefited from Taiwan’s financial aid for the country’s education system and technical support in agriculture, while Taiwan gained
advantages from Dominica’s political recognition of and support for the agenda of admission to international organisations. However, China’s $111 million offer in aid was tempting. It far outweighed what Taiwan had given in the past. Although Taiwan was irate over the ‘Dominican blow’ and the measures taken by China to lure away Taiwan’s allies, the incident left Taiwan with an opportunity to reconsider its foreign policies in the continuing struggle with China, under the circumstance that China’s economy is booming and the country is flush with dollars. The willingness of China to dole out such a huge reward to Dominica suggested its strategy of using generous aid package to entice Taiwan’s remaining diplomatic ties to switch allegiance to China. China perceived that its contributing to a completely isolated Taiwan would be a strategy toward stripping Taiwan’s assertion of statehood.

(4) Grenada
A controversy has arisen in the wake of Grenada Prime Minister Keith Mitchell’s trip to Beijing to seek aid from the Chinese government in repairing its ravaged economy. After the visit, China’s official mouthpiece, the Xinhua News Agency, released news regarding the re-establishment of official ties between China and Grenada on 21 January 2005, which led to Taiwan-Grenada relations becoming difficult (Chen, 2005a). This diplomatic setback happened when President Chen left for state visits to Palau and the Solomon Islands, pledging to boost Taiwan’s international profile. For the purpose of preserving national pride, Taiwan announced its severance of ties with Grenada on 28 January 2005 after verifying the fact that Grenada and China had signed a joint communiqué to resume full official relations in which, based on the ‘One-China’ policy, Grenada would be required to renounce diplomatic recognition of Taiwan.
Despite the fact that Taiwan had offered almost NT$322 million ($10 million) to help Grenada recover from Hurricane Ivan, which devastated the Caribbean country in September 2004, and had also offered NT$1.3 billion ($40 million) to help Grenada rebuild its cricket stadium, Grenada blamed Taiwan for not taking their diplomatic relations seriously and threatened to sever ties with Taiwan in favour of China (BBC, 2005a). The Grenada Prime Minister Mitchell revealed that he had negotiated a hurricane relief deal during his visit to China. In response, Taiwan proclaimed that 'it wasn't willing to play money games with rival China to keep diplomatic relations with Grenada and wouldn't give in to what it called extortion-like behaviour by the leader of its Caribbean ally', said MOFA (ROC) spokesman Michel Ching-long Lu (Caribbean, 2004). Besides, in an interview with the Agence France Presse, Lu condemned China for applying tactics to lure away Taiwan's allies, and also blamed Grenada for trying to use China as a bargaining chip to blackmail Taiwan into giving further financial aid. Lu quoted Grenada as cashing in on the cross-Strait confrontation, through its requesting Taiwan to pay $245 million for a five-year cooperation programme. Lu also revealed that Taiwan has extended $28 million in loans to Grenada since the establishment of official relations in 1989 (Jamaica, 2005).

Eventually, Grenada has benefited from China with support for rebuilding and expanding the national stadium for the 2007 Cricket World Cup, the construction of 2,000 housing units, a $1 million scholarship fund, and $6 million in grants in the diplomatic tug-of-war between Taiwan and China (Erikson, 2005). Once again, this diplomatic frustration brought Taiwan to the obvious realisation that giving foreign aid on the basis of mutual interests and humanitarian concerns was not without fault. Because of Taiwan's international status and China's top foreign-policy goal of isolating Taiwan, Taiwan had become involved in a costly diplomatic war with China.
Although the measure of deploying economic power within the national capability is still an accessible and possible means for Taiwan to break through diplomatic difficulties, a successful economic security policy is supported by the positive achievement of economic security at the macro-economic level. Without strong economic support, the deployment of economic security in the national security dimension is restrained and suppressed.

(5) The Republic of Senegal

On 25 October 2005 President Abdoulaye Wade of Senegal sent a letter to President Chen announcing the resumption of Senegal’s diplomatic ties with China. Meanwhile, Wade also expressed his willingness to maintain economic, business, and cultural relations with Taiwan after the termination of diplomatic relations. In his letter, President Wade wrote that ‘[s]tates have no friends, they only have interests’ (MOFA, 2005). This crude statement damaged President Chen heavily, because Chen had asserted confidently that ‘Taiwan’s continuing aid to Senegal has formed a close bond between the two nations’ during his state visit to Senegal on July 2002 (GIO, 2002c).

For safeguarding national integrity and sovereignty, Taiwan announced the immediate termination of diplomatic relations with Senegal and the suspension forthwith of all relevant assistance programmes - including aid for farming, irrigation, medicine, and education. The MOFA believed that the reason for Senegal to decide to break diplomatic ties with Taiwan was under monetary promises and political pressure from China (MOFA, 2005). According to information provided by the ROC Embassy of Senegal, China offered $200 million dollars-worth of aid to persuade Senegal to switch allegiances. The actual figures may, though, be as high as $2 billion, if projects such as the Friendship Stadium and the Bignona Water Conservancy Project, as well
as some other investment and energy deals, are included (GIO, 2007). Ironically, China frequently accused Taiwan of being involved in ‘dollar diplomacy’, but it appeared that China was doing the same kind of business in the battle of diplomacy vis-à-vis Taiwan.

Senegal is one of the countries that moved diplomatic ties between Taiwan and China to and fro three times (see Table 6.3). It severed ties with China and re-established diplomatic ties with Taiwan on 3 January 1996. Since then Taiwan has actively assisted Senegal in various programmes to develop its economy. In addition to assisting the country with its agricultural and fishery production, improvement of infrastructure, water resources, medical and public health and education, Taiwan has also helped Senegal with its youth employment, vocational training, industrial parks, and micro-loans to farmers and women. Furthermore, Taiwan has also signed a protocol with President Wade to help Senegal to set up a university to fulfil the project of universities for the future of Africa (GIO, 2001d). In total, Senegal has received more than NT$5 billion ($148.8 million) in aid from Taiwan over the ten years before switching its diplomatic recognition from Taipei to Beijing, according to President Chen (CT, 2005a). When President Chen carried out a state visit to Senegal on 2 July 2002, Senegalese officials expressed their appreciation for Taiwan’s aid and reaffirmed to Taiwan’s delegates their determination to consolidate Taiwan-Senegal relations. President Wade assured them that the bilateral relationship would surely only get better and the two countries would grow closer (GIO, 2002b). Nevertheless, in comparing with above assurances and President Wade’s comment on the letter of severance of diplomatic ties, Taiwan’s economic security scheme in the diplomatic domain is not without defect.
6.4 Economic Security and Head-of-State Diplomacy

6.4.1 Objectives of Head-of-State Diplomacy in the DPP Government

In 2000, Chen Shui-bian, the major opposition DPP-supported Presidential candidate, won the Presidential election. Inherently, the new DPP Administration has continuously struggled with China in the international arena for Taiwan’s ‘international space’ and diplomatic recognition, as did the previous Kuomintang (KMT) administration. While China remains Taiwan’s major threat to national security, the DPP government in Taiwan has striven to formulate its national security structure to protect itself against China from all perspectives. Given that the DPP is fundamentally against Chinese unification, China has taken ever more aggressive action to counteract Taiwan’s diplomatic engagement with third parties in the international arena so as to avoid nurturing in Taiwan an independence movement. Consequently, with few alternatives, the DPP Administration has followed the ‘pragmatic diplomacy’ foreign agenda set by the KMT to pursue Taiwan’s economic security policy in the battle of diplomacy, yet the DPP has been a strong voice that has always criticised the KMT’s foreign policy and international aid projects as ‘dollar diplomacy’ when the DPP was in opposition.

During President Lee Teng-hui’s twelve-year presidency from 1988, he several times implemented overseas diplomatic missions, which made the head-of-state diplomacy the most notable activities of pragmatic diplomacy in Taiwan (Lin, 1996: 84). The DPP government has continued practising this high-rank political leader diplomacy in order to boost and consolidate diplomatic relations with allies, as well as to promote the ‘Taiwan issue’ at the international level. To this end, President Chen conducted five overseas trips to visit Taiwan’s handful of diplomatic allies between 2000 and 2004 (see Table 6.5). Chen’s overseas visits included Senegal and Chad, the two states
that later severed diplomatic ties with Taiwan, on 25 October 2005 and 5 August 2006, respectively. Among Taiwan's diplomatic allies, Haiti is the only country that President Chen has not included in his trips up to end of 2006.11

<table>
<thead>
<tr>
<th>Date</th>
<th>States of Visit</th>
<th>Main Theme of Visit</th>
<th>Stop-over in US Cities</th>
</tr>
</thead>
<tbody>
<tr>
<td>21/05/2001 - 5/06/2001</td>
<td>El Salvador, Guatemala, Panama, Paraguay, and Honduras</td>
<td>Attending the Third Summit of the Republic of China and Central America held in El Salvador.</td>
<td>New York Houston</td>
</tr>
<tr>
<td>30/06/2002 - 10/07/2002</td>
<td>Senegal, Sao Tome and Principe, Malawi, and Swaziland</td>
<td>Visiting African Allies.</td>
<td></td>
</tr>
<tr>
<td>31/10/2003 - 6/11/2003</td>
<td>Panama</td>
<td>(1) Attending celebrations of the 100th anniversary of Panama's independence itinerary, and (2) receiving a human right award in New York.</td>
<td>New York</td>
</tr>
<tr>
<td>30/08/2004 - 5/09/2004</td>
<td>Panama and Belize</td>
<td>Attending the inauguration of Panamanian President Martin Torrijos.</td>
<td>Hawaii Seattle</td>
</tr>
</tbody>
</table>

Source: Edited by the author.

The President's head-of-state diplomacy carried a multi-dimensional mission to fortify diplomatic relations. There are at least six objectives designed within the package of Taiwan's head-of-state diplomatic mission, as follows. Firstly, head-of-state diplomacy is a symbol of national ability to practise sovereignty (Chen, 2000c; 2001a). The President, as the head of state, represents the state to implement the national capability of signing important agreements and communiqués with allies.

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11 Premier Su Tseng-chang was originally scheduled to visit Haiti to attend the inauguration of President-elect Rene Preval on 14 May 2006. Nevertheless, China threatened to veto a UN peace-keeping mission in Haiti, which made Haiti unable to act in any other way than to request Taiwan to send a lower-level official to the inauguration. This is the first time a Taiwanese leader has been directly rejected from visit diplomatic allies (CP, 2006b).
which evidences the fact that the ROC is indeed an independent sovereign state. Secondly, head-of-state diplomacy aims to proclaim the existence of the ROC in Taiwan. The head of state is the highest level of political leader to represent a state. The existence of the head of state means the existence of the state (Chen, 2001a). Therefore, the political meaning of President Chen’s overseas diplomatic visits stands for the existence of national sovereignty and, therefore, the existence of the state. Thirdly, it aims to safeguard relations with allies (OP, 2000b; Lu, 2001). Taiwan and China have been bitter rivals since 1949, with each trying to persuade allies away from the other through all possible and feasible measures. The President, as the highest-ranking political leader, represents the highest political authority of the state to be on guard against China’s objectives of isolating Taiwan and then of consolidating diplomatic ties with diplomatic allies. Thus, the head-of-state diplomacy embodies the utmost power to guarantee mutual relations.

Fourthly, it provides the opportunity to publicise the ‘cross-Strait issue’ on the world stage (Lu, 2001). It also publicises the national image at the international level (Chen, 2001a). China’s strategy toward Taiwan is to localise and belittle the so-called ‘Taiwan issue’ so as to downgrade Taiwan’s position merely to that of part of China, and thus to prevent any international assistance for resolving cross-Strait confrontation. For its own national security, Taiwan strives to promote the ROC as an independent sovereign state in the international community. A head-of-state overseas trip will attract greater attention from the international media, which can help to promote international profile of the ROC and its visibility (TT, 2001a). While President Chen’s head-of-state trip has grabbed international media attention, Taiwan can take the opportunity to publicise its national image and its political status within the political rivalry vis-à-vis China. Through massive international reports during
President Chen's overseas diplomatic visits, it promotes Taiwan's visibility throughout the world.

Fifthly, from Taiwan's perspective, head-of-state visits are official occasions upon which to reassure itself of its allies' support for its appeal for international participation. Because of Taiwan's unique political situation and non-UN member status, Taiwan needs allies' voices and efforts to support its objective of admission to UN membership, and the resumption of membership of other international organisations. Sixthly, Taiwan's DPP government regards President Chen's 'stop-over' visit in the US a symbol of the diplomatic breakthrough of Taiwan's international reach. Since 1995, when President Lee's private US trip to Cornell University caused the 1995/1996 Taiwan Strait Missile Crisis, for Taiwan's head of state to pay a visit to the US has become almost unfeasible (Wang, 1997: 32). Undoubtedly, it is almost impossible for Taiwan's president to pay a visit to the US without encountering China's strong opposition, thus putting the US into a political dilemma. Consequently, Taiwan's political leaders regard President Chen's transit visit to the US as a positive indicator of the ties between Taiwan and the US (BBC, 2006). Although the US explained its position in President Chen's transit stop-over as being only to 'make sure that his dignity is upheld', there 'wasn't any intention to send an official signal or message through this transit', China, on the contrary, considered any contact between the US and Taiwan as interference in the internal affairs of the Chinese government and as such should be stopped (Snyder, 2003; Dean, 2001). Consequently, President Chen's US transit stop-over became a new battle of diplomacy between Taiwan and China.\textsuperscript{12}

\textsuperscript{12} For the most recent discussion about the possible showdown between the US and China over Taiwan, see Swaine and Mulvenon (2001) and Cooper (2006).
6.4.2 Economic Aid to Allies

Taiwan has searched for political and diplomatic support from diplomatic allies in the international arena. In return, Taiwan has provided economic aid to allies as a *quid pro quo*. The Taiwan ICDF carries out international economic aid and cooperation programmes publicly and officially. Nevertheless, some economic aid packages involve highly political sensitivity and confidentiality that can hardly be undertaken through the usual bureaucratic process. Consequently, all of such categories of foreign aid projects have been listed in the ‘secret budget’ section under the MOFA (TT, 2004). According to DPP Legislator Trong Chai, the MOFA (ROC) spends around NT$13.7 billion ($400 million), equating to half of its budget, on assisting more than twenty allies (GIO, 2001a). There is, furthermore, a certain special Secret Diplomatic Fund through which the Taiwan National Security Bureau has arranged to make payments on some unusual occasions (Pomfret, 2002). As quoted from the *International Herald Tribune*, ‘the fund, which has existed for more than 50 years, is used to promote Taiwanese diplomatic activities’ and to engage in ‘a furious rearguard action to keep its dwindling number of diplomatic allies from defecting to rival China’ since the 1970s (IHT, 2006).

During his several head-of-state-diplomacy tours, President Chen has pledged to its allies that Taiwan would not only implement its promise of economic aid. It would also offer some new aid programmes to certain hosts respectively between 2000 and 2004. Although full details and accurate sums of money promised by Taiwan to allies during President Chen’s state visits cannot be listed, it is still possible to gain a picture of Taiwan’s effort to utilise its economic power to sustain relations with allies.\(^\text{13}\) In

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\(^{13}\) Due to the concern of national security, the confidential budget in managing defence, security, and diplomacy is still accepted in the ROC’s auditing system. Circumstantially, many foreign affairs expenses and economic aid to allies are paid under confidential accounts. For Taiwan’s Official
his début into head-of-state diplomacy in 2000, President Chen agreed to provide $4.8 million in loans to the Dominican Republic (DR), acting as guarantee to help DR secure a loan from the IMF (Lin, 2000a). Moreover, a consortium of Taiwan banks agreed to offer a $10-million loan for DR to build a high-tech park (THL, 2000a). Taiwan also planed to build a thermal power plant in DR at a cost of $60 million as a longer-term project (THL, 2000b). Furthermore, the Taiwan ICDF offered a total of $4.6 million to finance DR’s parliamentary modernisation programme (Chu, 2000). To Costa Rica, Taiwan provided $26.8 million in donations to finance the construction of a strategic bridge over the river Tempisque in the northern town of Nicoya (THL, 2000c). Into Nicaragua, Taiwan has poured no less than $150 million since re-establishing official ties in 1990, according to Taiwan’s official sources (UDN, 2000). Most of the aid has been in the form of preferential instalment loans, with many programmes still under way. Nicaragua is one of the Central American nations receiving the most in economic aid from Taiwan.

President Chen also promised to offer several new schemes of economic aid to Gambia, Chad, and Burkina Faso during his first head-of-state trip in 2000. As shown in Table 6.4, Taiwan has little bilateral international trade with any of the three western-African countries. Taiwan’s economic aid to these three states satisfied the political agenda rather than economic interests. Generally, the foundation of Taiwan’s diplomatic ties with these counties depended upon forms of agricultural and economic aid. Taiwanese agricultural specialists stationed in Gambia and Burkina Faso help the two African allies to develop their respective agricultural industries. Other than this type of technical assistance, Taiwan has also assisted with various infrastructure.

projects for those states. The most notable contribution to Gambia’s infrastructure was the construction of the main terminal at its airport. To help Gambia, Taiwan has poured more than $35 million into Gambia, particularly into the health sector (Lin, 2000c). In Chad, Taiwan has financed the construction of a bridge and a highway.\footnote{During his state visit in 2000, President Chen attended the inauguration ceremony of a Taiwan-financed highway, which has been named ‘Chen Shui-bian Boulevard’ in honour of Chen.} According to government sources, Taiwan has granted aid worth $128 million in areas such as health, education, water projects, and transportation since Chad established diplomatic ties with the ROC in 1997 (Lin, 2000c). In his state visit to Burkina Faso, President Chen reaffirmed that he would carry out all cooperation projects and agreements with Burkina Faso in the future. He promised to continue agricultural assistance, without mentioning the exact figure of this aid programme (Lin, 2000d). Taiwanese aid to Burkina Faso has included agricultural and technical assistance to help the people of this impoverished nation in dealing with its limited natural resources. The most notable economic aid project sponsored by Taiwan was a development project of a 1,000-hectare rice-growing area on the right bank of the Ngambe River. Meanwhile, Taiwan has also dispatched a medical assistance team now stationed in Burkina Faso to provide medical assistance.

In President Chen’s second head-of-state diplomatic trip in 2001, he promised El Salvador an aid package of $2.9 million for the reconstruction of the country from two massive earthquakes in 2001; $2.5 million to purchase construction materials with which to build 1,000 permanent houses, and another $400,000 for emergency rescue equipment (Lu, 2001). Furthermore, Taiwan agreed to make a loan of $50 million to the Central American Bank for Economic Integration (CABEI) for the development of small- and medium-sized enterprises (SMEs) in the Central American
countries. This was done so as to strengthen relations between Taiwan and those states. The loan was officially made through the Taiwan ICDF in 2004 (ICDF, 2005: 159).

In President Chen’s third official visit to four African allies in 2002, most of his itinerary was to join ribbon-cutting or opening ceremonies of ROC-sponsored facilities in the states he visited. For example, President Chen joined in the inauguration of a 22-km highway and a nursery school in Senegal. The newly-built highway is one of the projects of the Taiwan-Senegal five-year cooperation pact signed in 2000 (Lee, 2002). Furthermore, Taiwan has not only dispatched an agriculture mission to assist and instruct the Senegalese in the latter’s developing agriculture industry, but also provided an estimated $10 million in aid to enable Senegal to produce and export high-quality food products (Lee, 2002).

Similarly, President Chen inspected Taiwan’s aid projects in Sao Tome and Principe, such as a national library and a theatre (GIO, 2002a; 2002d). With regard to the new economic aid project, Chen promised in his interviews with the local media in Sao Tome and Principe that Taiwan would assist the country in developing its oil and natural gas resources. This project had been proposed by President de Menezes when he in 2001 visited Taiwan. In response to the project, Taiwan had already sent a team to evaluate the situation (GIO, 2002e). Furthermore, President Chen promised to assist the country in building public housing units, sports stadiums, and libraries, as well as in renovating government buildings and repairing highways both to help improve the quality of life of the people and to enhance mutual friendship (GIO, 2002f).
During the same overseas trip, Malawi assured Taiwan that the country would continue to support Taiwan's bid to join major international organisations, including the UN and the WHO, when President Chen visited Malawi (GIO, 2002i). Malawi is one of the states that faithfully co-sponsored and thus supported Taiwan's bid for re-admission to the UN during the period 2000-2004 (see Table 6.6). In return, Chen announced that Taiwan would continue to provide humanitarian aid to Malawi by donating 2,000 tons of corn worth US$300,000 (GIO, 2002i). To help people in Malawi obtain a better life, Taiwan, as early as in 1965, sent its first agro-technicians to Malawi in advancing agriculture technology. Meanwhile, since the establishment of Taiwan-Malawi diplomatic ties in 1966, Taiwan has assisted Malawi in building infrastructure, such as roads and a hospital, and giving technology training in different fields, such as computers, electrical engineering, the automobile industry, and carpentry. The two countries have maintained medical cooperation ties for more than thirty years. Taiwan sponsored Malawi in the amount of $18 million to help it to establish the 300-bed Central Hospital in Mzuzu, northern Malawi, in 1997, handed over to the Malawian government in October 2000 (GIO, 2002h). Furthermore, under a cooperation scheme, Taiwan continuously sends Taiwanese medical teams to be stationed in Malawi's Central Hospital and to train ten Malawian specialist doctors every year (GIO, 2002g).

6.4.3 Allies' Support for Taiwan's Appeal for International Participation

Signing joint communiqués with allies is one of the important ceremonies of head-of-state diplomacy, despite the fact that those political arrangements are mostly symbolic. In President Chen's first state visit trip in 2000, he signed joint communiqués with allies, including Costa Rica, Gambia, Burkina Faso, and Chad. Dominica and Nicaragua did not sign joint communiqués with President Chen at this
time. However, the two host states have also promised support for the admission of the ROC to the UN. Notably, this is the first time Costa Rica has changed its attitude from the pattern of the past few years by promising to support the ROC's bid for membership in the UN. In the Costa Rica-ROC communiqué, Taiwan pledged to support Costa Rica's membership of the Asia-Pacific Economic Cooperation (APEC), while Costa Rica promised to offer backing for Taiwan's bid to return to the UN (GIO, 2000a). Given Taiwan's non-UN-member status, Taiwan will need allies for it to submit a proposal for the inclusion of the representation of the ROC (Taiwan) in the agenda of the UN Annual Session. Taiwan will also need allies' voices to support such a proposal in the meeting. From Taiwan's viewpoint, gaining support from alliances is the essence of its objective of foreign affairs (MOFA, 2006a: 17).

Ever since the autumn of 1993, when Taiwan failed at its first bid for UN membership, it has continued such activities as a long-term national goal (Chang, 2000; MOFA, 2006a: 33). Between 2000 and 2004, Taiwan conducted its eighth to twelfth bids for membership of the UN. Although Taiwan tried but failed in its active bids to persuade the UN's General Assembly to consider re-admitting the ROC to the UN year after year, more than ten states had requested the steering committee to place the re-admission issue on the General Assembly's agenda every year (see Table 6.6). States such as Burkina Faso, Chad, Gambia, Malawi, Nicaragua, and Senegal were the faithful supporters that every year from 2000 to 2004 co-signed a joint letter to the UN Secretary General for inclusion of the representation of the ROC (Taiwan) in the agenda of UN Annual Session.
<table>
<thead>
<tr>
<th>Date</th>
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<th>No. of States</th>
<th>List of States Co-endorsed Letter</th>
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<tr>
<td>5/8/2003</td>
<td>A/58/197, A/58/197/Add.1</td>
<td>16</td>
<td>Belize, Burkina Faro, Chad, Dominica, Dominican, El Salvador, Gambia, Grenada, Malawi, Nicaragua, Palau, Sao Tome and Prinipe, Senegal, Solomon Islands, Swaziland, and Tuvalu.</td>
</tr>
<tr>
<td>10/8/2004</td>
<td>A/59/194</td>
<td>15</td>
<td>Belize, Burkina Faro, Chad, Gambia, Grenada, Malawi, the Marshall Islands, Nicaragua, Palau, Saint Kitts and Nevis, Saint Vincent and the Grenadines, Senegal, Solomon Islands, Swaziland, and Tuvalu.</td>
</tr>
</tbody>
</table>


(2) Edited by the author.

To some extent, Taiwan’s efforts to return to the UN are almost a ‘mission impossible’, because China has viewed such activity as a threat to its national territorial integrity (CPC, 2001: 231-233). In response, China has voiced strong opposition to Taiwan’s membership bid to obtain a seat in the UN. Furthermore, China has mobilised its own allies to block such a proposal. Similarly to Taiwan’s providing economic aid package to allies as *quid pro quo* for supporting Taiwan’s UN membership bid, China competed with Taiwan by providing generous aid to some countries, then asking them either not to support or to otherwise to vote against the issue. Soon after receiving
China's economic aid, those states avoided a row over supporting Taiwan by either being absent from voting or by supporting China’s opposition (Lin, 2001b: 70). In 2000, nineteen states supported the adoption of the proposal regarding Taiwan's appeal for UN membership to the agenda of the 55th session of UN General Assembly, while forty-seven states voiced their opposition (MOFA, 2000a). In 2004, there were a total of 115 states to join the debate over Taiwan's case for UN membership in the steering meeting. China has mobilised 93 states to vote against the proposed reconsideration of ‘Taiwan’s participation in the United Nations’ during the 59th session of the General Assembly. In the end, the ratio of support for and against the issue was 21 to 94 (including China itself) (MOFA, 2004b).

Given the fact that Taiwan possesses far fewer diplomatic allies than does China, the unfavourable verdict of Taiwan’s UN membership bid is almost decided in the first place.15 In spite of such dismal expectations, Taiwan gives wide publicity to raising such an issue in the international arena every year to avoid being forgotten by the international community, and to resist China’s ‘One China’ principle. Taiwan fights to uphold its right as a sovereign state by claiming its right to ask the UN to face squarely the fact of Taiwan's existence and the basic rights of its people. Due to China's obstruction, the proposal to bring Taiwan into the international body has never been listed into the agenda of the UN General Assembly over the years. Even though the long-term campaign for UN membership has been frustrated, seeking support from allies and friendly countries is still one of the core objectives of foreign affairs in Taiwan. Insistently, every year Taiwan devotes money, time, and human resources to promoting and to manoeuvring for the campaign of UN membership, yet

15 In August 2006, Chad switched its diplomatic ties from Taiwan to China, which left 24 diplomatic allies to Taiwan. In comparison, Chad is China’s 169th ally.
has made very little progress in the bid. Nonetheless, Taiwan’s persistent efforts to put the ‘Taiwan issue’ into the international area have, to some extent, publicised the cross-Strait relations as being an ‘international’ affair rather than a ‘domestic’ one. From this perspective, Taiwan’s effort is not without success politically.

6.4.4 President Chen’s ‘Stop-over’ Visit in the US
From the DPP administration’s viewpoint, enabling the leadership to make ‘stop-over’ visits in countries that do not have formal diplomatic relations with Taiwan is a significant diplomatic ‘breakthrough’ (Wu, 2003). In his first trip abroad in August 2000, the US granted President Chen a visa for a stop-over in Los Angeles. Nevertheless, because of China’s pressure, the Clinton Administration requested that the DPP government decline any requests by Congressmen to meet President Chen during his transit visit in Los Angeles (TC, 2000: 4). The outcome was that President Chen was confined to his hotel and received none of the US congressmen who originally wanted to visit President Chen in Los Angeles. In spite of such a situation, Taiwan was still convinced that it had won political and thus psychological support from some US law-makers (Tsao, 2000). To some extent, the effectiveness of drawing attention to ‘Taiwan issue’ at the international level is partially successful, at least in the eyes of the DPP.

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16 Because of China’s pressure, the Clinton Administration requested the DPP-government to decline any requests by Congressmen to meet with President Chen during his stop-over in Los Angeles. Those US politicians included Sam Gejdenson (D-CT), Howard Berman (D-CA), Nancy Pelosi (D-CA), Dana Rohrabacher (R-CA), David Wu (D-OR), Bob Wexler (D-FL), and Sherrod Brown (D-OH), who have all been consistent supporters of Taiwan in the House (TC, 2000: 4). ‘D’ stands for Democratic, and ‘R’ stands for Republican.

17 China considers any contact between the US and Taiwan as interference in the internal affairs of the Chinese government. Even simply granting Chen permission to cross US borders in transit was interpreted as an affront by the Beijing authorities. In contrast, Taiwan regards any arrangement over meetings between President Chen and US politicians as substantive advancement between Taiwan and the US politically and diplomatically.
In comparison with his first time of stepping out US soil, the US provided President Chen with much better treatment during his second trip abroad. On 17 May 2001, the House passed HCR135, which had been introduced on 15 May, welcoming President Chen to the US.¹⁸ The US agreed that President Chen could make stop-overs in New York and Houston on his trip to and from Central America. During President Chen's brief stay in New York, he met the then New York Mayor Rudolph Giuliani, former US Defense Secretary Caspar Weinberger, and two-time presidential candidate Steve Forbes (CNN, 2001). President Chen also held a dinner party with 24 US law-makers, including members of the US House of Representatives (IIR) such as David Wu (D-OR) and Ben Gilman (R-NY), as well as Senator Gary Ackerman (D-NY), Dana Rohrabacher (R-CA), and Tom Lantos (D-CA) in New York on 22 May 2001 (Epoch, 2001; Chen, 2001a). Furthermore, on his way back to Taiwan after the conclusion of the state visit, President Chen transited in Houston. In this brief stop-over, President Chen met US House Majority Whip Tom DeLay (R-Tex), the third-ranked Republican in the HR and three other Texas-supported IIRs including Kevin Brady (R-Tex), Solomon Ortiz (D-Tex), and Sheila Jackson-Lee (D-Tex) on 3 June 2001. Meanwhile, President Chen also met Lee Brown, Mayor of Houston, on the same day, although Brown kept a low profile to avoid raising from China any opposition to his economic interest with China (LT, 2001a).

Taiwan regarded President Chen's short stays in New York and Houston as having achieved a certain level of diplomatic and political success in terms both of the high-level treatment that Chen received and the massive news coverage that brought

¹⁸ The 'HCR 135' is a House of Congress Resolution that expresses the sense of the Congress welcoming President Chen to the US. For original text of HCR135, see http://www.fapa.org/CSBresolution/text.html; for the list of 42 co-sponsors of HCR135, see http://www.fapa.org/CSBresolution/cosponsors.html.
international attention. Meanwhile, Taiwan also treated President Chen's transit in New York as a positive indication of an improvement in Taiwan-US relations, because the US authority rejected China's opposition to its granting of a transit visa to President Chen. According to Taiwan's philosophy of pragmatic diplomacy, the engagement between President Chen and US politicians can be regarded as the way the wind is blowing in US policy vis-à-vis Taiwan, and thus signalled an improvement in Taiwan-US relations (Chen, 2001c).

In October 2003, President Chen was invited to attend the celebrations of the centenary of Panama's Independence. On his way to Panama, President Chen had a two-day stop-over in New York to receive a human rights award, and thus upon receiving the award to give his first-ever public speech in the US. For this event, the US HR unanimously passed HCR-302 expressing the sense of the Congress in welcoming President Chen to the US, with an overwhelming vote of 416 to zero, on 15 October 2003 (FAPA, 2003a). The Resolution claimed that Chen's visit marked another significant step in broadening and deepening the friendship and cooperation between the US and Taiwan. From the DPP government's perspective, President Chen's 'transit diplomacy' has been one of the great diplomatic achievements (THL, 2003). From the viewpoint of some political observers, President Chen's brief stop-over in New York 'brought several diplomatic breakthroughs', which 'excited the public and strengthened the US-Taiwan friendship' (Lin, 2003b).

Therese Shaheen (Chairman of the Board and Managing Director of the American Institute in Taiwan) and two Representatives greeted President Chen at New York's

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19 The award was bestowed by the International League for Human Rights.
20 For whole text of HCR 302, see FAPA (2003b).
JFK airport (Chen, 2004a). Besides, Chen has met both the incumbent and the former Mayors of New York, Michael Bloomberg and Rudy Giuliani, as well as Sheldon Silver (Speaker of New York State Assembly), and John Liu (New York City Council Member) in his hotel. President Chen met a total of two Senators and 14 members of the House Representatives, such as Chuck Schummer (Senator, D-NY), Jay Rockefeller (Senator, D-WV), Tom Lantos (Representative, D-CA), Gregory W. Meeks (Representative, D-NY), Robert Wexler (Representative, D-FL), Steve Chabot (Representative, R-OH), Cliff Stearns (Representative, R-FL), and Roscoe Bartlett (Representative, R-MA), during his stay in New York. A further six law-makers sent their regards by telephone, for example, the House Majority Whip Roy Blunt (R-Mo) (Chen, 2004a).

President Chen's meeting with US politicians was a courtesy visit. However, the DPP government would still regard those arrangements as demonstrating a certain level of diplomatic breakthrough from China's diplomatic containment. Taiwan needs US friends to help it to lobby for a more favourable US policy toward Taiwan. Therefore, to maintain sound political connections with some US politicians constitutes Taiwan's diplomatic strategy (Swaine and Mulvenon, 2001: 137). Many of those US politicians who visited President Chen during his transit stay in the US are Taiwan's long-term friends, who have been constant in their support for Taiwan.21 Given that the US is still international political leader, US policy towards Taiwan and China would offer a reference to other states in the international community. In this regard, President Chen's transit stop on US soil and meetings with the US political community is an

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21 Most of them belong to either bi-partisan of ‘Senate Taiwan Caucus (STC)’, established on 17 September 2003, or ‘Congressional Taiwan Caucus (CTC)’, established on 9 April 2002. For a list of the membership of the CTC (143 members), see http://www.fapa.org/TaiwanCaucus/members-alphabetical.html; for a list of the membership of the STC (23 members), see http://www.fapa.org/TaiwanCaucus/SENATE/index.html.
important part of Taiwan’s head-of-state diplomacy. The US has become a diplomatic battlefield between Taiwan and China. Taiwan regards it as a battle for its international reach.

6.4.5 Combining the Diplomatic Agenda and Economic Interests

Due to China’s opposition, Taiwan has encountered much hindrance to its dialogue with economic partners over the issue of Free Trade Agreement (Dent, 2005: 396). Under such circumstances, Taiwan needed to take a longer pathway and pay higher costs to ensure that pursuing its interests remained on course. Currently, Taiwan has already signed FTAs with Panama, Guatemala, and Nicaragua up to the end of 2006. Furthermore, Taiwan completed FTA consultations with El Salvador and Honduras on 27 November 2006 (Wu, 2006a). All of those partners are Taiwan’s diplomatic allies in Central America. Although Taiwan has striven to engage with its major yet non-diplomatic trading partners on the issue of FTA, such as the US, Japan, and ASEAN (the Association of Southeast Asian Nations), the progress of FTA consultations with those states has been very limited.\(^{22}\) The major difficulty stems from China’s ‘One China’ policy, as well as from the obvious attraction of China’s booming economy (Lardy and Rosen, 2005: 2).

To some extent, Taiwan’s FTA with Central American allies can contribute very little to its economic growth directly in terms of exports and imports, because those diplomatic allies have very few trading activities with Taiwan (see Table 6.4). Nevertheless, while considering diplomatic relations and the economic effects of FTAs between the US and Central American countries (CAFTA), signing FTAs with

\(^{22}\) Taiwan’s exports to the US comprise about 18 per cent of its total exports, while its export share to ASEAN plus China, Japan, and Korea constitutes about 62 per cent of total exports (Huang, 2006b).
Central American allies are to Taiwan an important economic security strategy. Such economic security aims not only at securing diplomatic relations but also at expanding North American markets (Hsu, 2004: 53). To this end, Taiwan endeavours to join the System for Integration of Central America (SICA), a Central American regional organisation, and was in early 2000 granted observer status, becoming the first non-Central American state in the group.23

In order to facilitate Taiwan's membership of the SICA and to obtain allies' support for gaining status as a dialogue partner of the NAFTA (North American Free Trade Agreement), President Chen led an entourage of 150 to visit five Central American allies and to attend the Third Summit of the ROC and Central America held at El Salvador in May 2001 (see Table 6.5). After the Summit, Taiwan and the eight allies in the Summit signed a joint communique and exchanged views on cooperation in the fields of politics, economic and trade development, investments, and tourism.24 These countries pledged to support Taiwan's bid for UN membership and for joining other international organisations, as was officially inked in the communique signed jointly at the close of the summit (OP, 2001). In economic issues, a consensus supporting Taiwan to be a non-regional member of the SICA and as a dialogue partner of the NAFTA was also reached among all Summit participants.

In return, Taiwan agreed to make a contribution of $240 million to finance the establishment of the ROC-Central American Economic Development Fund

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24 The eight allies are: El Salvador, Belize, Costa Rica, Guatemala, Honduras, Nicaragua, the Dominican Republic, and Panama.
Additionally, Taiwan has made a loan of $50 million to the Central American Bank for Economic Integration (CABEI) for the development of SMEs in the Central American countries. According to the Secretary General of CABEI, the ROC agreed to provide a $103 million cooperation fund to Central American states aiming to facilitate economic cooperation and development in the area. This deal has, however, been denied by the ROC authorities.

Taiwan’s aspirations to obtain full membership of the SICA exist because the SICA is expected to merge with other trade bodies to form the Free Trade Area of the Americas in 2005. A member status could help Taiwan maintain its foothold in the region and further strengthen its international image. Through the connection between Taiwan’s political and economic network in Central and South America, on the one hand, and with NAFTA, on the other, these regions will offer new opportunities for the trade and economic diplomacy of the ROC. This is Taiwan’s economic strategy by combining diplomacy and economic cooperation to enter into FTAs with non-diplomatically tied countries. Once FTAs between the US and CAFTA have taken effect, Taiwan can turn Central America into a free trade zone for Taiwanese businessmen. Taiwanese business can, by signing FTAs with each of its Central American allies, gain indirect tariff-free market access to the US (Kan et al., 2004: 24; Huang, 2006a). This is one of the economic security arrangements to resolve the

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25 According to the ‘Republic of China-Central American Economic Development Fund Agreement’ (ROC-CAEDF), signed at Taipei, ROC on 3 July 1998, the ROC agrees to make a contribution of US$20 million per annum for a period of 12 years with the first payment on 1 September 1998 and the last payment on 1 September 2009. The objectives of the Fund are for the promotion and deepening of economic, trade, and investment cooperation between the ROC and the Central American countries through specific projects and programmes. For the full text of the Agreement, see http://www.icdf.org.tw/english/e_affair_caf_law.asp.

26 The CAFTA was signed on 28 May 2004 between five Central American countries - El Salvador, Guatemala, Honduras, Costa Rica, and Nicaragua --and the US, and was later joined by the Dominican Republic on 5 August 2004. Due to strong resistance by several of the CAFTA countries’ parliaments, the implementation of the Agreement is still pending.
difficulties in accomplishing a Taiwan-US FTA.

6.5 The Evaluation of the Effectiveness of Economic Security on the Diplomatic Front

The evaluation of the effectiveness of economic security on the diplomatic front should be discussed from three perspectives: the national profile of Taiwan’s allies, China’s leverage, and Taiwan’s domestic economic and political situation. Those three factors weave together to shape the performance of Taiwan’s economic security in international relations.

(1) The National Profile of Taiwan’s Allies

Except for the Holy See, most of Taiwan’s diplomatic allies are small and impoverished countries in Africa, the Pacific, and Latin America. Many of them are still struggling under political instability and situations of domestic rioting. Some are even suffering continuing turbulence and require the involvement of a UN Peace-keeping Mission to help stabilise the country. These include Haiti, Liberia, and Macedonia. Given that many allies are in poor shape economically and are struggling within an unstable political environment, their relations with Taiwan are frequently under challenge whenever the countries’ national elections are held. Once the opposition party wins the administration office, the new leadership may possibly favour China, which gives China the opportunity to weaken Taiwan’s diplomatic ground and inflict extensive political damage on Taiwan. For example, President Chen visited Panama twice within twelve months, on November 2003 and September 2004. The actual mission of the second state visit to Panama was to secure diplomatic ties with the newly-elected Panama administration on the occasion of the inauguration of
There are many evident examples of the diplomatic tug-of-war between Taiwan and China that happened in the time when their respective allies were in the transition of power from one political party to another. For example, Nauru switched its recognition to China in 2002 then shifted back to Taiwan in 2005 under the current President Scotty, who was in power in March 2003 and was re-elected to serve a full term in October 2004. The Commonwealth of Dominica is another example of the severing of diplomatic ties with Taiwan under the newly-elected Prime Minister Skerrit. The case of Grenada resulted from its domestic economic deterioration, especially after the 2004 Hurricane Ivan incident. Despite the fact that Taiwan has provided more than $10 million in humanitarian aid to Grenada to reconstruct homes and infrastructure, Grenada nevertheless accepted China’s even more favourable amount of aid package at the diplomatic cost of Taiwan. Senegalese President Wade, who used to be an opposition leader, has been in power since 2000. In October 2005 Senegal accepted China’s generous economic aid and announced the re-establishment of formal diplomatic relations with China - without having informed Taiwan in advance of the proposed move.

For countries in a continuing situation of turbulence and domestic rebellion, such as Macedonia, Liberia, and Chad, China’s leverage of utilising its veto power in the UN Security Council over the deployment of UN peace-keeping missions becomes a lethal weapon to threaten those countries to change their diplomatic recognition from that of Taiwan to that of China. Guatemala, one of Taiwan’s allies, was the first example where China used its UN veto power as a weapon in the bitter diplomatic battle to frustrate Taiwan. In January 1997 China vetoed the dispatch of a team of UN
military observer forces to monitor the peace accords in Guatemala. Under pressure, Guatemala had to promise to stop supporting Taiwan's appeal for UN membership in a trade-off for China's support. Macedonia was another evident instance of where China has abused its UN veto power. China vetoed a UN resolution extending the mandate of UN peace-keepers in Macedonia two weeks after Macedonia's decision to establish diplomatic ties with Taiwan (BBC, 1999). On this point, Taiwan can do nothing to prevent China abusing its UN veto rights over the allies of Taiwan, because the latter has no seat in the UN. This situation of diplomatic inferiority compels Taiwan to fight a losing battle in diplomacy. The political disadvantages of its international status have undermined Taiwan's economic security agenda in the diplomatic dimension. In summary, from the above instances, it is clear that Taiwan's economic security can be fruitful only when the respective political situations of its allies are in a condition of stability. This external factor is not one under the control of Taiwan, and this in turn weakens the effectiveness of Taiwan's economic security.

(2) The China Factor

Although China is still a recipient of international foreign aid, it is a generous donor when involved in the battle of diplomacy with Taiwan. With a speedy and sturdy economic growth and a rise in its political influence at the international level, China is well equipped to compete with Taiwan for diplomatic allies. Owing to national interests and political concerns, some countries have surrendered relations with Taiwan to embrace China's generous offer. Under such circumstances, Taiwan is frustrated and irritated, yet has no choice other than to accept the consequences of and respect the decisions made by departing allies. In some cases, China's offer of an economic aid package becomes a bargaining point for allies in their negotiations with Taiwan. Grenada is an example of a former ally who switched its alliance to China
when Taiwan refused to counter-offer an unreasonable amount of aid - as it had been requested to do.

There is also another feature where Taiwan is unable to compete with China in terms of budget allocation. Given that China is a Party-centred state, the leadership of central government has absolute authority in deciding the amount of an economic aid package. In comparison, Taiwan is a democratic country with well-equipped institutions to scrutinise the government budget and expenses. In spite of some confidential budgets for secret diplomatic purposes and a special national security fund for national security objectives, all of those budgets and expenses are under the audit and scrutiny of Control Yuan. Consequently, MOFA (ROC) cannot make promises to allies without adhering to the government budget and institutions. Although some flexibility and pragmatic measures can apply to emergency diplomatic cases, the MOFA and diplomats cannot entertain unreasonable requirements from allies without the consent of a competent authority. Ironically, this positive aspect of the Taiwan government system becomes a deficiency in terms of competing through ‘dollar diplomacy’ with China to secure relations with allies.

(3) Taiwan’s Domestic Economic and Diplomatic Situation

In 2000 Taiwan experienced for the first time political transition of power from long-ruling KMT to the major opposition DPP. The installation of a new government brought with it a long bout of political upheaval in Taiwan that has fostered anxiety in many diplomatic allies of Taiwan. They feared that the new DPP government may not carry out economic aid agreements that had been concluded with the former KMT.

27 In the ROC government system, Control Yuan is one of the five government branches under the President. It is a watchdog agency that monitors (‘controls’) the government.
government. In order to clear allies’ doubt over Taiwan’s economic aid, Taiwan arranged head-of-state diplomacy aimed at consolidating diplomatic relations with allies. President Chen signed joint communiqués with allies to enhance further cooperation and to pledge the implementation of economic aid during his overseas state visits.

The DPP is a young political party, established in 1986, with little experience when it took administration office in running the government machine (Chu, 2001: 89). The government’s administrative efficiency deteriorated due both to the lack of administrative experience of the new government, and to the political party friction between the ruling DPP and the opposition pan-blue coalition in the Legislative Yuan.28 From the diplomatic allies’ viewpoint, Taiwan’s domestic political friction formed a crisis that may possibly affect Taiwan’s promises as regards economic aid programmes. From China’s perspective, Taiwan’s domestic political friction between its political parties and among its branches of government has given China an excellent opportunity to contact the diplomatic allies of Taiwan, because the government of Taiwan needs to afford greater attention to resolving the domestic political conflicts.

Furthermore, while the global economy was sluggish worldwide, Taiwan was no exception to economic difficulties. Taiwan experienced its first-ever negative 2.2 per
cent economic growth rate in 2001.\textsuperscript{29} With the domestic economic downturn, the public started questioning the government’s foreign policies over international aid to allies and friendly countries. Such public criticism not only weakened allies’ confidence, it also constrained Taiwan’s capability in dealing with its allies. This can be observed from several occasions during President Chen’s overseas state visits. When the President pledged to his allies that the Taiwanese government would provide certain amounts of aid, the premier of Executive Yuan and the MOFA officials started to explain the details of the economic aid projects or made strenuous denials over Chen’s proposals, facing criticism at home from both the public and the opposition parties. For example, an intensive debate triggered a series of explanations to be made by officials in Taipei to smooth the controversial news of the ‘Jung Pang Project’, a NT$7.5 billion ($226 million) project to assist the nation’s diplomatic allies in Central America with their development (Chiu, 2005). This news was released when President Chen was interviewed by \textit{Siglo Veintiuno}, one of the Guatemalan Newspapers, on 22 September 2005 during his state visit in Guatemala. According to the \textit{Siglo Veintiuno} report, Taiwan would give a $250-million aid only to Guatemala. Nevertheless, when Chinese-language media filed stories back in Taipei, the story developed that Taiwan would provide $250 million to its diplomatic allies ‘annually’. This incorrect news had stirred up a huge complaint by opposition parties and the public in Taiwan. Strong controversy raged in Taiwan. Eventually, this controversial news was corrected by several officials. The ‘Jung Pang Project’ was concluded to be a project ‘to help reduce the cost of investing in Central America for Taiwanese businesspeople, by subsidising up to 49 per cent of their business ventures and jointly breaking fresh ground in the region’ instead of financial aid to allies in the region (LT, 2005). Such embarrassing situations also have a substantially negative impact on the

\textsuperscript{29} Taiwan’s economic performance will be discussed in Chapter Eight.
effectiveness of Taiwan’s economic statecraft in diplomatic manoeuvring and its overall national economic security.

Based on the above three aspects, Taiwan’s economic security in the diplomatic domain was not in good shape overall, yet it did not result in total failure in the period between 2000 and 2005. Although Taiwan has lost five allies and gained two, the total diplomatic allies numbered 25 by the end of 2005. The figure is not optimum, but is much better than zero. Taiwan’s strategy of pragmatic diplomacy has encountered setbacks largely because of Chinese resistance (Dickson, 2001). Nevertheless, without active engagement with its allies and aggressive contact with potential supporters, Taiwan might have retained even less official recognition. On the other hand, Taiwan’s appeals for admission to membership of the UN and observer status in the WHO have so far been frustrated. The two campaigns have, however, attracted worldwide attention, which has encouraged discussion of the ‘Taiwan issue’ at international level. On this point, the two campaigns have gained a certain level of achievement. It has been in line with Taiwan’s national security agenda to raise the cross-Strait rivalry at the international level.

Regarding to the objective of participating in non-political organisations, Taiwan has made a better achievement. On 1 January 2002, Taiwan became the 144th member of the WTO. From Taiwan’s viewpoint, the WTO accession has symbolic meanings of consolidating Taiwan’s international status within the global economy (Chang, 2001). Meanwhile, it also broadens the horizon of Taiwan’s foreign relations (Chen, 2001b). Taiwan has established a Permanent Mission to the WTO in Geneva, which extends the country’s foreign station towards a global reach. The significance of the membership of the WTO has not only shown that the international community affirms
Taiwan's integrated economic performance. It has also fulfilled Taiwan's objective of pragmatic diplomacy in the establishment of substantive relations with those countries with which it has no official diplomatic ties by means of economic engagements. Nevertheless, Taiwan and China made no formal economic negotiations under the WTO trading framework. This is because of China's resistance to using the WTO trading framework as a channel through which to engage with Taiwan (Bush, 2003; Cho, 2004).

In bilateral trade negotiations, Taiwan signed FTAs with Panama and Guatemala in 2003 and 2005, respectively. The FTA negotiation with Nicaragua, El Salvador, and Honduras are proceeding (CP, 2006c). Taiwan has also actively striven for negotiation with some important economic partners, such as the US, Japan, Singapore, and New Zealand. Nevertheless, progress is minimal and very slow. With economic cooperation as their foundation, Taiwan signed FTAs with diplomatic allies, has strengthened bilateral relations, and has also facilitated Taiwan-based companies' expansion in the overseas market. From this content, the implementation of economic security in this section may be adjudged as acceptable.

6.6 Conclusion

This chapter has argued that an economic security policy in the diplomatic arena is the foundation of national security in Taiwan's case. The role of economic security in the battle of diplomacy between Taiwan and China enables Taiwan to break through its status of isolation internationally that was created by China's diplomatic containment.

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30 The Taiwan-Panama FTA came into force on 1 January 2004, while the Taiwan-Guatemala FTA was due to take effect in July 2006.
31 Taiwan and Nicaragua signed a FTA on 16 June 2006 (TT, 2006).
Employing economic security for its foreign policy has allowed Taiwan to win friendship and support for its legitimate existence in world politics and for its re-admission to membership of international bodies within the environment of interference from China. With international recognition Taiwan is able to conduct its foreign policy in line with the mainstream values espoused by the international community.

From the above research, Taiwan’s implementation of economic security policy for its political-security agenda to obtain international recognition and diplomatic relations is far removed from success in terms of the number of allies and the progress in participation in the international organisations demonstrated in Chen Shui-bian’s first term of Presidency. The economic security policy at the diplomatic level can still, however, be deemed as a feasible strategy: Taiwan can still claim twenty-five diplomatic allies, and can continue promoting the agenda of returning to the international arena through participating dynamically in international activities. These allies’ diplomatic recognition and their support for Taiwan’s appeals for admission of UN membership and other international bodies assist Taiwan in pursuing its national security agenda at the international level. Although certain other countries are reluctant to endorse Taiwan’s official identity, they do not deny the de facto existence of Taiwan. They maintain the substantively non-official function of diplomatic linkage with Taiwan. From this perspective, the result of Taiwan’s economic security in the diplomatic dimension is fairly acceptable, if not fully satisfied.

Nevertheless, such an economic security agenda meets many challenges and much difficulty from China’s growing economic power, as well as from China’s political influence in the international balance of power. As an ascending economic and
political power in the international community, China is capable of shaping the international balance of power and thus the international security structure. China’s international influence is the major factor in devastating Taiwan’s effectiveness in economic security. Following the growth of its own economic power, China’s capability to lure away Taiwan’s allies is also rising, and this serves to weaken the effect of Taiwan’s economic-diplomatic statecraft to a greater or lesser degree. Although Taiwan’s economy can be sustained as world’s twentieth-largest, China has achieved the position of the world’s sixth leading economy in 2004. The original economic leverage is no longer in favour of Taiwan. If Taiwan wants to compete with China in terms of economic aid to allies, China may be the probable winner on the basis of its massive economic power. This situation can be seen from Taiwan’s capability to stabilise relations with allies in the occasion when China aggressively establishes economic and trade connections in African and Central American regions. Taiwan has not failed in its freedom of action to develop new possible diplomatic relations and to maintain relations with allies, yet it gradually falls into a passive position in defending itself against China’s diplomatic sabotage.

In this difficult and endless diplomatic tug-of-war, Taiwan struggles for national security in the international system. To some extent, Taiwan cannot blame those countries that embraced China after ignoring Taiwan’s long-term assistance and friendship. Every political leader has his/her respective national agenda for development and security as well as difficulties to be resolved. It is also clear that money is not the only factor that can shape and influence another’s political decision to be in favour of Taiwan or China. Other factors, such as the domestic political situation of allies, China’s permanent membership of the Security Council, geo-politics, and the global political climate all play important roles in the
Taiwan-China diplomatic war.

There is one aspect that Taiwan must carefully review and reconsider. Given China's massive economic power, Taiwan should consider how to make the best use of its limited economic resources through economic aid programmes to facilitate national security in the diplomatic war \textit{vis-à-vis} China. Taiwan's diplomatic allies are more interested in the capabilities of Taiwan in providing economic aid, while industrialised trading partners put greater attention on Taiwan's economic performance and achievement. Although the two are different in perspective, both are in the same context: the economic domain. This finding underscores the importance of economical security within the national security framework. The economic security statecraft at the diplomatic level is still a feasible strategy. However, this effectiveness is weakened given that Taiwan is no more economically superior to China now than it was in the 1970s and 1980s. Therefore, the effectiveness of head-of-state diplomacy, which the DPP government practises frequently, has deteriorated. On the other hand, the macro-economic level of economic security is even more important than before in supporting Taiwan's national security - not only for the support of foreign policies, but also for continuing economic development and national prosperity.
7.1 Introduction

This chapter will explore the practice of economic security in the battle of political rivalry between Taiwan and China, evaluating the dynamics of Taiwan’s effort in utilising economic issues as a measure for its pursuit of security ends in the hostile cross-Strait relations. The chapter examines the way in which both China and Taiwan have politicised cross-Strait economic relations, mainly by tightly linking the economic relationship to their respective political agendas. The main objective is to discuss a concept of economic security involving the utilisation of economic measures to obtain the objective of national security. This aspect of economic security is to use economic measures to sustain security, or to prevent or minimise insecurity. It will focus on how and to what extent Taiwan has utilised its economic measures to resist China’s political manoeuvring. Several cross-Strait economic issues initiated by Taiwan or by China between 2000 and 2005 will be discussed intensively in order to construct an understanding of this specific question. Through those case studies, a broad concept will be provided regarding the way in which Taiwan has, to fulfil its national security objectives, developed cross-Strait economic-related issues to interact with China.

This chapter is organised as follows. A brief review of Taiwan’s perception of the security threat with respect to China will be presented after this introduction. The
following section will illustrate the emergency measures taken by Taiwan to stabilise its economic confidence when it faces China's political and potential military threats. Next, the chapter moves on to review how Taiwan and China utilise economic issues to defend their respective security objectives. This specific question will be discussed from three perspectives. Firstly, it will discuss economic measures that both Taiwan and China have tried to mobilise to satisfy their respective domestic economic requirements as well as to maintain their political stances and national security. Secondly, it will discuss how Taiwan responds to China's economic proposals, and vice versa. Thirdly, it will illustrate the consequences of the economic security approach and impact. After that, the chapter then moves on to discuss the role of Taiwanese businesspeople in China and their capacity to influence government policies. This section aims to examine the relations between state and market, as well as the extent to which the market can affect government's political decision. Lastly, a conclusion to the chapter will be drawn in accordance with the concepts explored in the foregoing sections.

7.2 China’s Strategy towards Taiwan and Taiwan’s Security

China's strategy in the Taiwan Strait is focused on deterring Taiwan from moving towards de jure 'independence'. Its approach to preventing Taiwan independence is multi-faceted: integrating political, economic, cultural, and military instruments to coerce and shape Taiwan's behaviour. In its Defence White Paper released on 27 December 2004, China denounced Taiwan's government as having imposed a serious threat affecting China's security environment and regional stability (PRC, 2004). On 14 March 2005, China's legislature, the National People's Congress (NPC), passed the 'Anti-Secession Law' to pinpoint its determination in strongly 'opposing and
checking Taiwan's secession from China' (NPC, 2005). The law, on the one hand, states that China's unification is the 'sacred duty', in the accomplishment of which China will adopt non-peaceful means to 'protect China's sovereignty and territorial integrity' if Taiwan is in the fact of secession from China. On the other hand, China enumerates measures that China is willing to take to realise peaceful unification, such as expanding cross-Strait exchanges, including cultural, economic, educational, science and technology, health, and sports exchanges. Given that China has not renounced the use of force against Taiwan, China's strategy towards Taiwan combines the credible threat to use military force with the economic and cultural tools that China has at its disposal. China tried to use its growing economic links with Taiwan to influence political behaviour on Taiwan.

Similarly, in Taiwan's first-ever *National Security Report* issued in May 2006, the report points out that China has tried to utilise its economic power to undermine Taiwan's internal harmony and to weaken that government's authority (NSC, 2006: 147). The report exhaustively explained internal and external threats to national security that Taiwan encounters. Taiwan points out that 'China poses the greatest challenge to Taiwan's national security' and 'Taiwan has endured considerable threats from China as it strives to maintain its independence and sovereignty, ensure democracy, and remain militarily secure' (NSC, 2006: 3). Taiwan's government interprets it such that China tries to utilise economic measures to ensure the collapse of Taiwan's security.

With this understanding, Taiwan has never felt comfortable with respect to security threats ensuring from China, although China has always asserted that cross-Strait economic co-operation shall be free from the interference of the political rivalry (eg.,
From Taiwan’s viewpoint, the gradual liberation of economic ties with China is not without risk (MAC, 2006a). Taiwan’s government is concerned that the country will over time be caught in China’s ‘Two Hands’ tactics. In this regard, Taiwan must take an even more cautious attitude in order to prevent China’s ‘stick’ from undermining its economic and social stability, given that the development of cross-Strait economic integration is crucial to the underpinning of Taiwan’s prosperity by Taiwan’s economic performance. Consequently, the Taiwanese government has always put the brakes on the booming cross-Strait business to prevent its economic interaction with China from spiralling out of control. The self-constraining ‘No Haste, Be Patient’ (NHBp) economic approach towards China in 1997 and ‘Proactive Opening with Effective Management’ (POEM) economic policy in 2002 are products of such political concerns.¹

Given that China has never hidden its intention to use force, if necessary, to push for future unification, Taiwan has, of course, received this message loud and clear. The interesting point is why Taiwan is willing continuously to ‘dance with the enemy’ who has never spared its efforts to threaten Taiwan’s national security. This question involves considerable economic and political complexity. The cross-Strait economic involvement will be discussed in the Chapter Eight. From the political perspective, while Taiwan and China are linked with each other in an economic regime, economic strength may function as Taiwan’s shield for national security (Chen, 2000a; Roy, 2004). Thus, economic engagements and economic measures have grasped a position as a means of supporting political interests. This also gives Taiwan the momentum to balance its objective of economic security between economic prosperity and the national security agenda.

¹ For a detailed discussion, see Chapter Four.
From Taiwan’s perspective, there are three layers of meaning within which Taiwan is able to negotiate with China. First of all, cross-Strait negotiation means that China accepts Taiwan’s status. Secondly, as long as the two sides can re-open talks, the possibility of military confrontation will decrease because the possibility of misjudging the counterpart’s intentions is reduced. Thirdly, while political risk diminishes because of the mutual talks, Taiwan’s business environment will improve and can attract wider investment. Consequently, the economic aspect of the security objective can also be improved. From China’s perspective, economic measures can constitute an advantage for China in forming forces to impel Taiwan to negotiate according to China’s conditions, given that Taiwan is in a situation of economic stagnancy and suffers domestic political conflict between the political parties (Bush, 2003: 67). From such a perspective, some cross-Strait economic issues have become political stakes with which both Taiwan and China are manoeuvring to achieve their respective national security objectives. The trade-off between economic interests and political concerns lies at the core of the tug-of-war. The security objectives of China include preventing Taiwan from becoming effectively independent, and pushing for unification under the ‘One China’ principle. Taiwan’s security objectives include maintaining its autonomy in handling its own affairs with sustainable prosperity, and retaining its legal status in the international arena: these are the security objectives towards which Taiwan strives for (NSC, 2006: 147-148).

7.3 The Best Sword and Shield: Taiwan’s Economic Capability

7.3.1 The National Financial Stabilisation Fund

Taiwan experienced acutely capital outflow and sharp turbulence in the stock market after a series of Chinese missile tests and military exercises near Taiwan in 1995 and
1996. The Taiwan Weighted Stock Index (TWSI) fell by 4.2 per cent when China on 18 July 1995 announced missile tests in the Taiwan Strait. The TWSI dropped 20 per cent in total. The value of New Taiwan Dollar slumped for ten per cent in the second half of 1995. The Taiwanese government mobilised in this period $23.7 billion in foreign exchange reserves to stabilise the panicking financial market and to restore investors’ confidence (Chen, 1999: 146; Roy, 2000: 87; Sheng, 2001: 121-123). In 1996, when China’s aggressive military posture triggered panic among Taiwanese investors, the Taiwanese government distributed NT$200 billion ($6.5 billion) as an emergency measure to consolidate the Stock Market Stabilisation Fund (SMSF). The SMSF helped the TWSI to achieve a rise of five per cent and restored investors’ confidence accordingly (Yeh, 2006). Afterwards, soon after President Lee’s announcement of ‘special state to state’ relations vis-à-vis China was made public in July 1999, China’s prompt and angry response with massive-scale troop mobilisation and missile tests triggered a wave of panic among Taiwanese stock investors over the simmering political and military confrontation. The panic in sales caused the TWSI to decline by 3.9 per cent on 14 July 1999. The Taiwanese feared that domestic political turmoil could render Taiwan vulnerable to hostilities from China. This wave of a stock market crisis was, finally, on 19 July 1999, relieved and the TWSI stabilised under government intervention (Tung, 2002a: 71).

These falls reflect the fragility and sensitivity of stock markets. They also illustrate the significant impact of political fluctuations on stock markets as well as on financial markets in general. With the adverse experience of non-economic factors’ precipitating the severe downfalls of the stock market and financial market caused by

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2 For literature discussing the establishment and operation of the SMSF, see Yao (2000) and Yeh (2006).
China's military threat, the government in Taiwan decided to establish the *ad hoc* National Financial Stabilisation Fund (NFSF) to provide a financial cushion in the event of unexpected economic turmoil. The aim of the NFSF is to maintain the stability of the capital and financial markets in the event of their being disturbed by any unusual factors or events originating from either domestic or overseas sources, ones that may endanger national security (OP, 2000a: 17). The NFSF was promulgated on 9 February 2000 in accordance with the ‘Statute for the Establishment and Administration of the National Financial Stabilisation Fund’ (SNFSF). The total sum at its disposal is NT$500 billion (about $16.3 billion), of which NT$300 billion comes from four government-run funds. The rest may be borrowed from public banks (OP, 2000a: 17-19). The NFSF is an economic instrument through which the government may stabilise political power and national security through, in tum, the stabilisation of the economy. A steering committee is to be held before each instance of the activation of the fund, according to the SNFSF.

From the time of its establishment, the steering committee agreed to activate the NFSF four times in 2000, while the NFSF was brought into effect three times in that year (Hsieh, 2002: 27-29). On the first and the second occasions, the fund was used in March 2000 immediately before and after the Presidential election, when the political situation was unstable due to its being the first transfer of government power. The NFSF invested NT$51.4 billion and then NT$2.7 billion in the market, which helped the TWSI to rebound effectively. The third time was in response to China's large-scale military mobilisation and exercises between 15 and 31 May 2000. The NFSF was not then, however, closely involved in the stock market. The fourth time was in October

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3 The four funds are: the Postal Life Insurance Reserves, Labour Insurance Fund, Retirement Fund, and Civil Service Pension.

4 For a study discussing the establishment and performance of the NFSF, see Hsieh (2002).
2000, when the NFSF poured NT$120 billion ($3.6 billion) into the stock market following heated controversy over the government’s decision to halt construction of the partially-built fourth nuclear power plant. The fund was also activated in response to certain other events, such as the US terrorist attack on 11 September 2001 and during Taiwan’s 2004 presidential election, in order to retain investors’ confidence. Nevertheless, no capital was invested in the stock market around the times of those events. This reveals that the fund has also provided a psychological effect on economic security.

7.3.2 The Presidential Election in 2000 and its aftermath

In an attempt to influence Taiwan’s Presidential election on 18 March 2000, the rhetoric from China grew heated in the weeks leading up to it. China also arranged military training missions to employ psychological warfare towards Taiwan. Aside from the indirect political connotations inherent in China’s military threats, there was an immediate impact on the Taiwanese economy. China’s threats triggered a series of sharp falls in the TWSI. One week before the Presidential election in 2000, the TWSI was down by 157.67 points on 10 March, and by 617.63 points on 13 March, the sharpest fall ever recorded. The value of the New Taiwan Dollar also encountered sharp fluctuations under the heavy pressure of depreciation in response to political concerns.5

On 15 March 2000, Chinese Premier Zhu Rongji forcefully threatened to launch war to prevent Taiwan’s separation from China (Hawkins, 2000: 6). Following this, academician Xu Bodong warned that China would take military measures to invade

Taiwan if a pro-independent candidate were elected, which fanned anxiety in Taiwan’s investors (CNN, 2000b). The TWSI was down sharply by 282.40 points, or 3.27 per cent, when it opened on the morning of 15 March. The index eventually closed at 8,640.03, down by only 195.55 points because information was revealed that the NFSF would the next day enter the market to reverse the decline. After an emergency meeting in the early morning of 16 March, the committee of the NFSF agreed to activate the fund in order to prevent turbulence on the stock market from affecting both the process of the Presidential election and national security. On 16 March the TWSI plunged by as much as 4.5 per cent at the beginning of trading. It finally bounced back after the involvement of the NFSF through its aggressive input of $1.5 (NT$51.4 billion) billion into the stock market (Tung, 2002a: 72). With the support of the NFSF capital, the TWSI rose by 42.73 points on 16 March, and by 80.51 points on 17 March.  

After the result of the election was made public, panic selling re-emerged on Monday, 20 March 2000. Investors were concerned that the victory of Chen Shui-bian, the pro-Taiwan independence Democratic Progressive Party (DPP) Presidential candidate, could cause further tensions in the hostility across the Taiwan Strait. The TWSI opened down by more than three per cent through much of the session. Once again, the state-led NFSF rushed into the market, preventing the index from falling by more than 227.22 points, or 2.6 per cent, to close at 8,536.05. The Taiwanese government also pledged to support the stock market by using cash injections from the stabilisation fund ‘when necessary’ over the next two weeks (Chen, 2000d; CNN).  

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This announcement, coupled with China’s moderation of its belligerent tone in the aftermath of the election by saying it would wait to judge Chen Shui-bian by his deeds, had stabilised investors’ confidence. The TWSI index rose rapidly to 9,856.60 on 28 March, an increase of a total of 1,320.55 points within one week from 20 March. The NFSF had accomplished its intended role, designed as it was to stabilise the stock market.

With China’s immense psychological pressure from its military exercises and the threat of taking military measures to invade Taiwan, the flow of capital out of Taiwan surged. Financial losses increased as a result of the crisis in confidence. As a counter-measure, the NFSF is able to provide temporary relief, although it is less likely to be able effectively to reverse stock market trends merely through the investment of capital. The above case has demonstrated that the NFSF showed the Taiwanese government’s economic strength to tackle expediently an economic crisis while suffering the circumstances of being confronted by non-economic factors. It has also illustrated how Taiwan utilised economic measures accordingly to tackle a crisis that resulted from China’s threats. With the operation of the NFSF, Taiwan’s economic confidence can soon be resumed and its economic operations can swiftly return to normal, which can in the long run facilitate its economic security.

7.4 Economic Issues versus Political Purposes

7.4.1 The Three Direct Links

The three direct links (TDL), which refer to direct travel, trade, and communications

7 See n.6.
(postal and telecoms), were a highly charged political issue between Taiwan and China. Both parties used the issue to lure the other and to defend their respective positions within the context of political struggle. The notion was first introduced in January 1979 when China’s NPC initiated the offer of a ‘carrot’ to Taiwan (NPC, 1979). From then the issue had constantly been discussed in articles and conferences both domestically and internationally. As Interviewee E11 said, he had participated in a variety of meetings and conferences, held in the past fifteen years in Taipei, Shanghai, Beijing, and other cities in China by both officials and academics regarding the TDL issue. Regrettably, this economic dimension of the issue stagnated because of the existence of political interference, especially from Taiwan. Another Chinese scholar (Interviewee: H1), a retired official in charge of Taiwan affairs at the provincial level, pointed out that Taiwanese political leaders used the TDL as an issue to fulfil their own political agenda yet disregarded the public’s requirement of convenience in direct transportation across the Taiwan Strait. From the perspective of Interviewee E9, China already made concessions on the issue of the TDL by accepting the name of cross-Strait transportation as the ‘cross-Strait line’ instead of as a ‘domestic line within a state’, and by allowing each side to interpret the transportation by their respective intention. He believed the TDL would provide an opportunity for China to accept Chen Shui-bian as well as offering a stepping stone for Chen to resolve cross-Strait stand-off.

On those points, Taiwan’s official (Interviewee: I3) argued that government had its long-term agenda and full-scale national security considerations. The TDL was not only an economic-related issue. It involved a broader range of national missions, the interviewee added. In fact, according to President Chen’s Cross Century China Policy

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8 Interviewee H3 held a similar view.
White Paper, released by the DPP for the Presidential election campaign in 2000, Chen and DPP specifically supported opening up communication, transportation and trade links to embrace trade with China (MAC, 2004c: 125-137). Thus, the promotion of the TDL was one of the items on the government agendas. China claimed, however, that the TDL were referred as ‘domestic routes within a country’ and insisted that Taiwan’s acceptance of the ‘One China’ principle was an essential step towards the resumption of meetings on any cross-Strait issue. Taiwan would stand firmly on its principle by declaring that talks should not be carried out under any political preconditions. Consequently, without China’s co-operation and the huge gap caused by differences on the issue, no progress of cross-Strait relations and direct transportation were achieved. Nevertheless, as Interviewee I3 added, Taiwan has enforced the ‘Mini Three Links’ as an experimental measure for direct transportation between Taiwan’s costal islands and China’s cities in the Taiwan Strait. 9 This pioneering direct transportation across the Taiwan Strait demonstrates Taiwan’s positive intention to facilitate a comprehensive TDL, according to the interviewee.

According to another Taiwanese scholar who was an ex-political appointee, Taiwan’s MAC carried out several pieces of research and analyses regarding the TDL for the President’s reference. Nevertheless, political considerations have always surpassed the economic aspects of advantages resulting from direct transportation across the Taiwan Strait (Interviewee: I4). Based on this comment, it is clear that the issue of the TDL is a stake for political gain that Taiwan utilises in its bargaining with China, although the TDL is originally an economic issue. For the TDL issue, the Taiwanese government also came under pressure from business groups. For example, the American Chamber of Commerce in Taipei (AmCham), in its 2004 Taiwan White Paper, has raised the

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9 The Mini Three Links will be discussed in the following section.
sense of urgency over the fact that many multi-national companies had moved to relocate senior executives for Greater China operations from Taipei to Hong Kong, Singapore, or Shanghai due to the absence of direct cross-Strait transportation (AmCham, 2004: 4; 8). The Taiwanese government clearly appreciated such a development and the economic consequences of the absence of direct cross-Strait transportation, yet the political interests of persons behind these moves were, unfortunately, at a higher priority than was economic benefit (Interviewee: I4).

From Taiwan’s perspective, ‘political difficulties’ constitute the main barrier necessary to be overcome before Taiwan and China can begin negotiations on the issue of the TDL, as then Chairperson of MAC Tsai Ing-wen remarked in a public speech in the US (Tsai, 2002). With the huge political differences between the two, Taiwan perceived that the direct cross-Strait transportation would undermine its national security and the health of its economic structure (MAC, 2003c). Taiwan perceived that China’s call was a trick to push Taiwan to accept its ‘One China’ principle, rather than was the issue of the TDL. Taiwan feared that unconstrained direct links would be tantamount to inviting a ‘Trojan Horse’ into Taiwan (IT, 2002). Taiwan was also concerned that the growing economic integration with China would not only increase unemployment in Taiwan, but would also diminish Taiwan’s prospects of political independence. Consequently, President Chen and the DPP did not adhere to their original presidential campaign mandate: that supporting cross-Strait direct transportation. Taiwan concluded that Taiwan should not unleash direct transportation recklessly (MAC, 2003c). Political concerns outweighed economic interests in the end. Consequently, throughout Chen’s first term of Presidency, Taiwan and China were never able to set a course to negotiate the issue because of the lack of trust. China refused to engage with President Chen and the DPP
government (Interviewee: H3).

On the other hand, Taiwan wants to keep the TDL issue firmly on the cross-Strait negotiation list, which can give Taiwan leverage and space in its bargaining with China (Lu, 2004: 128). To this end, despite China's intention of ignoring the authority of President Chen and the DPP government, Taiwan has from time to time urged China to re-open cross-Strait consultations on the issue of the TDL. For example, in his 2004 National Day speech, President Chen called for peace talks and other 'concrete actions' with China in order to reduce tensions and to facilitate progress in the Three Links policy (MAC, 2005d: 8-13). In fact, Taiwan realises that liberalisation of the TDL can create some economic significance because of the concomitant decrease in transportation costs. Direct transportation between Taiwan and China can help to facilitate part of Taiwan's economic policy: that of establishing Taiwan as a business operations centre (MAC, 2003c: 5-18). However, Taiwan's government also equally comprehends that the TDL is a bargaining chip in negotiations with China only because it is a matter of direct concern to China. Because of China's insistence on binding the 'One China' principle with the TDL, Taiwan realises that the issue is one through which Taiwan may resist China's political takeover. Taiwan can use China's precondition of the 'One China' principle as an excuse to postpone negotiations over the TDL. Thus, the TDL may always be an economic issue that Taiwan can use in bargaining over its security concerns. Regrettably, this political manoeuvring of an economic issue has, however, also placed the DDP government in the dilemma of maintaining a balance between

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10 On this point, Interviewee D2 took a different view. He personally believed that Taiwan has already missed its best opportunity to use the TDL to bargain with China because of the high trade dependency. Furthermore, due to the fact that both governments across the Taiwan Strait were bounded by their respective political ideologies, the possibility for China to resume talks with the DPP was very slight.
traditional economic concerns of security, especially in the circumstance of an
economic downturn, and the broader concept of economic security.

7.4.2 The ‘Mini-Three-Links’

The Mini-Three-Links (MTL) involves shipping links between Taiwan’s off-shore
islands and Mainland China. The MTL is an economic policy initiated unilaterally by
Taiwan. It was put into practice on a trial basis on 1 January 2001.\textsuperscript{11} Two Taiwanese
vessels made the pioneering voyage from Kinmen to Xiamen on 2 January 2001, while
the first official Chinese vessel to trip from Xiamen to Taiwan-controlled territory set
off on 6 February 2001. Covering both passenger and cargo ships, the MTL allows
residents of Kinmen and Matsu to travel directly to the mainland and to import a
limited number of items from Fujian Province. According to Taiwan’s agenda, the
MTL policy was supposed to be a pilot programme towards a future full TDL across
the Taiwan Strait. The plan and implementation of the MTL followed four major
principles: (1) awarding national security the highest priority; (2) adhering to the
legislative spirit of the ‘Statute of Off-shore Island Development’; (3) integrating and
complementing the ‘three links’ within WTO (World Trade Organization) rules, and
(4) establishing a stable and normal cross-Strait relationship (MAC, 2000a).

The MTL is Taiwan’s efforts to boost economic development in its off-shore islands
as well as to comply with the rules of the WTO. Aside from economic consequences,
the MTL is an economic policy initiated unilaterally by Taiwan and aiming to push
China to resume cross-Strait dialogue (MAC, 2000a). The unilateral announcement of
the MTL by Taiwan has temporarily put China into a passive position. Initially, China
showed no enthusiasm for discussing this issue with Taiwan (ETT, 2001b). While

\textsuperscript{11} For an overview of the implementation of the MTL, see MAC (2001: 20-23).
Taiwan called for negotiations on the issue of the MTL, China responded with little interest and emphasised the MTL was a local-to-local level affair, as Wang Zaixi (Vice-minister of China’s Taiwan Affairs Office of the State Council) stated on 14 December 2000 (MAC, 2000b). The Chinese official policy towards Taiwan’s approach of the MTL was with no rejection, no response, and no support. Finally, China showed its acceptance and assigned the Fujian local government to call on non-governmental organisations in the Taiwan islands of Kinmen and Matsu, and the Chinese cities of Fuzhou and Xiamen, to facilitate the MTL-related procedures (CPC, 2001: 155).

China insisted that the MTL was an ‘internal affairs’ across the Taiwan Strait. China assigned the local government of Fujian to take in charge of the issue in an attempt to downgrade Taiwan’s position to that of one of China’s provinces in order to uphold its long-lasting ‘One China’ Policy (ETT, 2000). China avoided expressing enthusiasm for the limited MTL yet continued to call for much broader direct transport links. It also sceptically accused Taiwan having played politics over the MTL and warned that Taiwan’s intentions would not lead to dialogue (AFP, 2001). On the other side of the Taiwan Strait, Taiwan continued its schedule and evaluation, despite the fact that bilateral negotiations for the MTL were frustrated. The policy was expanded in June 2002, when Taiwan began permitting Taiwanese who are not residents of Kinmen and Matsu, including family members of Kinmen and Matsu residents, Chinese spouses of Taiwanese citizens, and Taiwanese businesspeople working in Fujian Province and their dependents to travel directly between the two off-shore islands and China. Furthermore, in order to reduce smuggling and to boost the economic development of the off-shore islands, the Taiwanese government also expanded the list of products that the off-shore islands may import directly from China (MAC, 2002a: 28-29).
Between January 2001 and December 2004, under the MTL policy, 5,147 trips were made by ships between the off-shore islands of Taiwan and China (TIER, 2004: 41). According to news released by Taiwan’s Government Information Office (GIO), there was about $107 million-worth of goods crossing the Taiwan Strait under the MTL mechanism as of the end of May 2004 (Fanchiang, 2004). Although the total number of direct crossings made between Taiwan and China through the MTL conduit is not particularly large, the relaxation of the ban on direct travel has allowed a total of 323,946 passenger trips from Taiwan to China between 2001 and 2004, while 18,568 Chinese visited the off-shore islands in the same period (TIER, 2004: 42).

Irrespective of whether the MTL is the first step towards the future full TDL, as President Chen said at Dadan Island on 9 May 2000, or a goodwill gesture of President Chen and his Administration to thaw relations with China, China’s lack of enthusiasm for the limited links form the main obstacle to the development of the mechanism of the MTL. However, the MTL has so far become part of cross-Strait ties, which were under the process of expansion. The scope of the MTL has expanded from those who have been registered as resident in Kinmen or Matsu to allow more people to take advantage of the conduit between China and Taiwan. Although the latest report regarding the MTL showed that it had failed to achieve the goals towards enhancing economic development on the off-shore island six years after its implementation, the MTL has nonetheless facilitated exchange between the two sides of Taiwan Strait over time (MAC, 2006b). The MTL has not proceeded smoothly due to China’s refusal to sit down with Taiwan officials and work out accompanying measures. Nevertheless, the issue has brought the two sides into occasional dialogue with each other, which may, at least, give Taiwan’s government some conditions to

12 For President Chen’s speech at Dadan Island, see MAC (2004c: 46-48).
voice its right to sovereignty regarding the issue of the MTL.

7.4.3 Cross-Strait Charter Flight Negotiation

The landmark indirect chartered flights are also evidently a product of political rivalry between Taiwan and China. The arrangement also demonstrates Taiwan’s efforts in using economic measures to withstand China’s approach of ‘One China’, as well as to sustain the national agenda of its sovereign right. On 24 October 2002, the Taiwanese KMT-supported legislator John Chiang initiated proposals of Lunar New Year charter flights between Taiwan and China (Chen and Tu, 2005). This first-ever charter flight provided for Taiwanese businesspeople to return to Taiwan for the Lunar New Year finally took place on 26 January 2003, after Chiang’s shuttling between the two sides of the Taiwan Strait, mediating with the Chinese authorities and the Taiwan’s MAC (Chiang, 2003). The two governments across the Taiwan Strait conducted no direct formal bilateral negotiations over the issue because of their huge differences regarding the ‘One China’ policy.

The Taiwanese government’s response to the proposed charter flight eventually changed from opposition for the reason of national security to welcoming cross-Strait negotiations on this issue (Chiang, 2003). On 12 November 2002, Taiwan’s then Premier Yu Shyi-kun confirmed, in Legislative Yuan for the Question and Answer Section, that Taiwan would approve the 2003 Lunar New Year Charter Flight on an indirect basis through a stop-over in Hong Kong or Macao. Following, in a regular Press Conference on 15 November 2002, MAC Vice-Chairman Chen Ming-tong claimed that the MAC was ready to await face-to-face negotiations on the charter flights arrangement with China (MAC, 2003b).
In response to Taiwan’s decision, China declared that it would consider the application of charter flights on the basis of the actual situation. With the persistent ‘One China’ principle and intention of isolating the DPP government, China refused Taiwan’s proposal to resume SEF-ARATS consultations over the issue of the charter flight. Alternatively, China suggested that the aviation pact could be negotiated by airline associates, appointed by the respective governments. On this point, Taiwan insisted that ‘civilian sector could not represent the government in dealing with matters involved public authority’ (MAC, 2003a: 237). In the end, under the situation of the absence of bilateral consultation for avian cooperation, Taiwan allowed only Taiwanese airlines to file applications with the Chinese government to obtain permission for indirect charter flights between Taiwan and China during the Lunar New Year holidays in January 2003 (MAC, 2002b: 27-29). Despite allegations from China of a lack of sincerity from Taiwan regarding the charter flight programme, China finally approved the first indirect charter flights by six Taiwanese airlines to China on 7 January 2003 (Chung, 2003).

In this event, despite both governments’ understanding that the success of the plan for the charter flight would be a good means of gaining the support of Taiwanese businesspeople, both governments adhered to their respective political stances. Taiwan had not been able to push China into relaxing its ‘isolated-DPP strategy’ so far that it would start contacts with the DPP government, while China could not force Taiwan to authorise a private organisation to negotiation an issue that involved the sensitive issue of national security. On the other hand, because Taiwan’s government regarded this proposal as an agreement between China and the KMT, Taiwan was reluctant to make any concessions during the process. Taiwan perceived that China

13 For introduction of SEF and ARATS, see Chapter Four.
aimed to use this issue to force Taiwan into submission. Consequently, Taiwan adopted a firm stance in arranging this event and finally pushed China to take a pragmatic approach: to give the green light for the charter flight plan. Although the charter flight arrangement was of a largely symbolic significance, it was potentially significant in moving towards direct air links between the two rivals in the future (Yan and Yang, 2004: 104-105). With such a result, Taiwan had created a business opportunity for Taiwan’s flight airline companies, as well as resolving transportation problems for Taiwanese businesspeople during the holiday period. To some extent, Taiwan’s efforts to resist China’s political will were fulfilled.

After the landmark indirect charter flights across the Taiwan Strait in 2003, the 2004 programme was suspended due to the two governments across the Taiwan Strait having different political stances on the issue. On 15 August 2003, Taiwan’s Executive Yuan issued the ‘Assessment of the Impact of Direct Cross-Strait Transportation’ as a basic document regulating the future implementation of direct cross-Strait transportation. In the document, Taiwan insisted that direct transportation must progress through bilateral negotiations, given that Taiwan’s sovereign right and security must be upheld. The negotiations must be guided by the government and for the fulfilment of the utmost welfare of the Taiwanese people (MAC, 2003c). As then MAC Chairwoman Tsai Ing-wen said, a feasible negotiations model between Taiwan and China should be on the premise that ‘the Mainland should respect our government authority and our government officials should be able to fully direct the substance of the talks’. Taiwan’s sovereignty was central to the negotiations. Tsai also added that if China was ready, then both sides could commence the talks without any restriction at all (Tsai, 2003a). Taiwan began to take a tougher attitude on this issue. The 2004 Presidential election must be the main factor in this development (Chao, 2003). As
Interviewee I4 revealed, the MAC’s research reports regarding cross-Strait relations had been selectively released by the DPP government to facilitate its election. ‘Some reports that showed in favour of China would generally be disregarded to avoid undermining the government’s space for political manoeuvre’, Interviewee I4 added. Because President Chen was seeking to campaign for a second term of Presidency, a firm attitude over cross-Strait issues would help him secure loyalty from DDP supporters.

Similarly, China also had its own consider and weight. Although China wanted to conclude the charter-flight issue as earnestly as did Taiwan, China was not enthusiastic in dealing with the DPP government over the issue of the 2004 charter flights. China did not want to surrender to President Chen credit for this issue, especially before Taiwan’s 2004 presidential election (Lam, 2002). China insisted that functional talks across the Strait must be in line with the ‘One China’ principle. The reason behind such insistence was that China wanted to make sure no illusion or interpretation of ‘two Chinas’ or ‘two states’ entered any cross-Strait talks or negotiation (Interviewee: E9).

In the case of the 2004 New Year charter flight project, China in mid-November 2003 publicised its proposition over the issue to be ‘direct, non-stop, and reciprocal’ (Xinhua, 2003b).14 Taiwan showed its acceptance of a direct charter flight yet proposed SEF-ARATS talks as the forum for the issue. Taiwan insisted that the opening of two-way, non-stop cross-Strait charter flight services should involve the exercise of public authority, which would need prior negotiations (MAC, 2004d). China, however, declined to negotiate the necessary technical details with Taiwan. It

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14 The term 'reciprocal' means to allow Chinese carriers to participate in the charter-flight services.
ruled out the proposal of resuming SEF-ARATS talks, and insisted that this issue should be negotiated by airline companies as authorised by the respective governments. On 17 December 2003, China’s Taiwan Affairs Office of the State Council (TAO) released its policy paper on ‘Promoting the Cross-Strait “Three Direct Links”’ to expound China’s basic position and policy views on the TDL. According to the document, the cross-Strait transportation should be operated and negotiated by Taiwanese and Chinese airline or sea-line companies because the transport was internal affairs within the Taiwan Strait rather than an international line (TAO, 2003a).

Originally, China tried to force through a compromise by allowing Taiwanese to operate direct flights from China to Taiwan in 2004 if Taiwan could agree to accept reciprocal direct two-way flights for 2005 (Niou, 2003). Needless to say, Taiwan rejected China’s proposal under the circumstance of its being without bilateral negotiation. For the reason of national security and the lack of an appropriate negotiation channel, Taiwan did not agree to China’s proposition, while China in turn failed to accept Taiwan’s proposal that negotiations should be guided by the government. Consequently, the two sides reach no consensus for arranging charter flights for the 2004 Chinese New Year holiday. For this result, China blamed Taiwan for using political interference to manipulate an economic issue (TAO, 2004).

Briefly, both Taiwan and China utilised the charter flights issue to bargain for their respective political conditions. Although both sides wanted to reach an agreement on the issue, the two insisted on their respective political principles. In this case, Taiwan exploited the issue to safeguard its sovereignty and for political interests, while China wanted to push Taiwan into accepting the ‘One China’ policy. Taiwan’s intention to use this issue as a bargaining chip in negotiation with China is evident. To some
extent, Taiwan had remained within its own national agenda and policy in dealing with the cross-Strait direct charter flight issues. The whole negotiation process between Taiwan and China over the charter flight issue has illustrated how Taiwan utilised an economic issue to obtain political objectives and to sustain its security vis-à-vis China.

7.4.4 Tourism Promotion

Taiwan cut all contacts with China at the end of the Chinese Civil War in 1949. Similarly, China has since then also restricted visits by its citizens to Taiwan. This situation changed when Taiwan allowed from 1987 Taiwanese residents to visit China for family reunions, sightseeing, and business, although China retained tight restrictions on its people’s visiting Taiwan for the purpose of tourism. As one of the items on the agenda of the Economic Development Advisory Conference (EDAC), concluded on 27 August 2001, Taiwan decided unilaterally to de-regulate tourism to Chinese residents (MAC, 2004c: 25-28). On 19 December 2001, Taiwan issued ‘Regulations Governing the Permission for Mainland Personnel to Come to Taiwan for Tourism Activities’ as a guideline towards promoting Mainland tourists to visit Taiwan.\footnote{For the full text of the ‘Regulation’, see MOI (2001).} According to the tourism regulation, Chinese tourists were categorised into three groups. The first category of Chinese tourist concerns those Chinese who are residents in China and plan to visit Taiwan via Hong Kong or Macao. The second category of Chinese tourist involves Chinese tourists who visit other international destinations to enter Taiwan as a transit stop and for sightseeing activities. The third category is comprised of those Chinese passport-holders who already reside outside China. At the first stage, Taiwan from 1 January 2002 opened the tourism market only to the third category of Chinese tourists. Subsequently, on 17 July 2003, Taiwan
further lifted its ban on the second category of Chinese people, allowing them to visit Taiwan.

There are three layers of reasoning for Taiwan to embrace Chinese tourists. Firstly, Chinese tourists can bring a potent economic force and boost retail sales, as has been evident in Hong Kong since China relaxed its rules on travel in 2003. Taiwan expects that China’s holidaymakers can create at least NT$19.2 billion ($600 million) for Taiwan’s tourism sector, according to Taiwan’s Tourism Bureau (Lai, 2007). Secondly, as Taiwan’s Chairman of MAC Joseph Wu said, it is a good opportunity for the Chinese to understand Taiwan’s permissive democracy during their trip to Taiwan, which may bring a greater understanding of Taiwan and thus improve cross-Strait relations (Wu, 2006c). Thirdly, Taiwan hopes this topic can persuade China back to the negotiation table over the tourism issue. Taiwan understands that Chinese people cannot visit Taiwan as tourists without the legal grounds supporting such a move, according to China’s regulation. Taiwan also realises that the issue of allowing the first category of Chinese tourists to visit Taiwan involves the enforcement of administrative authority. Taiwan expects in due course to arrange consultation with China for discussion of full-scale tourism through official and semi-official talks in a certain suitable form (MAC, 2002c: 38-39).

China responded very mildly to Taiwan’s unilateral open policy to Chinese tourists commencing on 2002, although China has long urged Taiwan to lift the ban on Chinese tour groups visiting Taiwan. China took no concerted action in response to Taiwan’s policy. Consequently, there were in toto only 34,069 tourists from China visiting Taiwan, in comparison with 10.08 million trips made by people from Taiwan to the mainland in the same period between 2002 and 2004 (TIER, 2005b: 39-40).
There are at least two reasons for China to be slow to respond Taiwan’s tourism proposal. Firstly, China did not want to give Chen Shui-bian and DPP government credit over the tourism issue before the 2004 Presidential election and legislative election in December 2004. Adhering to the ‘One China’ principle and opposing ‘Taiwan independence’, China explicitly announced its refusal of contact with President Chen and DPP government (TAO, 2005).\footnote{According to Interviewee 16, China also placed a ban to limit pro-DPP Taiwanese scholars’ academic visits to China, especially on the occasions when cross-Strait relations were tense, for example, before and after the 2004 Presidential election. Similarly, Interviewee H3 mentioned that China would also cancel Chinese scholars’ academic visits to Taiwan in order to send a clear signal over China’s dissatisfaction towards Taiwan.} In order to isolate Taiwan’s government, China also maintains its political rhetoric that China will ‘never change the principle of placing hope in the Taiwan people’ (Hu, 2005). China realised that most of the Taiwanese would rather maintain the status quo of Taiwan: neither unification nor ‘Taiwan independence’. According to the four public opinion surveys on cross-Strait relations in Taiwan sponsored by the MAC, it was found that on averaged approximately 86 per cent of Taiwanese agree to maintaining the broad concept of status quo of Taiwan in 2004 (see Table 7.1). In the face of Taiwan’s DPP government, China’s priority of the ‘Taiwan issue’ has shifted from pushing for utmost unification to ‘preserv[ing] the status quo through opposition to any move by Taiwan to seek de jure independence’ (Ching, 2005; also see Shulsky, 2000: 40-41). On this point, Interviewee A5 shared the view and added that ‘China was not keen to resolve the “Taiwan issue” and to push for unification at this stage so long as Taiwan could keep on the track of the “One China” policy’.

Secondly, China intended to attribute the achievement of cross-Strait negotiations to Taiwan’s opposition parties. Consequently, the TAO finally announced on 3 May 2005 that it would lift a decades-old ban on mainlanders visiting Taiwan as tourists at
the end of an historic trip to the mainland by Taiwan's KMT leader Lien Chan (Reuters, 2005). On 21 May 2005, China's NTA called for negotiations with Taiwan over the details. It suggested that Taiwan and China could arrange consultation on the issue of first-category of Chinese tourists through private tourist institutions. China persistently retains its tactics towards Taiwan by avoiding contact with the Taiwanese government and President Chen.

Table 7.1 Perspective of the Taiwanese Public on the Issue of Unification or Independence: 2004

<table>
<thead>
<tr>
<th>Month of Survey in 2004</th>
<th>April</th>
<th>July</th>
<th>September</th>
<th>December</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independence as soon as possible</td>
<td>3.3</td>
<td>5.4</td>
<td>6.9</td>
<td>7.4</td>
</tr>
<tr>
<td>Status quo now/independence later</td>
<td>16.6</td>
<td>16.7</td>
<td>18.7</td>
<td>14.6</td>
</tr>
<tr>
<td>Status quo indefinitely</td>
<td>18.0</td>
<td>18.5</td>
<td>18.8</td>
<td>22.1</td>
</tr>
<tr>
<td>Status quo now/decision later</td>
<td>40.0</td>
<td>36.7</td>
<td>40.7</td>
<td>39.0</td>
</tr>
<tr>
<td>Status quo now/unification later</td>
<td>9.8</td>
<td>10.7</td>
<td>11.0</td>
<td>11.1</td>
</tr>
<tr>
<td>Unification as soon as possible</td>
<td>2.0</td>
<td>2.6</td>
<td>1.6</td>
<td>2.5</td>
</tr>
<tr>
<td>Don't know</td>
<td>10.3</td>
<td>9.4</td>
<td>2.3</td>
<td>3.3</td>
</tr>
<tr>
<td>The broadly defined status quo</td>
<td>84.4</td>
<td>82.6</td>
<td>89.2</td>
<td>86.8</td>
</tr>
</tbody>
</table>

Note: The broadly defined status quo includes 'status quo now, decision later', 'status quo now, unification later', 'status quo now, independence later', and 'status quo indefinitely'.

Source: MAC (2005d: 118); edited by the author.

On this point, President Chen, in an interview with the Economist on 17 May 2005, accused China of instigating and creating a division within Taiwan so as to isolate the Taiwanese government and Chen's authority (Economist, 2005). In response, the Taiwanese government insisted that negotiations must be conducted between the governments or under the authorisation of both governments. Taiwan reiterated that its government would not accept any agreement entered into between China and any unauthorised opposition parties or civic institutions of Taiwan (MAC, 2005a). Despite the fact that Taiwan understood that Chinese tourists could help to boost Taiwan's tourism sector as well as to bring a rise in domestic retailing, Taiwan would not and could not give up the symbolic meaning of government's authority of domination over
the issue. For Taiwan, the meaning of cross-Strait negotiations lies in China’s recognition of the position of Taiwan. The symbolic significance is greater than the reality of negotiating itself. In other word, Taiwan wants to show its sovereign right in making decisions and in dealing autonomously with foreign countries. This is what Taiwan strives for. It is Taiwan’s national security.

China understood Taiwan’s intention and strategy. Thus, China trod the path to promote this tourism issue very slowly. Finally, on 28 October 2005, Shao Qiwei, China’s NTA director, led a visiting delegation to Taiwan for a ten-day ‘unofficial’ inspection tour of Taiwan’s sightseeing sites and tourist facilities (MAC, 2005b). This 66-member delegation, invited by the Taiwan Visitors Association (TVA), included 31 provincial-level directors of tourism administration. It was the highest rank of Chinese official delegation in tourism that had ever visited Taiwan since 1949. With the hope that the delegation would escalate China’s supporting policies so as to open the floodgates for Chinese tourists to Taiwan, Taiwan’s tourist sector provided the highest level of reception and service to the Chinese delegation. In a sensational report, it reportedly mentioned that the delegation demanded the removal of the national flag and pictures of the President of the ROC from one of the hotels they stayed on their tour (Epoch, 2005b). From this action, it is not difficult to understand how badly Taiwan’s tourism community wanted to secure the potentially huge business opportunities generated by Chinese holidaymakers.

Before the Chinese delegation left Taiwan, Shao Qiwei said that China was ready to send tourists to Taiwan and hoped for ‘non-government tourism organisations from Taiwan’s tourism industry to start consultations with their mainland counterparts’ to bring the issue to reality (Xinhua, 2005a). He also optimistically expected that his
government could issue some necessary supporting policies to lay the legal grounds to enable Chinese tourists soon to visit Taiwan. However, because Taiwan’s three-in-one local-level government election was scheduled in early December 2005, China postponed this issue to prevent the DPP candidates of the election benefiting from this issue. It was not until 15 April 2006 that China finally issued the ‘Procedures for the Management of Mainland Residents Travelling to the Taiwan Region’. According to the Chief of Staff of China’s NTA, the aim of this regulation was to implement the consensus that was reached between Chinese President Hu and Taiwan’s KMT leader Lien during their meeting in April 2005 (CDNS, 2006). Once again, China showed its reluctance to open contact with Taiwan’s government, although the final decision of whether to open the Taiwanese tourist market to China lay in the hands of Taiwan’s government. In response, Taiwan kept on urging China to show its sincerity and to start bilateral negotiation on this issue (MAC, 2006c).

For more than five years since Taiwan launched the Chinese tourists programme, little visible progress was achieved. The issue of the full-scale visiting by Chinese tourists of Taiwan is suspended in the air, because the China authorities had not at the end of 2006 agreed to take the basic step of adding Taiwan to the list of vacation destinations for Chinese tourists. Apart from the resolution of the necessary legal grounds, there are also many substantial problems relevant to cross-Strait negotiation that must be settled, such as visa, personal identification confirmation, illegal overstaying, travel disputes, etc. While Taiwan insists that the two sides should organise extensive talks to discuss those problems, China asserts that those issues are the internal affair of China that can be discussed by tourism agencies within the framework of the ‘One China’ principle. It seems that the economic issues cannot be solved effectively by

17 For the full text of the ‘Procedure’, see NTA (2005).
means of economic practice. The Chinese authorities have persistently stood on their ‘One China’ principle as the guideline for developing various cross-Strait relations. In contrast, Taiwan hopes to break through China’s containment. Once again it has been demonstrated that both Taiwan and China utilise economic topics for each to achieve political ends. It is evident that Taiwan has employed this economic issue to protect its de facto integrity of national sovereignty, which it believes to be of the utmost interest of national security.

7.4.5 The Case of the Zero-Tariff on Fruit Exported to China

Given the absence of mutual trust between Taiwan and China and the long existence of political dispute, there exist many deep-seated and partially concealed political concerns behind bilateral engagements. Because of the involvement of the political element, the cross-Strait exchange generates external costs that may threaten Taiwan’s national security (Chang, 2004). There is also a popular thought that China has used economic interactions in the politically united front tactics in order for China to undermine Taiwan’s security (Juan and Chen, 2004). This uncomfortable scepticism arises especially when one side unilaterally takes steps to relieve constraints towards the other side. For example, on 28 July 2005 China unilaterally announced grand preferential zero-tariff treatment for fifteen kinds of fresh fruit from Taiwan to enter into force from 1 August 2005 (MOC, 2005).

For China, this official announcement had realised the promise that the TAO had made during the visits of Lian Chan, Chairman of the KMT, in late April, and James Soong, Chairman of the People’s First Party (PFP), in mid-May 2005. For Taiwan, the KMT and the PFP are Taiwan’s two major opposition parties. Lien ran in the Presidential campaign with Soong as his running mate in a combined KMT-PFP coalition against Chen Shui-bian in 2004.

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as the MAC asserted, China’s zero-tariff on Taiwanese fruit exported to China was China’s united front tactics that Taiwan should respond carefully (MAC, 2006d: 35-36). However, Taiwan’s farmers were all welcoming such progress because, with the huge Chinese market, farmers obtained more numerous opportunities to cope with the problem of the fluctuations in fruit prices caused by an imbalance between supply and demand, especially during the harvesting season. Furthermore, the development of the agriculture sector was severely affected by acute competition from foreign fruits imported into Taiwan under the WTO trading agreement (see Table 7.2). Although many obstacles needed to be managed, especially the government’s consent and supporting policies, most of the agriculture-related sectors were expecting such a development.

Table 7.2  
Trade Statistics of Taiwan’s Fresh Fruit and Fruit-Processing Products: 2001-2005

<table>
<thead>
<tr>
<th>Year</th>
<th>Export</th>
<th></th>
<th>Import</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>Year-on-Year Growth Rate %</td>
<td>Amount</td>
<td>Year-on-Year Growth Rate %</td>
</tr>
<tr>
<td>2001</td>
<td>87</td>
<td>-5.7</td>
<td>340</td>
<td>14</td>
</tr>
<tr>
<td>2002</td>
<td>73</td>
<td>-16.5</td>
<td>380</td>
<td>11</td>
</tr>
<tr>
<td>2003</td>
<td>95</td>
<td>30.2</td>
<td>400</td>
<td>6.8</td>
</tr>
<tr>
<td>2004</td>
<td>86</td>
<td>-9.3</td>
<td>420</td>
<td>6.5</td>
</tr>
<tr>
<td>2005</td>
<td>83</td>
<td>-13.9</td>
<td>510</td>
<td>19.3</td>
</tr>
</tbody>
</table>

Source: Liu (2002; 2003) and Lee (2004; 2005; 2006b); edited by the author.

The Taiwanese government, however, agreed reluctantly to this arrangement and responded passively. In a statement published by the MAC on 28 July 2005, Taiwan insisted on designating the Taiwan External Trade Development Council (TAITRA) as a window for integrating and overseeing export-related matters. This was rather than farmers’ associations or the KMT, as originally proposed by China (MAC, 2006d: 38). There were multifaceted reasons for Taiwan’s reluctance to proceed. Firstly, this
agricultural-product arrangement was initiated during the visits to China by the opposition parties, the KMT and the PFP. China responded to the two-party visits by way of releasing a series of incentives for Taiwan. The ruling DPP and the administration in Taiwan did not, of course, appreciate such a result. They regarded such an arrangement as a kind of undermining of authority of the government by through creating contradictions in Taiwan (MAC, 2006d: 36). Secondly, because Taiwan and China entered the WTO at almost the same time, the two sides did not go through a consultation process with each other. Taiwan’s WTO mission called for consulting negotiations with China regarding the normalisation of the trade relations of the two countries, yet China failed to respond (COA, 2005). China’s unilateral announcement of offering preferential treatment to the importing of Taiwan’s fruit aimed to prevent direct contact with Taiwan’s official institutions, such as the WTO mission.

Taiwan perceived that China’s political intention was explicit in the matter of the fruit case. According to MAC’s statement, China’s unilateral promotion of an agriculture exchange with Taiwan was ‘by offering Taiwan extremely limited short-term benefits’ to gain ‘long-term economic and political advantages over Taiwan’. China also tried to define cross-Strait agriculture negotiations as ‘internal affairs’ in order to evade their regulation through WTO agreements (MAC, 2005c). Consequently, Taiwan urged China to negotiate the fruit issue with Taiwan in accordance with the WTO regulations. However, China did not respond in depth to Taiwan’s insistence on

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19 For a literature discussion of China’s resistance to negotiating within the WTO framework, see Cho (2004). The case of China’s announcement on 23 March 2002 to launch an investigation into the allegation of the dumping of cold-rolled steel by Taiwan steel makers was a vivid example of China’s intention to resist negotiation with Taiwan within the WTO framework. In an attempt to negate Taiwan’s WTO status, China failed to send a formal notice either to Taiwan’s WTO Mission or to the Taiwanese government. China instead contacted only some private enterprises directly (Fong, 2002: Tsai, 2002b: 69; Wang, 2003; Chiang, 2004: 18-19).
negotiations within the WTO framework, but continuously emphasised that cross-Strait exchange came under 'domestic affairs' within 'One China'. It urged Taiwan to allow some private representative agricultural associations in Taiwan, such as the Provincial Farmers' Association and the Agriculture Cooperatives, to organise a delegation to discuss the related technical details with China (Xinhua, 2005b). It was evident that the two counterparts had little consensus in forming a possible environment for negotiation, although both had frequently urged the other to put aside political differences in order to pave the way towards a constructive environment to promote cross-Strait relations and cooperation.

Nevertheless, the government in Taiwan could not, for the sake of its agricultural sector, reject the fruit case because the development of this sector had suffered severely owing to the acute competition with a multitude of foreign fruit imports to Taiwan under the WTO trading agreement, and to an economic downturn in Taiwan. Farming groups desperately needed a larger market for their products so as to make a profit from exports. Besides, most of the farming industries are located in the central and southern regions of Taiwan, and constitute a significant share of DPP supporters (CNA, 2004). Under the consideration of maintaining the balance between economic interests, on the one hand, and political issues, on the other, Taiwan agreed to negotiate with China regarding the fruit-export-China issue with an exceptionally cautious manner. Although the fruit export proposal was an opportunity for the government to solve its agricultural problems, Taiwan intended to deal with China at its own pace

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20 Fourteen per cent of populations living in the central region and 11 per cent in the southern region of Taiwan reply on 'agricultural and forestry and fishery and animal husbandry' industries (DGBAS, 2001).
In the process of the seesawing battle of resistance in the context of the fruit case, Taiwan missed out because of its unfavourable domestic economic situation on acquiring leverage for freedom of action in dealing with China. Despite fruit exports’ constituting only a small portion of trade from Taiwan to China, as shown in Table 7.3, Taiwan could not, if only for the sake of its agricultural sector, totally disregard China’s offer. If the current government in Taiwan is more capable of managing its economic environment, it can handle this distressing situation in a more flexible and confident manner. The government could be able to arbitrarily to refuse China’s initiative. It could meanwhile proceed at a pace that it believed suitable and beneficial to all parties without any undermining of its authority. Because of its unfavourable economic performance in recent years, the government in Taiwan could accept such an agricultural export arrangement only unwillingly, and could programme correlated administrative policies only passively. In some respects, this development did not undermine Taiwan’s overall economic security, given that the government remained capable of taking charge of the matching policy - as it indeed ought. Nonetheless, this has demonstrated explicitly that Taiwan’s economic security was shaky in terms of its capability to employ economic measures with both freedom of choice and freedom of action. In other words, a weak economic performance will not only weaken the security of the economic dimension. It will also lessen the strength of its economic security in respect of utilising economic measures for security aims.
Table 7.3  Taiwan’s Agricultural Products Exported to China: 2001-2004

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Taiwan’s Products Export to China (1)</th>
<th>Agricultural Products Export to China (2)</th>
<th>Percentage of agricultural exports to total export (3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>4,745,400</td>
<td>48,890</td>
<td>1.03</td>
</tr>
<tr>
<td>2002</td>
<td>9,945,000</td>
<td>66,350</td>
<td>0.67</td>
</tr>
<tr>
<td>2003</td>
<td>21,417,300</td>
<td>175,596</td>
<td>0.82</td>
</tr>
<tr>
<td>2004</td>
<td>34,020,100</td>
<td>291,772</td>
<td>0.86</td>
</tr>
</tbody>
</table>

Source: (1) TIER (2005b: 25).  
(3) Calculated by the author.  
Note: Figures are according to statistics of the ROC Customs.  
(3) = (2)/(1).

7.5 ‘Using Business to Encircle Politics; Using the Public to Pressure Officials’

Because of historical sentimental factors and geo-politics, the cross-Strait economic exchange is never a purely economic activity. China’s economic policy towards Taiwan evidently contains political goals (Chang, 1993). In May 1979, China promulgated the ‘Temporary Regulations Regarding Opening Trade with Taiwan’, which is the first article that regulated cross-Strait trade relations. As stated in the regulations:

Trade with Taiwan is a special form of trade in the transitional period before Taiwan returns to the motherland, which is to promote the economic linkage between the mainland and Taiwan, to obtain the support of Taiwan’s entrepreneurs, to create conditions for unification of the motherland (Cited in Roy, 2004: 1).

In December 1990, the then Chinese President Yang Shangkun set a guideline that China should concentrate on developing cross-Strait relations through economic and other exchanges in order to exploit economics to apply pressure on politics, and to utilise the private individual to pressurise the official. In his words, ‘[w]e should lead cross-Strait exchange in the direction to facilitate unification of the motherland and
the four modernisations' (MAC, 1998a: 56-58). A similar assertion had also been voiced by former Chinese President Jiang Zemin during an event of the Eighth Conference of Chinese Ambassadors and Consular Officials in July 1993. He asserted that the most important approach to realise the unification was by reinforcing economic linkages, especially by attracting more capital from large-scale Taiwanese enterprises. After the two economies had integrated, China could utilise economics to influence Taiwan and in due course promote unification (Kao, 1994b: 8).

With such understanding, Taiwan interpreted that China’s open door to Taiwan’s businesspeople was a disguised economic scheme in an attempt to ‘use people to pressure the officials’ and to ‘use business to encircle politics’ (MAC, 1998b: 568). The philosophy behind this argument is on the basis of assumption that the growing intimate economic relations between Taiwan and China would promote Taiwan’s trade dependency on China. Thus, some interest groups involved in the cross-Strait economic exchange will emerge and exploit their influence to shape Taiwan’s domestic opinions and public policies, which will progressively push the Taiwan government to make some structural changes over its China policy (Chang, 1993). Due to there being no official link between Taiwan and China, Taiwanese businesspeople are the main actors in the cross-Strait economic exchange. On this point, Taiwan’s businesspeople have, unfortunately, become deeply involved in the cross-Strait political rivalry, although businesspeople always reiterated they are profit pursuers and have no interest in politics.21 However, both governments try to use

21 Several statements were made by interviewees when the author in 2004 conducted a field trip to China and Taiwan. Interviewees’ statements may be summarised as follows. A4: ‘I am so sad that I must say that businesspeople have no motherland. We have no interest in politics’. D1: ‘For small-sized businesses, they can create new scope of business opportunity in China. For larger-sized enterprises, as my company, we are looking for the “second spring” of business development. Profit and persistent development of enterprise are the two aims that we pursue’. E2: ‘Wherever they can earn money, businesspeople will consider investing there’. E3: ‘China’s economic prosperity and business
Taiwanese business circles as their means to exploit their respective political rivalry.

7.5.1 The Capacity of the Business Circle to Change Government Policy

Given the political hostility between Taiwan and China, the impact of the cross-Strait economic activities on Taiwan’s policy is unambiguous. From the statistics of cross-Strait trade and investment as well as a variety of rules and regulations regarding cross-Strait people-to-people interactions that both Taiwan and China have implemented, there is no doubt that the enthusiasm of the Taiwanese business community to improve economic ties with China has facilitated the engagement between Taiwan and China. With growing economic exchange between Taiwan and China, Taiwan’s trade dependency on China has over the years been growing. It is also unavoidable that the higher trade dependence on the Chinese market will give China more leverage to impose influence on business circles for them to raise some economic and political issues that involve business interests. Furthermore, interdependence and integration between the dynamic Taiwanese business community and Taiwan’s strategy of economic growth and national security has created bottom-up impact on the political employment of economic instruments at the central government level.

To some extent, such close economic connection with China has also changed the political landscape in Taiwan, as well as making some political élites change their

opportunity are the major factors that attract Taiwanese entrepreneurs to invest in China’. E4: ‘Political issues are the government’s responsibility. Our purpose lies in earning money’. I1: ‘Businesspeople are driven by profit and business opportunities’. G1: ‘Business is borderless. Businesspeople pursue maximising profits. Political issues are too heavy for us’. G2: ‘Politics is a silly topic’. G6 and G7: ‘Basically, we put all our energy into business development. Politics is for politicians, which is beyond our capability’.

22 For cross-Strait economic statistics, see Tables 4.2 and 4.3. For a review of rules and regulations regarding cross-Strait people-to-people interactions implemented by Taiwan and China, see Chapter Four.

23 Cross-Strait economic interaction will be discussed in Chapter Eight.
position vis-à-vis China. Similarly, China has experienced this, too. Both governments have adjusted some policies to accommodate the business community’s opinion or to lobby on certain perspectives. However, the governments’ adjustment of economic policy is not necessarily made under pressure. In many cases those economic adjustments are the government’s effort to grasp newly emerging opportunities, which help to promote economic security materially. For example, the Taiwanese government has gradually relaxed restrictions on small-scale investment in China, as discussed in Chapter Four. It is because the government understands that China’s relatively cheap production costs can help small- and medium-sized enterprises (SMEs) to improve their competitiveness and create the ‘second spring’ of business. On the other hand, the government vigorously exercised their discretional power over large-scale investment projects in China because Taiwan must retain some leading edge industries in Taiwan. This illustrates that adjustment of the government’s policies is a consequence of careful evaluation, rather than merely blind obedience under pressure.

The role and the capability of Taiwanese entrepreneurs to influence political issues with regard to unification and sovereignty are arguable. This can be discussed from three perspectives. Firstly, the government dominates the right to policy making. Due to Taiwan’s unique state-sanctioned political structure, the government is responsible for the creation of institutional structures and control over its economy (Cheng and Chu, 2002: 37). Business is neither able to assert itself as an autonomous political actor, nor can business élites influence the centre of the political decision structure.  

24 SMEs constitute the majority of Taiwan’s investment in China, especially in 1990s. Details will be discussed in Chapter Eight.  
25 For a literature discussion on the evolution of relations between the government and business circles, see Huang (2004b).
Even after democratisation since the 1980s, Taiwan's government can retain its political salience in policy decisions because Taiwan's large capitalist are few in number and do not play a significant political role (Tien, 1997: 123). Although some leading business élites have a certain degree of influence in commercial and political circles, their capability in shaping government policy is, nevertheless, confined.

Secondly, the government's interests prevail. According to the conventional wisdom, the state is the sole autonomous unit in society that is relatively independent of societal pressures. Generally, in the case of direct confrontation between states and non-state actors, the state authority is more influential. Thus, while a state adopt a particular policy that advocated by non-state actors, it is because the state has the same interests as advocators. It also denotes that the particular policy is easily adopted and has little contrary consequence to state interests. Consequently, if China intends to hi-jack Taiwanese businesspeople to force Taiwan into political compromise, Taiwan can refuse, unless such a measure is also in Taiwan's own interests. For example, Taiwan's tycoon Wang Yung-ching, Chairman of the Formosa Plastics Group (FPG), had on behalf of the business and industry community met President Chen to call for opening the TDL with China for their business interests. In response, President Chen explicitly pronounced that the political concern remained a higher priority than did economic issues, although he understood the importance of economic interaction with China (TEN, 2002). Governments will formulate policies after careful consideration on account of national interests. The movement of implementing the NHBP and the POEM economic policies represents the Taiwanese government's capacity to regulate cross-Strait economic relations and to tackle China's political intentions on the ground of national security concerns and the circumstance of domestic economic interests.
Thirdly, Taiwan’s business community is too weak to influence government decisions. In terms of financial capability, SMEs are less capable of influencing government policies than are large-scale enterprises, although it is not absolute impossible. Taiwan’s economic dynamism is established by the massive export-oriented SMEs (Yu, 1998; Yu and Wang, 2001). Those SMEs are also the major civilian-level actors involved in the cross-Strait economic relations. Besides, China’s ability to lure giant Taiwanese conglomerates remains constrained. Unlike SMEs, which can easily avoid government’s regulations to invest in China, large-scale investments in China are under the Taiwanese government’s cautious scrutiny and approval. In spite of the liberalisation of the control of foreign exchange, the government maintains enormous administrative discretionary power, which is strong enough to intervene in Taiwanese firms’ investment in China. As Interviewee 14 explained, ‘[t]he reason for the large-scale enterprises willingness to comply with the government’s regulations is because of the existence of political and economic interests that are under the government’s control’.

The power of influence of the Taiwanese business circle over the government is, because of the uniqueness of cross-Strait relations, not highly significant, especially in policy formulation. To promote policies towards China, the Taiwanese government uses both carrot and stick to lure and to discipline investors who invest in China. The latest published book regarding the story of Taiwanese tycoon Wang Yung-ching of the FPG has revealed how in 1992 the Taiwanese government used extreme suppressive measures to threaten a forceful blockade of the FPG if Wang insisted in investing in China. This concerned the $7 billion Petrochemical Industry in Hai Cang (China). When Wang was forced to relinquish an already settled agreement with the Chinese government, the Taiwanese government compensated Wang by allowing him
preferentially to establish the No. 6 Naphtha Cracking Project in Mailiao (Taiwan). It also agreed the FPG could build the first privately-funded industrial port, independent power plant, and oil refinery in the same development package (Lu, 2007). Under such compromise, the FPG's developing project in Taiwan progressed smoothly. Nevertheless, the group also missed the opportunity to become the largest petrochemical industry worldwide, given that China had agreed to Wang's opening in the Chinese domestic market within the Hai Cang investment package.

7.5.2 Taiwanese Businesspeople in China: Under Pressure from Both Sides

Combining the above three conditions has provided an explanation that the influence of the economic sector on Taiwan's government is limited. Furthermore, by examining the treatment that Taiwanese businesspeople have received from the respective governments, it also provides a clear picture of whether or not businesspeople have the capacity to push a government into action. Given the political wrestling across the Taiwan Strait, businesspeople are, to some extent, under pressure from both governments. The major driving force for businesspeople to venture across the Taiwan Strait is, of course, in their own business interests. Through cross-Strait trade and investment, China has become Taiwan's major source of trade surplus, which supports Taiwan's economic growth. Taiwanese enterprises, similarly, contribute to China's economic development and prosperity. According to Taiwan's Bureau of Foreign Trade quoted statistics released by China's Ministry of Commerce, in 2005, among the list of the top 200 exporters in China, 88 of these are foreign-invested enterprises. Thirty-seven of those 88 foreign-invested enterprises were Taiwan-invested enterprises (BOFT, 2007). The thirty-seven enterprises created exports valued of $71.3 billion, 9.4 per cent of China's exports of $762 billion in 2005 (Zoom, 2006). Taiwanese businesses' economic contribution to both sides is evident.
However, businesspeople are subject to both governments’ control. With political hostility and national security concerns, Taiwanese businesspeople fall into a sensitive situation. On the one hand, both governments praise the business sector’s economic contribution and provide economic incentives to attract investment. On the other hand, businesspeople are under both governments’ pressure in different ways. Taiwanese businesspeople in China are sandwiched between the two governments. Both governments try to befriend and to manipulate them. Both governments work hard to maintain good relations with the business group. For example, both governments are competing in organising events for directors of Taiwanese Business Associations in China (TBA), especially in the three traditional festivals, namely, the Dragon Boat Festival, the Mid-Autumn Festival, and the Chinese Lunar New Year. Every year Taiwan will host the Chinese Lunar New Year party to invite directors of TBAs in China to Taiwan. President Chen will participate in the party to exchange opinions over Taiwan’s China policy and the businessmen’s suggestions. China has similarly organised the Chinese Lunar New Year gathering to invite directors of TBAs to meet Chinese President Hu Jintao in Beijing. Generally, businesspeople are willing to participate in such events because they can express their opinions to the government authorities directly.

However, as Interviewee H6 mentioned, the majority of directors of TBAs preferred to join in with China’s event only in more recently years, because they want to retain their political neutrality. They do not want to take the risk of being smeared politically simply because of their participation in gatherings hosted by the Taiwanese government. From this perspective, China has certainly succeeded in its goal of influencing Taiwanese businesspeople in terms of keeping a wide berth from the Taiwanese government. One of the reasons is that TAOs have arranged for their
officials ‘to accept TBAs’ employment to help business affairs promotion’, according to the official regulation of the TAO (TAO, 2003b). In the same regulations, it is also clearly illustrated that ‘directors or chairmen of the associations must comply with the ‘One China’ principle and support the unification of nation’. Every local-government level of the TAO maintains very close ties with TBAs in order to oversee Taiwanese businesspeople, as several interviewees have mentioned. Furthermore, as Interviewee H6 observed, Taiwanese businesspeople are more fearless of voicing criticisms over Taiwan’s mainland policy and urging for the liberalisation of regulations over cross-Strait interactions. Taiwan finns had hoped for a widening of cross-Strait trade ties, such as allowing direct flights with China, scrapping a cap on Chinese investments, and opening the island to mainland tourists. In contrast, in China they would rather keep a low profile no matter how inappropriate they feel China’s policies may be, as Interviewee H6 added. The reason is clear: no one wants to get into trouble in China due to speaking too freely, especially on politically sensitive topics. Interviewee H4 made a succinct comment on this point by saying that ‘[t]he situation of Taiwanese people in China is, just like Chinese old saying, “under other’s roof, one has to lower one’s head”’. On this point, Interviewee I2 (a Taiwanese official) said that he would personally advise businesspeople to focus on business development and steer clear of political issues. This has revealed the embarrassing situation of Taiwanese businesspeople and the huge difference in the respective political environments of Taiwan and China.

Both governments nevertheless use their engagement with enterprises to send political signals to the other side. For example, an official of the TAO said on 2 May 2004 that China would no longer in future specify by name those who were ‘green (pro-Taiwan

26 For example, Interviewees: A4, C3, D1, H6, and I7.
independence), Taiwanese businesspeople. However, on 24 May, the TAO declared that Taiwanese businesspeople who 'come to make money here and then go back to support Taiwanese independence are not welcome' (Sina, 2004). Following, on 31 May, on the front page of the People's Daily directly criticised Chimei Group Chairman Hsu Wen-long, also a presidential adviser to President Chen, an enthusiastic supporter of independence. It was clear that China tried to send a signal to Taiwanese businesspeople that China hoped businesses would stand aloof from politics, at least keep their distance from the Taiwan independence movement (Interviewee: I2). China’s efforts to crack down on Taiwan independence are manifest.

China split Taiwanese businesspeople into two groups: welcome, and unwelcome. For the unwelcome, it tightened its measures against those enterprises by, for example, stricter tax inspections, cutting down on loans available to Taiwanese businesspeople, and launching investigations into their personal backgrounds and political affiliations (Chiu, 2004). The most notable example was the large-scale tax raid on the Taiwan-invested Zhenjiang Chimei Chemical (ZCC) on June 2004. A huge amount of tax officials from China's administration of taxation accompanied public security officers to rush into ZCC for a large-scale tax investigation. The scale and the formulation of the tax raid were seemingly in an attempt to 'dig out the roots of the company completely', as Interviewee D1 had commented. China utilised business measures, such as allegation over tax fraud, against Taiwan-invested enterprises to serve China's political aims. For the welcome group, China arranged for President Hu Jintao to visit Taiwan-invested enterprises (TIEs) to boost entrepreneurs' confidence in investing there. For example, on 4 May 2004, Chinese President Hu visited HeJian

27 Interviewee D1 recited one of the manger-level staff in ZCC.
Technology (HeJian) and the Rechi Precision Company in Kunshan (Rechi) (Sina, 2006).

For reasons of economic security and political manoeuvring to demonstrate its authority, the government in Taiwan has adopted strict supervision mechanisms to oversee the activities of the Taiwan enterprises (STDN, 2002). China’s engagement with TIEs is transparent to Taiwan’s authorities. Coincidently, three days after Hu’s inspection tour of Kunshan, Rechi Chairman Chen Sheng-tien, who received Hu Jintao, was under the Taiwanese government’s investigation for insider trading. Following, the Rechi Precision (Taiwan), the world’s fourth-largest and Taiwan’s largest air-conditioner compressor producer, was alleged to have made an illegal investment in China (Chang, 2005). A similar investigation took place into Robert Tsao, then chairman of the United Microelectronics Corporation (UMC), the world’s second-largest contract chip manufacturer. Tsao was under investigation over UMC’s indirect investments into China’s HeJian Technology without having obtained prior approval from the government (CP, 2006d). Tsao was charged with breaking the business accounting law and other offences and the UMC was fined NT$5 million over its investment into HeJian (CP, 2006e). Both Chen and Taso decided to resign from their respective positions as group Chairman and have been under controversial juridical investigation.

In fact, the controversial cases of the UMC and the Rechi originated from the Taiwanese government’s effort to safeguard economic security by imposing a self-constraining economic approach towards China, as well as Taiwanese businesses’ endeavour to sustain their respective commercial security and development. The two cases have once more confirmed how Taiwanese businesses strive for business
competitiveness under the circumstance of cross-Strait political rivalry by undertaking some implicitly indirect business operations. Because of the ceiling amount on investment into China, many companies have no other choice but to take a contingent detour. Many of them transfer capital to China through paper companies in the Cayman Islands and the British Virgin Islands to conduct investments in China. Some of them also conduct investments in the names of individual shareholders in order to be able to cope with the difficulties caused by the investment ceiling set by the Taiwanese government. To invest to China, irrespective of whether through a third company or an individual shareholder, enterprises must assume many extra unnecessary costs and risks. The two cases have revealed the expensive prices that firms have paid for their investment arrangements in China under Taiwan’s China investment policy. Meanwhile, it also clearly illustrates Taiwanese government’s firm stance on safeguarding national security, and how Taiwan makes use of economic measures to retain its strategy of economic security, even to the extent of undermining the harmonious relations between the government and the business circle, thus running the risk of scaring off domestic investment.

The two examples have revealed that Taiwanese businesses have become important targets of political wrestling between the two governments across the Taiwan Strait. Both governments have manoeuvred their respective tactics to serve their political interests through economic issues. This has also exposed the Taiwanese government’s determination against China’s economic mechanism to TIEs. Given the business performance of UMC and Rechi, Robert Tsao and Chen Sheng-tien are two symbolic influential figures in Taiwan’s business circle. 28 They are also important

28 Robert Tsao was appointed to be presidential adviser to President Chen from 20 May 2000 to 19 May 2004.
entrepreneurs who contribute to Taiwan’s economic growth. Nevertheless, given their business reputation and influence, their current situation made it clear that the idea of ‘using business to encircle politics, using the public to pressure officials’ was far beyond reality. Taiwan’s government retains the freedom of action and freedom of choice to determine economic measures through which to tackle China’s economic impact and China’s intention of using economic inducements and business pressure to urge political concessions from Taiwan.

7.6 Conclusion

This chapter has argued that Taiwan’s economic security is a necessary precondition for Taiwan’s national security within the context of cross-Strait political hostility. By examining the dynamic of Taiwan’s capability in manoeuvring economic issues as a measure for its pursuit of security ends in the hostile cross-Strait relations, it has confirmed that economic issues that involve cross-Strait engagement are plausible measures to safeguard Taiwan’s security objectives, albeit arguably. Given that the environment of threat to Taiwan is primarily created by China, growing and intensive cross-Strait economic ties may possibly be exploited by China to undermine Taiwan’s security on the one hand, while it may also possibly be employed by Taiwan as a shield for national security. This is because the vigorously growing economic ties between Taiwan and China have formed a platform for the two sides to engage with each other formally within the ideological hostility. Therefore, the only contact channel between the two, the economic linkage, has become an instrument used by the two counterparts as a negotiation chip to secure their respective national security objectives. On this point, it is no surprise that the cross-Strait economic activities are not pure economic issues, but fall under the shadow of a political struggle. The
trade-off between economic interests and political concerns lies at the core of the tug-of-war.

The above examples have illustrated how and to what extent Taiwan has utilised measures to ensure its political aims and national security interests. All of those economic issues are employed by Taiwan or China to push the other into making political concessions, as well as to achieve economic objectives. Thus, negotiations on economic issues have become the 'battlefield' on which Taiwan must defend not only its economic interests, but also its national security objectives. Behind each individual issue, Taiwan has been steadfast in its political stance. It continues to secure its sovereignty and to strive for equal footing with China. China adheres persistently to the 'One China' principle. Taiwan’s insistence and China’s persistence are two sides of the same coin. The core of the cross-Strait rivalry lies in Taiwan’s sovereignty. Both Taiwan and China regard their respective insistence as encapsulating the utmost in national security.

The costs of the trade-off between economic interests and political concerns are, however, never inexpensive. The cross-Strait economic activities have never been practised under what could be considered ‘normal’ conditions. Although the direct links for air and shipping services between the two sides are the objective requirements for their economic development and contacts in various fields, the inflexible political antagonism makes of the issue a remote fantasy. The lack of direct transportation between Taiwan and China has become a justification for many foreign investors to withdraw their investment in Taiwan and as a result to shift to Chinese cities. Such events have further devastated Taiwan’s already uneasy economic situation. Furthermore, the Taiwanese government has put its relations with business
circle at risk by setting a self-constraining economic policy to regulate cross-Strait economic activities. This point has been analysed in the section regarding the issue of China’s tactics of ‘using business to encircle politics and using the public to pressure officials’. It found that the role and the capability of Taiwanese entrepreneurs to influence Taiwan’s political issues with regard to unification and sovereignty are arguable. It also indirectly implies that China’s leverage to utilise business to force Taiwan to accept its political terms is also questionable. Although some leading business élites have a certain degree of influence in commercial and political circles, their capability in shaping government policy is constrained. The case study has demonstrated that Taiwan’s economic security is being upheld, although the cost is high in terms of the damage to government-business relations.

This chapter has adopted certain economic issues that involve cross-Strait engagement as the vehicle towards examining the concept of economic security. Within the analysis of those issues, it has, on the one hand, demonstrated the way Taiwan utilises economic issues to support its economic security policies. It has also illustrated the effectiveness and limitation of such employment depending on the performance of the domestic economy, on the other. This has explicitly pinpointed the crucial role of the macro-economic level of economic security in the promotion of such an economic security policy. Without a sound and healthy domestic economic foundation, the freedom of choice and freedom of action of the formulation of an economic security policy are confined. Its effectiveness will thus diminish. On this point, Taiwan shall put more strength into maintaining its domestic economic health so as to sustain freedom of action and freedom of choice in facing any challenge from China.
CHAPTER EIGHT
THE IMPACT OF CROSS-STRAIT ECONOMIC INTEGRATION ON TAIWAN'S ECONOMIC SECURITY

8.1 Introduction
The previous chapters have examined illustrations of Taiwan's efforts of utilising economic measures in striving towards its own perspective of national security in the international diplomatic arena and within the cross-Strait politico-economic engagement while doing so within the framework of political antagonism. It has found that economic performance is an important factor affecting Taiwan's success of its economic security policy vis-à-vis China. Given the importance of economic performance to support Taiwan's economic security policy to withstand China in pursuit of Taiwan's national security agenda, the significance of cross-Strait economic ties to Taiwan involves not only economic implication but also political sensitivity. This chapter examines Taiwan's economic security with respect to its economic structure, as well as to its economic strength and capability of generating prosperity when it conducts economic engagements with China under the given cross-Strait relations. It aims to determine whether or not the economic interdependence between Taiwan and China undermines Taiwan's economic strength and thus threatens Taiwan's economic security.

This chapter will focus on the impact of cross-Strait trade and economic exchange on Taiwan's economic development. It is to examine how cross-Strait economic integration has influenced Taiwan's economic structural transformation, and its capability of maintaining economic growth and prosperity over the period between
2000 and 2004. The chapter is organised as follows. A brief review will be given of Taiwan’s economic performance over the period between 2000 and 2004, and the difficulties it faced. The following section will illustrate the development of trends in Taiwan’s investment in China and cross-Strait trade relations. It is an effort to explore Taiwan’s competitiveness in the economic domain within the cross-Strait economic relations. Next, the chapter moves on to review debates over economic security concerns when Taiwan conducts trade and economic engagements with China. Lastly, a conclusion to the chapter will be drawn in accordance with the concepts explored in the above section.

8.2 Taiwan’s Economic Performance and Economic Security Concerns vis-à-vis China

Taiwan was in the 1980s famous for its excellent economic performance, with a high economic growth rate, low inflation, a low unemployment rate, mild income distribution, sound public finance, and huge foreign exchange reserves (Yu, 1999b: 142). However, the economic miracle was not sustained in the beginning of the twenty-first century. In 2001, when the adverse effects of the international economic recession became more apparent, Taiwan’s foreign trade was affected and met with unprecedented difficulties. In 2001, Taiwan experienced for the first time since 1952 negative economic growth (-2.2%). Its total trade fell by 20.2 per cent, within which exports decreased by 17.2 per cent and imports by 23.4 per cent, although the trade balance maintained a surplus of $15.6 billion (TIER, 2005b: 54). The unemployment rate soared from 2.98 per cent in 2000 to 4.6 per cent in 2001, a record high for the previous five decades. The unemployment rate further grew to 5.2 per cent in 2002, despite the fact that the Gross Domestic Product (GDP) growth rate had reached 3.94
per cent in that year. Although the unemployment rate finally settled at 5.0 per cent in 2003 and 4.4 per cent in 2004, those figures were still much higher than the ten-year average unemployment rate in the 1980s (of 2.08%) and the 1990s (of 2.05%) (CEPD, 2005: 19).

With the improvement of the global economy as a whole, Taiwan’s economy returned to its normal upturn from 2002. Nevertheless, domestic investment increased slowly, and companies were continuing to move their production bases overseas (see Table 8.1). More companies exported their production bases and shifted their business operations to China. This aggravated the unemployment problem in Taiwan. The number of new enterprises fell by 2.02 per cent in 2001, as compared to 2000 (MOEA, 2002b: 44). Among them, the number of new small- and medium-sized enterprises (SMEs) fell by 1.99 per cent, while the number of new large-scale enterprises fell by 8.81 per cent (see Table 8.2). Total investment in regions other than China came to $3.97 billion in 2003, and $3.38 billion in 2004. Investment in China totalled $7.7 billion in 2003, which accounted for 65.98 per cent of Taiwan’s total outward investment, and $6.94 billion or 67.24 per cent in 2004 (see Table 8.4).

Table 8.1 Taiwan’s Gross Fixed Capital Formation and Private Sector Investment: 2001-2004

<table>
<thead>
<tr>
<th>Year</th>
<th>Cross Fixed Capital Formation</th>
<th>Private Sector Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>Growth Rate</td>
</tr>
<tr>
<td>2001</td>
<td>19,100</td>
<td>-20.22</td>
</tr>
<tr>
<td>2002</td>
<td>18,787</td>
<td>-1.64</td>
</tr>
<tr>
<td>2003</td>
<td>18,749</td>
<td>-0.2</td>
</tr>
<tr>
<td>2004</td>
<td>22,796</td>
<td>21.58</td>
</tr>
</tbody>
</table>


1 For analysis on current structural unemployment in Taiwan, see Chen (2005b: 384-385).
2 'New enterprises' are those enterprises in existence for less than one year.
From the above context, a growing amount of observers have argued that investment in China was one of the major factors that should take responsibility for Taiwan’s decline in economic performance and surging unemployment rate during this period (LT, 2001b; Huang, 2001d; Wu, 2002: 57). According to news released in October 2002 by Taiwan’s Executive Yuan, 66.8 per cent of interviewees of a public survey perceived that the high unemployment was caused by the movement of the manufacturing bases to China (RDEC, 2002). This survey has reflected three facts. Firstly, many Taiwanese manufacturers have shifted their production processes to China. Secondly, there has been insufficient new investment to supplement the job loss in the same period. Thirdly, this news also reflected Taiwan’s struggles with the question of whether to fear expanded economic contact with China as a threat to its economic security, or to welcome it as a contributor to Taiwan’s prosperity, given that China is Taiwan’s major source of trade surplus, as shown in Table 4.3.

To a large degree, Taiwan’s economic downturn was the consequence of several internal and external factors. Domestically, the shock to the Taiwanese economy was caused primarily by a sharp turn-around in internal economic policy in 2000 after the Presidential elections, which triggered a political struggle between the ruling party

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Table 8.2 Newly Established Enterprises by Size: 1999-2004

<table>
<thead>
<tr>
<th>Year</th>
<th>Size</th>
<th>Large Enterprises</th>
<th>SMEs</th>
<th>Total Newly Established enterprises</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td></td>
<td>679</td>
<td>100,744</td>
<td>101,423</td>
</tr>
<tr>
<td>2000</td>
<td></td>
<td>545</td>
<td>96,723</td>
<td>97,268</td>
</tr>
<tr>
<td>2001</td>
<td></td>
<td>497</td>
<td>94,803</td>
<td>95,300</td>
</tr>
<tr>
<td>2002</td>
<td></td>
<td>477</td>
<td>91,435</td>
<td>91,912</td>
</tr>
<tr>
<td>2003</td>
<td></td>
<td>647</td>
<td>111,507</td>
<td>112,154</td>
</tr>
<tr>
<td>2004</td>
<td></td>
<td>375</td>
<td>108,235</td>
<td>108,610</td>
</tr>
</tbody>
</table>


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3 For studies concluding that Taiwanese investment in China has little effect on Taiwan’s domestic investment and unemployment, see Ma et al. (2002) and Hsu and Liu (2004).
and opposition parties (Wu, 2002: 67; 155; Hsu, 2002: 157; Kao, 2003b: 39). A string of skimpy proposals were publicised by the newly-established Democratic Progressive Party (DPP) government. This in some ways de-stabilised domestic economic confidence. Firstly, there was the controversial cancellation of the fourth nuclear power plant, with $3 billion already expended and an equal amount of compensation to the contractors. This event fostered an opposition-led campaign to oust the President (GIO, 2000b; Yin, 2004: 184). The abruptness in the making of decisions because of party conflict then the ensuing protest calling for resumption of the nuclear power plant project threw society into a great state of uncertainty. On this point, interviewee I5 noted that 'the sense of uncertainty discouraged private investment in Taiwan'. Secondly, the policy to shorten the working hours for the labourer was another occurrence that accelerated the process of moving labour-intensive manufacture to other countries with cheaper labour resources, mainly China (Huang, 2001b: 33). From the perspective of businessmen, the Taiwanese government raised an anti-business tendency towards the business community, as Interviewee I5 commented. Thirdly, under a dubious argument asserting to stop the 'hollowing out' effect caused by the large exodus of capital, a government official advocated levying tax on businesses headed to China. Although the proposal was quashed immediately it was unveiled, business circles were convinced that the government polices were drifting and the government was hostile (Jan, 2001: 36). Against such a political and economic backdrop, investors hesitated about making new investments in Taiwan because of the lack of confidence. This worsened the already depreciating economy and Taiwan's competitiveness (Tsai, 2004: 47). In short, policy inconsistencies undermined business confidence and new investment in Taiwan, and resulted in the consequence of few new job opportunities.
External factors also weighted heavily on Taiwan's economic downturn in 2001. Taiwan fostered a deep dependence on international trade to support economic growth. Weak global demand and the cyclical downturn in the global electronics product market thus affected Taiwan's overall economic performance dramatically. The sharp downturn in the production and export of information and communications technology (ICT) goods in the global market caused by the subsequent world-wide economic slump in 2001 pushed Taiwan's economy into its first full-year contraction on record in that year (Hsu, 2002: 157; AmCham, 2002: 6). Such a dismal downturn in economic growth gradually recovered because the external factors were in 2002 resolved through the continuous expansion of the world economy. To some extent, the economic difficulties have illustrated the fact that Taiwan is so much a part of the global economy that its economy can never be viewed as separate from the global economic network.

Within the circumstance of an economic slump and a rising unemployment rate in Taiwan, the issue of an economic ‘hollowing out’ phenomenon caused by asymmetric economic dependence on China has raised much concern in Taiwan (CNA, 2002; Berthelsen, 2003). The hollowing out argument is straightforward: the asymmetric economic dependence on China has led to the exodus of capital and jobs from Taiwan. In the long run, Taiwan will suffer de-industrialisation and experience economic recession. Many Taiwanese political figures raised concerns that the growing trade and investment with China have led the country's economy overly to depend on economic relations with China and imposing negative impact on Taiwan's economic development. For example, Annett Lu, Taiwan's vice-President, reiterated the hollowing-out argument by claiming that ‘Taiwanese investments in China have had a "grotesque" impact on Taiwan’s economic development over the past ten years' (cited
in Bolt, 2001: 88). Huang Tien-lin, a national policy advisor to President Chen Shui-bian, suggested that trade relations with China constituted China’s ‘strategies aimed at making Taiwan quench its thirst with poisoned drinks’ (Huang, 2003b). Because of the long-term state of hostility between China and Taiwan, as well as China’s explicit claiming to utilise economic engagement as political measures for unification, from the viewpoint of the Taiwanese political elite, the cross-Strait economic exchange is not only an economic issue but also involves political and security sensitivities. They are concerned that a massive and rapid economic integration built on the foundations of quaking political rivalry and Taiwan’s asymmetric economic dependence on China may ruin Taiwan’s economic health on the one hand, while on the other giving China the leverage to ‘hijack’ Taiwan’s economy so as to blackmail its leaders for political concessions (Leng, 2002: 262; Chen and Chu, 2001: 220).

To conclude the complexity of cross-Strait relations, interviewee 12 made an honest and apposite comment as follows:

Without the Chinese market Taiwan could not enjoy a high amount of trade surplus. The economic strength accumulated from the trade surplus is the stepping-stone that Taiwan uses to step into world and to maintain diplomatic relations with allies. Economic strength also supports Taiwan’s capability of armed procurement. Ironically, Taiwan uses money earned from the Chinese market to build up its national strength to combat against China on the diplomatic and military frontiers. From Taiwan’s perspective, China is a threat to national security on the one hand, while it is also an opportunity on the other, given the long-lasting cross-Strait antagonism.
8.3 The Cross-Strait Economic Interaction: Building Economic Co-operation on the Foundation of Political Rivalry

8.3.1 Problematic Statistics

Due to political concerns, the Taiwanese government officially prohibits businesspeople from conducting ‘direct’ trade and investment with China. Although the ‘indirect’ economic policies have deterred normal economic engagement across the Taiwan Strait, there has been little sign that cross-Strait business activities have been slowing down (see Tables 4.2 and 4.3). With Taiwan’s ‘indirect’ investment regulations, four types of business practice have been created. They result in the difficulty in collecting reliable statistics on investment in China. Firstly, the development of the international capital market allows Taiwanese enterprises to raise funds in international financial markets and to invest in China via shell companies in third countries. Many investment projects adhere to the cap set by the Taiwanese government. Others, in contrast, also raise funds in the international financial market for investment to China. Secondly, according to Taiwan’s economic policy towards China, all Taiwanese investment projects in China must invest through a company registered in third countries or areas (Lin, 2001c). This regulation of indirect investment is the reason that many investments to China are through offshore shell capital holding companies in tax-exempt countries, such as the British Cayman Islands and the Virgin Islands in the Caribbean. Thirdly, to some extent, making investments in China through some offshore capital holding companies has become a feasible measure for business to avoid the government’s constraining policy (Tung,

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4 For details about Taiwan’s self-constraining economic policy and the cap on the investment amount in China, see Chapter Four.
5 The author was told this by Interviewee D1, a Taiwan-Invested Enterprise’s high-rank manager.
6 Interviewee H1 confirms that his company also through this investment mode invests in China. According to Chiou et al., the British Virgin Islands are the Taiwanese investors’ most favoured choice among many third places for the establishment of holding companies (Chiou et al., 2003: 35).
2002b: 23-25; Kao, 2003a). It is also a safety measure to protect investment in China.\(^7\)

Fourthly, many Taiwanese investors in China either failed to gain approval from the Taiwanese government or else they registered with a lower value than the real amount of investments (Mai et al., 2000: 193-194). Consequently, putting all situations together, it suggests that the statistics of investment released by the Taiwanese government agency are somewhat shadowy and thus incompletely reliable.

In this regard, the Chinese data stand closer to reality in comparison with Taiwan’s statistics as shown in Table 4.2, although some researchers suggest that China’s figures also underestimate the real scale of investment from Taiwan.\(^8\) According to China’s official statistics, Taiwan’s total accumulated investment in China was conservatively estimated at $80 billion between 1978 and 2004, (TIER, 2005b: 30). Nevertheless, given that many Taiwanese companies and investors have long been found to manoeuvre around Taiwan’s investment restrictions, many observers suggest that Taiwanese accumulated investment in China is variously estimated at between $100 billion and $200 billion if indirect investment through third countries is factored in (Shapiro, 2002; Smith, 2002; Tsai, 2002; Wu, 2002: 107; Huang and Schuman, 2004b).

Although there is no agreement regarding the actual amount of capital flows into China, there is little contrary argument over the actually capital flow that asymmetrically pours into China from Taiwan. The cross-Strait investment activities actually refer to asymmetric capital outflow from Taiwan to China. For security

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\(^7\) As interviewee G2 explained, his capital was remitted from the US, therefore his company was identified as a US-invested firm. Consequently, the company should be free from the possible consequence of cross-Strait political disturbance, if it happened.

\(^8\) This information was provided by Interviewee E15, a Shanghai-based scholar.
concerns, Taiwanese government did not allow Chinese investment into Taiwan before Taiwan adopted the new ‘Proactive Opening with Effective Management’ (POEM) economic policy and lifted the ban over Chinese investment to the category of real estate in 2002. According to Joseph Wu, Chairman of the MAC, only three cases of real estate transaction had been approved by March 2006 under the POEM policy since it came into effect on 1 July 2002 (Wu, 2006b).

For two-way trade, figures collected from the Customs and Excise divisions of Hong Kong, China, and Taiwan over cross-Strait indirect trade have displayed huge discrepancies. There are two reasons other than government’s indirect trade regulation that have been raised as factors causing such differences among the three Customs (Mai et al., 1998: 169). Firstly, China’s trade, investment, and regulatory systems are neither transparently nor consistently enforced. Secondly, some Taiwanese manufacturers deliberately fail to declare that China is the final destination of their exports, so as to avoid institutional interference. As shown in Table 4.3 and Figure 8.1, the export figures collected by Chinese Customs have been routinely overvalued, while Taiwan customs’ statistics has been consistently undervalued. Although this situation has been improved since 2002 when Taiwan deregulated a long list of products, earlier prohibited from being exported to China, Chinese Customs’ figures remained the highest among Hong Kong, China, and Taiwan.

This statistical issue has drawn many researchers’ attention (e.g., Kao and Sung, 1998: 1-13; Fung, 1997: 34-37; Huang, 2004: 108-114). For the purpose of reflecting real trade amounts across the Taiwan Strait, the Mainland Affairs Council (MAC) established a formula to estimate Taiwan’s exports to China by including the difference between Taiwan’s exports to Hong Kong and Hong Kong’s imports from
Taiwan plus transit trade to China. The MAC’s estimation has been accepted as reflecting more accurate data than those of other institutions. For import figures, Taiwan Customs’ collection is the highest among the three Customs. The MAC also adopts these figures as its reference. Therefore, this thesis will adopt the MAC’s estimation for Taiwan’s exports to China and will take Taiwan Customs’ figures for imports from China.

8.3.2 The Mechanics of Cross-Strait Investment

(a) Motivations of Investment to China

Different factors provide the motivation leading outward FDI to different host countries (Makino et al., 2002). The choice of investment location is based on location advantages of factors such as consumer preference, resource endowment, the relative wage rate, and government policies in tax, tariff, foreign exchange, and incentive schemes (Dunning, 1998). Taiwan’s outward FDI are motivated by a variety of factors, including the costs of production, the internationalisation of transaction, the

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9 For details of the MAC’s calculation formulation, see TIER (2005b: 26).
costs of internationalisation of transaction involved in exporting, or licensing a product to another country. There is a large separate body of literature, theoretical and empirical, focusing on Taiwan’s outward FDI into China. Commonly, Taiwanese investments in China can be classified into two categories: cost-oriented, and market-oriented (Chen, 1992; Chen and Yang, 1999).

Cost-oriented investment entails searching for lower-cost overseas manufacturing bases, a defensive measure for business to retain their export markets. In the 1980s, Taiwan experienced rapid appreciation of the New Taiwan Dollar (NT$), rising land and labour costs, a steadily worsening labour shortage, and environmental controversies that together pushed up the cost of business operations in Taiwan. Taiwanese enterprises were forced to out-source the manufacture of products to foreign locations in order to overcome a gradually loss in competitiveness in world market caused by the high cost of operations (Kuo, 1997; Lin, 1997: 183-184; Hsu, 2004: 54). Many labour-intensive business, especially those cost-sensitive SMEs, sought to relocate manufacturing plants to neighbouring countries where cheaper land and labour costs were available, principally to mainland China and South-east Asia (Yin, 2004: 100-107; Hsu and Liu, 2004). The coincidence of China’s economic ‘Open Door’ policy and Taiwan’s state of being under economic challenge fostered a climate for Taiwanese enterprises to engage in investment in China. As Interviewees G1 and H4 confirmed, their enterprises have invested in China since 1992, attracted by China’s low costs in terms of labour and land, tax benefits, and identical language, although the overall political atmosphere and economic environment in China were at that time under-developed.11 The objective for their investments in China is to find a

10 For example, Chen (1992); Chen (1996); Chen and Yang (1999); Liu and Lin (2001); Zhang (2001); Chen et al. (2004a); Chen et al. (2004b), and Lin and Yeh (2005).

11 Interviewee G1 said that he always carried more than $20,000 cash in his pocket in the first few
'second spring' of development for their respective traditional labour-intensive manufacturers.

While SMEs are generally driven by the cost factor, large-scale enterprises pursue market share. With Taiwan's progressively relaxing restrictions on investment in China, many large-size Taiwanese enterprises with high capital and technology intensities after the mid-1990s invested in China. The market-oriented FDI was looking for business expansion and for sustainable competitiveness of enterprises. Investors aimed at establishing overseas manufacturing bases and footings to gain access to China's colossal potential market (Kuo, 1997; Kao, 1999: 168-171). According to Taiwan's official surveys on overseas investment of the manufacturing industry published in 2004, 49.1 per cent of outward investment to China was motivated by 'host countries' massive markets', followed at 47.5 per cent by the motivation of 'taking advantage of huge low-cost labour' (see Table 8.3). It revealed that the market factor has become an important determinant driving Taiwanese investors to Chinese markets.

Table 8.3  The Major Motivations of Taiwanese Outward Investment: 2002-2004

<table>
<thead>
<tr>
<th>Motivation</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>To China*</td>
<td>Overall</td>
<td>To China*</td>
</tr>
<tr>
<td>Host countries' massive markets</td>
<td>45.9</td>
<td>63.6</td>
<td>47.7</td>
</tr>
<tr>
<td>Taking advantage of huge low-cost labour</td>
<td>50.0</td>
<td>62.8</td>
<td>52.3</td>
</tr>
<tr>
<td>Under foreign customers' demand</td>
<td>22.9</td>
<td>33.4</td>
<td>27.5</td>
</tr>
<tr>
<td>Following Taiwanese customers</td>
<td>23.4</td>
<td>27.2</td>
<td>23.2</td>
</tr>
<tr>
<td>Deterioration of Taiwan's economic environment</td>
<td>28.2</td>
<td>36.1</td>
<td>23.5</td>
</tr>
</tbody>
</table>

Note: 1. *Including China and Hong Kong.
2. Figures represent the percentage of interviewees regarding the specific reason as their motivation to invest abroad or in China.

years when he was in China. It was in preparation for an emergency in the event that China fell into a state of riot.
Gradually, as more manufacturers moved to China, the 'industrial clustering effect' (ICE) and 'economies agglomeration effect' were generated. While upstream and downstream of industrial suppliers move to China, the clustering effect has become a pulling strength that forces companies as a result to adopt the same investment strategy. On this point, Interviewees E8 and I1 have confirmed that the motivations for their respective companies to invest in China are following the clustering effect. As Interviewee I1 emphasised, in the business world, enterprises must catch up with the movements of their business competitors in order to maintain their competitiveness. Similarly, while more manufacturers moved to China because of the 'industrial clustering effect', more peripherally-related business also moved to China 'under customers' demand' and thus formed the 'economies agglomeration effect' (MOEA, 2002a; 2003a; 2004a). On this point, as shown in Table 8.3, an increasing percentage of Taiwanese outward investment to China was motivated by 'foreign customers' demand' and 'following Taiwanese customers'. Some peripheral service industries, such as banks, transportation, import/export agencies, and so on also come to China at customers' requests to form agglomerative business operation. Thus, combining the clustering effect of the hi-tech industry and the 'economies agglomeration effect' of many peripheral services industries, Taiwan's investment in China is accelerated (see Table 4.2).

In more recent years, the factor of 'deterioration of Taiwan's economic environment' has been mentioned in accounts as a determinant to investment abroad. As shown in Table 8.3, the factor of the 'deterioration of Taiwan's economic environment'

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12 For a definition of the industrial clustering effect (ICE), see Porter (1998) and Cook et al. (2001). For a discussion on different types of ICE, see Markusen (1996).

13 Firms tend to agglomerate in order to benefit from scale economies and simultaneously would locate close to the market so that transport costs were minimised (Krugman, 1980).
remained the fifth major reason for Taiwan-invested enterprises (TIEs) to invest abroad, although the percentage showed decreasing tendency between the period 2002 and 2004. In this context, it is suggested that Taiwan’s domestic political friction between ruling and opposition parties has undermined Taiwan’s economic environment, which became a force accelerating the flow of FDI abroad, especially to China.

(b) Evolution of Taiwanese Investment in China

The evolution of Taiwanese investment in China is the result of Taiwanese businesses’ endeavour for business expansion and competitiveness, as well as being in the national economic interests and political concerns of both the Taiwanese and the Chinese governments. With Taiwan’s gradually liberal economic policies towards China and China’s economic incentives, the growth of Taiwanese investment in China has soared dramatically in terms of scale and scope. The wave of Taiwanese investment in China can be divided into four stages since its onset at the end of the 1980s (Hsia, 2004: 27-29). The four stages were the trial and seeding stage, the expansionary stage, stagnant stage, and recovery stage.

The first stage started from 1987, when Taiwan allowed Taiwanese residents to pay family visits to China, and continued to 1990. The second stage was from 1991 to 1995. In this stage China re-confirmed its ‘Open Door’ policy and the ‘Socialism Market Economy system’ after Chinese leader Deng Xiaoping’s trip to the southern provinces in 1992. Coincidentally, Taiwan allowed some manufacturing industries to invest in China in response to China’s legalisation of investment for some personal computer (PC)-related products in 1992 (Naughton, 1997: 186). The benign

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14 For literature discussion China’s economic reform, see Kao (1999).
cross-Strait political climate of the 1993 semi-official Koo-Wang Talks further promoted Taiwan’s investment in China. Thus, Taiwan’s investment into China grew rapidly at this stage. In 1993, Taiwan was China’s second-largest FDI source, which accounted for 11.4 per cent of China’s total inward FDI (Lin, 1997: 171-172; Mai et al., 1998: 71). Taiwan’s investment in China increased dramatically from a contracted amount of $5.54 billion in 1992 to $9.96 billion in 1993 (see Table 4.2).

The third phase was between 1996 and 1999: the period was shaped by both non-economic and economic factors. The 1995 and 1996 Taiwan Strait Missile Crisis escalated political tensions and rivalry between Taiwan and China, which resulted in a negative growth in investment, according to China’s official statistics (see Table 4.2). The impact of the 1997 and 1998 Asian financial crises on China’s economic performance caused foreign and Taiwanese investors to slow down their pace of investment. The fourth stage was stimulated by China’s WTO accession as well as by China’s new incentive measures for attracting foreign investment. From 2000, there was a new wave of Taiwanese investment in China, with significant growth in terms of both the scope of the industries and the scale of the investment amounts. The new wave of investment was pulled by the high economic growth in China and was pushed by the consequence of political instability in Taiwan (Hsu and Liu, 2004: 211). In 2001, the contracted amount of Taiwanese investment in China surged to $6.91 billion, which was about 71 per cent growth compared with that in 2000 (see Table 4.2). By the end of 2004, the Taiwanese accumulated contracted FDI in China was $79.93 billion for a total of 64,626 projects (see Table 4.2). It is worth noting that the new wave of investment from Taiwan to China in the period between 2000 and 2004 accumulated to $35.56 billion, which was 44.8 per cent of total accumulated contracted amount of Taiwanese investment in China over years, according to China’s
As well as there being a rapid increase in the total amount of investment into China, the average scale of each investment also rose. The average amount per project was $0.86 million in 1992, while the average amount per project in 1995 was $1.21 million: for the first time, over $1 million per project (see Table 4.2). After then, the size of project swelled. In 2004, the average amount per project was $2.33 million, which was a doubling in size compared with that in 1992. The enlargement of the singular project had a three-fold significance. Firstly, investment projects transferred to more capital-intensive industries. Secondly, it implied that Taiwanese businesspeople felt more comfortable regarding China’s business environment and political atmosphere across the Taiwan Strait.15 Thirdly, increasing amounts of large-scale enterprises and stock listed companies invested in China.16 On this point, Taiwan’s stock market and economy was sensitive not only to military aspects of the ‘China factor’, but also economic ones.

According to Taiwan’s official statistics, China is Taiwan’s largest destination for outward investment. Taiwan’s investment in China was $174 millions in 1991, which was 9.51 per cent of Taiwan’s total outward investment (TOI). In 1995, the numbers increased dramatically to nearly $1.1 billion, or 44.61 per cent of Taiwan’s TOI for that year. In comparison, the ratios further increase to 67.24 per cent in 2004 (see Table 8.4). In only one decade, China had become the largest destination for Taiwan’s

15 According to Interviewees A4, D1, and H4, all agreed that China made much progress in terms of its law enforcement for business, in comparison with the situations in the early 1990s and currently. Regarding cross-Strait political rivalry, they would rather believe that China would keep its promise to protect Taiwanese investors in the event of any unfortunate cross-Strait military confrontation.
16 According to Taiwan Stock Exchange Cooperation (TSEC) and GreTai Securities Market (GTSM), up to the second quarter of 2006, 484 companies listed on the TSEC and 351 companies listed on the GTSM had already conducted overseas investment in China (FSC, 2006).
outward investment, although all Taiwanese outward investment to China was subject to the regulation and review of the Taiwan government. On aggregate, the share of Taiwan's accumulation of approved outward investment to China as a percentage of TOI was 49.51 per cent up in 2004, following the share of 18.74 per cent in British Central America (TIER, 2005a: 31). Up to the end of 2005, about 33.7 per cent of outward FDI of British Central America in China was from Taiwan (BOFT, 2007). Statistics suggest that Taiwan's self-constraining investment policy towards China has a limited effect on halting ventures in China.

Table 8.4 Taiwan's Approved Outward Investment (AOI): 1991-2004

<table>
<thead>
<tr>
<th>Period</th>
<th>Total AOI (TAOI)</th>
<th>AOI (not including China)</th>
<th>AOI to China</th>
<th>AOI to China for Electronic and Electric Appliances</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>Amount</td>
<td>Amount</td>
<td>% of TAOI</td>
</tr>
<tr>
<td>1991</td>
<td>18.30</td>
<td>16.56</td>
<td>1.74</td>
<td>9.51</td>
</tr>
<tr>
<td>1992</td>
<td>11.34</td>
<td>8.87</td>
<td>2.47</td>
<td>21.78</td>
</tr>
<tr>
<td>1993*</td>
<td>48.29</td>
<td>16.61</td>
<td>31.68</td>
<td>65.60</td>
</tr>
<tr>
<td>1995</td>
<td>24.50</td>
<td>13.57</td>
<td>10.93</td>
<td>44.61</td>
</tr>
<tr>
<td>1996</td>
<td>33.95</td>
<td>21.65</td>
<td>12.29</td>
<td>36.20</td>
</tr>
<tr>
<td>1997*</td>
<td>72.28</td>
<td>28.94</td>
<td>43.34</td>
<td>59.96</td>
</tr>
<tr>
<td>1998*</td>
<td>53.31</td>
<td>32.96</td>
<td>20.35</td>
<td>38.17</td>
</tr>
<tr>
<td>1999</td>
<td>45.22</td>
<td>32.69</td>
<td>12.53</td>
<td>27.71</td>
</tr>
<tr>
<td>2000</td>
<td>76.84</td>
<td>50.77</td>
<td>26.07</td>
<td>33.93</td>
</tr>
<tr>
<td>2001</td>
<td>71.76</td>
<td>43.92</td>
<td>27.84</td>
<td>38.80</td>
</tr>
<tr>
<td>2002*</td>
<td>100.93</td>
<td>33.70</td>
<td>67.23</td>
<td>66.61</td>
</tr>
<tr>
<td>2003*</td>
<td>116.68</td>
<td>39.69</td>
<td>76.99</td>
<td>65.98</td>
</tr>
<tr>
<td>2004</td>
<td>103.23</td>
<td>33.82</td>
<td>69.41</td>
<td>67.24</td>
</tr>
</tbody>
</table>

Source: CEPD (2005: 270; 272), and calculated by the author.
Note: * includes the number of the registration of previously unregistered.

(c) The Change of the Investment Structure in China

Taiwan's investment into China is a business strategy aimed at obtaining the economic security of business. The growth of Taiwanese investment in China coincides with the growth of Taiwan's exports to China over years. This development
involves the division of labour and cross-Strait supply chain (Ma et al., 2002: 20). In the production system, Taiwan is a supplier of parts and components as well as of capital, management expertise, technical expertise, marketing capability, and links to the world market, while China offers its relatively low costs of labour, land, and raw materials for manufacturing finished commodities for export (Chen, 1994b; 1998; Chan and Lo, 2000).

With the trend towards globalisation and the gradual liberation of economic policies from the two sides of governments, the evolution of Taiwan’s investment in China has gradually reached four tendencies in the context of formation and content (Lee and Wu, 2003: 109-116). Firstly, the investment category has changed from the traditional labour-intensive consumer industry to a new ICT industry (Clough, 1993: 44; CIER, 2002). Currently, some industries with more capital input and technology-intensive manufacturing, such as ICT industries, have become the mainstream of investment in China (see Table 8.4). More than 30 per cent of Taiwanese ICT manufacturing firms have already invested in China (Lee and Wu, 2003: 110). The ICT industries have already formatted a whole commodity supply chain, from upstream parts and components suppliers to downstream assembling manufacturers in the Yangtze Delta. The industrial clustering effect is evident.

Secondly, large-scale firms have replaced SMEs to take the lead in investment in China. With more stock-listed firms investing in China, the scale of the single investment project is larger, as mentioned above. Furthermore, because of the mechanism of the cross-Strait division of labour, TIEs gradually formed an industrial clustering effect in China. They also attracted many related SMEs and peripheral sectors to move to China, which has eventually created the economies agglomeration
effect. Consequently, lead by the large-scale enterprises, Taiwanese investors in China have transferred from operating businesses alone to working with other TIEs collectively by forming strategy consortia or by programming industrial integration vertically or horizontally for the developing Chinese market (Lee and Wu, 2003: 109-116).

Thirdly, the impetus for Taiwanese investment had shifted from cost-driven to market-driven. In 1980s Taiwanese investors in China sought low-cost production factors in order to establish labour-intensive manufacturing bases. Maintaining a relative advantage in export-oriented products was the major concern for the TIEs in China. Gradually, with China’s recent economic boom and the liberation of the Chinese market after its accession to the WTO, setting manufacturing bases to exploit Chinese market became one of the important reasons for enterprises to venture into China. Many TIEs in China transferred some of their production capacity from exporting to the international market to selling in Chinese market (Lee and Wu, 2003: 114). Many new investments were focused on the Chinese market.

Fourthly, Taiwanese investment in China had gradually spread from Southern to Northern provinces. With progressive liberation policies, the Chinese central government decentralised authority to allow provincial governments to organise investment policies. Attracting foreign investment and facilitating economic growth is the top priority of every local government. With preferential incentives, foreign investments have gradually spread from the south to the north of China. Taiwanese investors have established new clustering areas in cities along the Yangtze Delta, for example, Suzhou, Wuxi, Chanchao, Hangzhou, and Ningbo. According to Taiwan’s

17 Interviewees B1, C1, C2, and G7 have made similar statements.
official statistics, in 2004 approved investment to China mainly concentrated in Yangtze Delta area, such as Jiangshu and Zhejiang province. The former accounted for 52.76 per cent of total direct investment from Taiwan, while the latter accounted for 9.93 per cent of that (TIER, 2004: 31). On aggregate, from 1991 to 2004, about half of Taiwanese investment was accommodated in Jiangshu province (43.28 per cent) and in Zhejiang (6.64 per cent) (TIER, 2005b: 31).

8.3.3 Rapid Growth in the Value of Bilateral Trade Flows

(a) Major Source of Trade Surplus

There are three characteristics of the cross-Strait trade relations in the past two decades. Firstly, trade moved asymmetrically from Taiwan to China via third countries or areas. More than 80 per cent of indirect bilateral trade across the Taiwan Strait were exports from Taiwan to China. Taiwan’s indirect trade with China via Hong Kong increased massively from $3.9 billion in 1989 to $61.6 billion in 2004 (see Table 4.3). The latter was 15.8 times greater than the former. This illustrated that the cross-Strait trade had grown significantly in the past 15 years, although political interaction fluctuated in response to political manoeuvring by the respective leaders.

Secondly, Taiwan’s trade surplus gained from China generally showed an upward tendency. From 1993, Taiwan’s trade surplus with China ran higher than Taiwan’s overall international trade balance (see Table 4.3). The aggregate from 1991 to 2004 of Taiwan’s total amount of trade surplus with China was $236.9 billion. The amount gained from trade with the world as a whole was $149.8 billion. Statistics suggest that Taiwan would be in a situation of trade deficit if Taiwan had gained no trade surplus from China. By taking more recent years, for example, from 2000 to 2004, the total accumulated trade surplus gained from China was $109.0 billion, and that gained
from the world was $65.0 billion. These statistics illustrate that trade with China has incontrovertibly supported Taiwan's economic growth. It is worth noting that Taiwan's trade balance with the world fluctuates in accordance with the performance of the global market, yet Taiwan's trade surplus gained from cross-Strait trade persistently displays an ascending trend (see Figure 8.2). On this point, Taiwan's trade surplus with China was in part because of Taiwan's trade competitiveness in the Chinese market, and in part because of the fact that the Taiwanese government had unilaterally imposed restrictions against importing Chinese commodities. 18

Figure 8.2

![Taiwan's Sources of Trade Surplus](chart.png)

Note: Trade surplus gain from world has included trade with China.
Source: Edited by the author in accordance with statistics in Table 4.3.

Thirdly, as the cross-Strait trade expanded over time, the ratio of Taiwan's trade with China to its overall trade in the world progressively grew. The ratio increased from 3.31 per cent in 1989 to 18.03 per cent in 2004 (see Table 8.6: A1). This situation coincided with Taiwan's trade ranking in China. In 1990, Taiwan was China's fourth trading partner, amounting to $52 billion (Tung, 2003a: 39). According to China Customs statistics, in four consecutive years from 2001 to 2004, Taiwan was China's

18 Since Taiwan's entry into the WTO in 2002, Taiwan has gradually made more liberal the restrictions on Chinese commodities imported into Taiwan. Nevertheless, by the end of February 2005, a share of 21.7 per cent of the total Chinese commodities was still on the list of banned imports (BOFT, 2005).
second-largest source of suppliers (see Table 8.5). In the same period, Taiwan was China’s fourth-largest trading partner in 2002, while in the other three years Taiwan was China’s fifth-largest trading partner. In contrast, from Taiwan’s standpoint, China was Taiwan’s third-largest trading partner and second-largest export market in 1993 (Tung, 2003b: 42). In 2003, with total exports amounting to $35.4 billion and imports amounting to $11 billion, China has for first time surpassed Japan and the US to become Taiwan’s largest trading partner in terms of both imports and exports. The above figures suggest the fact that the cross-Strait trade moved rapidly. It was neither affected by Taiwan’s self-constraining economic policies nor slowed down by any detrimental effects of the political struggle between the two governments.

Table 8.5 China’s Trade with Taiwan and Taiwan’s Trade Position in China

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Bilateral Trade</strong></td>
<td>323.4 (5)</td>
<td>446.5 (4)</td>
<td>583.7 (5)</td>
<td>783.2 (5)</td>
</tr>
<tr>
<td><strong>Trade Deficit</strong></td>
<td>-223.4 (1)</td>
<td>-223.4 (1)</td>
<td>-403.6 (1)</td>
<td>-512.3 (1)</td>
</tr>
<tr>
<td>China’s Import from Taiwan</td>
<td>273.4 (2)</td>
<td>380.6 (2)</td>
<td>493.6 (2)</td>
<td>647.8 (2)</td>
</tr>
<tr>
<td>China’s Export from Taiwan</td>
<td>50.0 (9)</td>
<td>65.9 (9)</td>
<td>90.0 (8)</td>
<td>135.5 (9)</td>
</tr>
</tbody>
</table>

Unit: US$ billions

Note: Figure inside the bracket represents rank of Taiwan.

The way in which Taiwan’s trade surplus gained from its trading with China can be interpreted in two aspects. From the optimistic perspective, the massive surplus proves that Taiwan’s products offer strong competition in the Chinese market. This can be regarded as Taiwan’s economic strength and capability in the generation of prosperity. The Chinese market supports Taiwan’s current stage of economic growth. Taiwan shall seize the opportunity at the right time. Nevertheless, from the pessimistic viewpoint, regardless of the unsolved political wrangle and the possibility for China to utilise economic engagement as means to approach political ends, Taiwan’s
economic dependence on its trade surplus with China exerts considerable risk. Taiwan's heavy dependence on the Chinese market could be dangerous if China experienced a slowdown (Lin, 2003c: 251). Any country that depends on a single market to support its economic operation would be at great risk if the market were to encounter any challenge or setback.

(b) Driven by FDI but showing a Declining Tendency

There were three features in the structure of Taiwan's exports to China in the previous two decades. Firstly, exports from Taiwan to China maintained an upward tendency over the years, except in 1998 and 2001, according to statistics estimated by the MAC (see Table 4.3). The two exceptions were caused by the world-wide economic disruptions. In 1998, the Asian region experienced a financial crisis. In 2001, the economic recession was global. It is worth noting that the cross-Strait political struggle and the possibility of military confrontation has not weakened trade activities across the Taiwan Strait, for example, the 1995/96 Taiwan Strait missile crisis, China's large-scale military exercises in 1999 after President Lee's 'special state-to-state relationship' theory, and President Chen's 'one country to each side' assertion in August 2002. Given this context, it is suggested that the cross-Strait trading activities are part of the global supply chain within the global economic system.

Secondly, Taiwan's export dependence on China increased on a year-by-year basis. Taiwan's total exports to China as a percentage of total exports world-wide were at 3.31 per cent in 1989; the ratio grew to 10.46 per cent in 1995, and to 18.03 per cent in 2004 (see Table 8.6: A1). The growing dependence was evident. The cross-Strait economic cooperation in the context of the division of labour and the business
mechanism of ‘Taiwan taking order, China producing’ provided the two important sources of impetus for such development (Liu et al., 2003: 114). Taiwanese manufacturers increasingly out-sourced orders to offshore producing centres in more recent years. The figure of foreign production ratios has clearly illustrated this situation. The ratio of foreign production to Taiwan’s overall exports increased from 17.46 per cent in 1997 to 32.51 per cent in 2004 (CEPD, 2006: II-3-19). While TIEs received out-sourcing orders from Taiwan, they generally needed to import some parts and components from Taiwan, and this as a result further increased Taiwan’s exports.

Table 8.6 Trade Interdependence between Taiwan and China: 1989-2004

<table>
<thead>
<tr>
<th>Year</th>
<th>A1</th>
<th>B1</th>
<th>A2</th>
<th>B2</th>
<th>A3</th>
<th>B3</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989</td>
<td>3.31</td>
<td>3.51</td>
<td>5.03</td>
<td>5.63</td>
<td>1.12</td>
<td>1.12</td>
</tr>
<tr>
<td>1990</td>
<td>4.23</td>
<td>4.47</td>
<td>6.54</td>
<td>8.24</td>
<td>1.40</td>
<td>1.23</td>
</tr>
<tr>
<td>1992</td>
<td>7.60</td>
<td>7.05</td>
<td>12.95</td>
<td>13.09</td>
<td>1.55</td>
<td>1.32</td>
</tr>
<tr>
<td>1995</td>
<td>10.46</td>
<td>8.02</td>
<td>17.40</td>
<td>14.71</td>
<td>2.98</td>
<td>2.08</td>
</tr>
<tr>
<td>1996</td>
<td>10.95</td>
<td>8.21</td>
<td>17.87</td>
<td>14.93</td>
<td>3.02</td>
<td>2.03</td>
</tr>
<tr>
<td>1997</td>
<td>11.13</td>
<td>8.11</td>
<td>18.39</td>
<td>15.77</td>
<td>3.42</td>
<td>2.14</td>
</tr>
<tr>
<td>1999</td>
<td>11.12</td>
<td>7.16</td>
<td>17.52</td>
<td>12.86</td>
<td>4.09</td>
<td>2.32</td>
</tr>
<tr>
<td>2000</td>
<td>10.84</td>
<td>6.60</td>
<td>16.87</td>
<td>11.18</td>
<td>4.44</td>
<td>2.49</td>
</tr>
<tr>
<td>2001</td>
<td>12.10</td>
<td>5.46</td>
<td>17.86</td>
<td>9.01</td>
<td>5.50</td>
<td>2.22</td>
</tr>
<tr>
<td>2002</td>
<td>15.39</td>
<td>6.03</td>
<td>22.56</td>
<td>9.98</td>
<td>7.06</td>
<td>2.44</td>
</tr>
<tr>
<td>2003</td>
<td>17.07</td>
<td>5.44</td>
<td>24.52</td>
<td>8.57</td>
<td>8.61</td>
<td>2.50</td>
</tr>
<tr>
<td>2004</td>
<td>18.03</td>
<td>5.34</td>
<td>25.83</td>
<td>8.01</td>
<td>9.93</td>
<td>2.81</td>
</tr>
</tbody>
</table>

Note: The values of export from Taiwan to Mainland China are estimated by the MAC.
A1 = total indirect trade between Taiwan and China/Taiwan’s total amount of foreign trade.
B1 = total indirect trade between Taiwan and China/China’s total amount of foreign trade.
A2 = Taiwan export to China/Taiwan’s total amount of exports.
B2 = China’s import from Taiwan/China’s total amount of imports.
A3 = Taiwan’s imports from China/China’s total amount of imports.
B3 = China’s export to Taiwan/China’s total amount of exports.

Thirdly, a great portion of Taiwanese products exported to China is driven by Taiwan’s FDI, which involved the global division of labour. Taiwan exported intermediate and capital goods to TIEs in China, while TIEs in China assembled those
intermediate goods into finished products and re-exported them to world markets. However, according to several surveys conducted by the MOEA between 2000 and 2004, all illustrated that the share of Taiwan’s supply of parts and components to TIEs gradually declined (MOEA, 2000a-2004a). It is a trend that the increasing amount of TIEs obtains necessary inputs from local TIEs or other foreign-invested enterprises in host countries. This has, in turn, reduced Taiwan’s exports of such related categories of products.

(c) The Structure of Taiwan’s Import from China: Showing a Rising Tendency
During 1992 and 1998, Taiwan’s merchandise structure of imports from China was similar to Taiwan’s overall imports (Mai et al., 2000: 213-225). In this period, Taiwan’s imports from China were no longer basic agricultural and industrial raw materials. Import products are closely related to Taiwan’s investment in China (Mai et al., 2000: 220). According to Taiwan’s customs statistics, imports from China were concentrated on four categories of commodities in descending order: (1) electrical equipment, parts, and accessories; (2) machinery, mechanical appliances, parts, and accessories; (3) Iron and Steel, and (4) mineral products. The top two categories of products accounted for 28.3 per cent and 19.8 per cent of Taiwan’s imports from China in 2004. The year-on-year growth rates of the two import categories were 39.1 per cent and 32.5 per cent in the year (TIER, 2004: 24).

According to Taiwan’s official statistics, the amount of imports from China to Taiwan was in a rising tendency over years. Goods from China represented 1.40 per cent of Taiwan’s total imports world-wide in 1990. The figure has surged to 4.44 per cent and

\[ \frac{4745.8}{16678.7} = 28.45\% \]
\[ \frac{3332.9}{16978.7} = 19.98\% \]

19 Data collected from TIER (2004: 24; 26); and calculated by the author.
9.93 per cent in 2000 and 2004 respectively (see Table 8.6: A3). The reason behind such development was because of Taiwan's security concerns. Originally, many Chinese products were not allowed to import to Taiwan. Therefore, the amount of imports was far smaller than Taiwan's exports to China. Progressively, while Taiwan opened up import categories under the principle of upholding national security and maintaining the positive development of Taiwan's industries, the import amount has enlarged and the import goods were more versatile over years.

With more liberal import policies to satisfy the WTO norms, many consumer products are allowed to import from China to Taiwan. Many Taiwan's domestic manufacturers have faced severe price competition with Chinese products. Footwear, for example, has rushed into Taiwan's market massively after the ban of this product has been lifted on 15 February 2002. The market share of made-in-China shoes rose from 38.69 per cent in 2003 to 52.67 per cent in 2006. Due to the average cost of a pair of Chinese-made shoes is only a quarter of Taiwan-made shoes, which make the local shoes manufacturers under a severe competition (Ho, 2006). Reportedly, the number of shoe manufacturing companies dropped from 1,500 in 2003 to 1,200 at the end of 2005, while the overall production of local shoemakers fell from 3.9 million pairs in 2003 to an estimated 3.15 million pairs in 2006 (Ho, 2006). Taiwan's shoes industry has faced increasing competition and challenge by the low price made-in-China shoes.

8.4 The Implication of Economic Security: Challenge and Opportunity

8.4.1 The Impact of Investment in China on Taiwan's Industrial Structure

Due to political dispute over sovereignty and national identity, Taiwan has always
taken cautious attitude in dealing with issues regarding the cross-Strait economic exchange. Government in Taiwan has carefully elaborated self-constraining economic policies to scrutinise economic activities with China in an attempt to protect economic security of Taiwan. Paradoxically, while the unfavourable political climate distorts the ordinary business practice across the Taiwan Strait, the massive cross-Strait economic activities have promoted China to be Taiwan’s largest trading partner and the leading source of trade surplus. China is also the largest recipient of Taiwan’s approved outward investment.

While the surging investment flows to China, issues over whether Taiwanese FDI in China had adversely affected the industry growth in Taiwan has been seriously concerned. With the increasing electronics and ICT industries ‘going west’ into China, economic concerns of deindustrialisation or industrial ‘hollowing out’ effect in Taiwan over time and capital outflow has stirred a great debate. Those issues have been raised frequently to verify Taiwan’s economic security. The centre of the debate is the impact of the outward FDI in China on Taiwan’s industry development.

(a) Hollowing Out or De-industrialization

There is a separate large body of literature focusing on the topics of impact of cross-Strait economic ties on Taiwan’s economic development, especially on effect of hollowing-out or de-industrialisation, from macroeconomic perspective. Most of literatures focus on the impact of outward investment on Taiwan’s export and employment. By taking different definition of industrial hollowing-out and employing different methodology and different research period, conclusions of empirical researches are varied. Given different research period, some found that FDI will strengthen rather than weaken the viability and competitiveness of domestic industries.
in Taiwan (e.g., Chou and Wu, 1990; Yu, 1995; Kao, 1997b; Chen and Ku, 2000). Some others get opposite conclusions and suggest that overseas investment has caused the growth of unemployment and lessened domestic investment activities. They concluded that the industrial hollowing-out has already happened in Taiwan (Hsieh, 1999; Hsu and Liu, 2004; Chen, 2003b; Liu and Hsu, 2006).

With above discussion, it is necessary to give a clear notion of industrial 'hollow out' before further research. According to Rowthorn and Ramaswamy, the industrial hollow out phenomenon is also known as de-industrialisation. One of the major characteristics of so-called ‘hollowing out’ is that a continuous declines in the share of manufacturing employment (SOME) (Rowthorn and Ramaswamy, 1998). According to their argument, the effect of de-industrialisation is a natural consequence of the industrial dynamism in an already developed economy, given that the national economic development is dynamic and always under a process of adjustment so as to match world economic impulsive force. Consequently, de-industrialisation in the developed countries implies the growth of the living standards, which are likely to be increasingly influenced by productivity developments in the service sector (Rowthorn and Ramaswamy, 1997).

There are also several theories and models to examine the issue of Taiwan's industrial development. For example, Chen and Su suggest using two elements to examine Taiwan's economy with respect to the situation of industrial hollowing-out (Chen and Su, 1988). The two elements are: (1) the proportion of manufacturing as percentage of GDP, and (2) the productivity of the manufacturing industry. In their theory, the situation of hollowing-out is occurred when both elements decline simultaneously. Another model is created by Hsieh. In his model, three indexes are used to examine
de-industrialisation, which includes (1) the net value of FDI flows (inward FDI – outward FDI) is negative; (2) unemployment is rising, and (3) the proportion of manufacturing as percentage of GDP is decreasing. According to Hsieh’s theory, when the three indexes satisfy the model in a given period coincidently, the given country was in a situation of de-industrialisation (Hsieh, 1999).

(i) Applying Rowthorn and Ramaswamy’s theory

In Taiwan, the average share of manufacturing employment (ASOME) was 27.4 per cent during the period from 2000 to 2004, in which the highest rate is in 2000 with 28.0 per cent and the lowest is in 2002 and 2003 with 27.1 per cent (see Table 8.7). In comparison, the ASOME during the period from 1995 to 1999 was 27.5 per cent. Statistics suggest that Taiwan’s SOME was facing slightly decline over years. Nevertheless, the share of service employment (SOSE) in Taiwan is growing progressively. The five-year average SOSE increased from 52.62 per cent during the period from 1995 to 1999, and to 58.98 per cent during the period from 2000 to 2004. Based on SOMEs and SOSEs listed in Table 8.7, the transformation of Taiwan’s economic structure is in line with Rowthorn and Ramaswamy’s theory. Taiwan was in the economic transaction process: from the manufacturing sector to the service sector. Some phenomena of de-industrialisation are the natural consequence of industrial dynamism, which will eventually be managed as long as the national economic transformation reaches a stage of completion.
Table 8.7 Share of Manufacturing and Service Employment: 1995-2004

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>SOME</td>
<td>27.1</td>
<td>26.7</td>
<td>28.0</td>
<td>28.1</td>
<td>27.7</td>
<td>27.72</td>
</tr>
<tr>
<td>SOSE</td>
<td>50.7</td>
<td>52.4</td>
<td>52.3</td>
<td>53.2</td>
<td>54.5</td>
<td>52.62</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Years</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>SOME</td>
<td>28.0</td>
<td>27.6</td>
<td>27.1</td>
<td>27.1</td>
<td>27.3</td>
<td>27.42</td>
</tr>
<tr>
<td>SOSE</td>
<td>55.0</td>
<td>56.5</td>
<td>57.3</td>
<td>67.9</td>
<td>58.2</td>
<td>58.98</td>
</tr>
</tbody>
</table>

Note: The five-year average was calculated by the author.

(ii) Applying Chen and Su’s Theory

According to Chen and Su’s theory, two indices need to be examined: firstly, the proportion of manufacturing as a percentage of GDP is fluctuated and have presented a tendency to decline (see Table 8.8). Secondly, the statistics for the growth rate in labour productivity in manufacturing during the same period are all positive (see Table 8.8). Applying Chen and Su’s theory to the above figures, Taiwan was not in a situation of industrial hollowing out in the period between 2000 and 2004, because the two elements did not decline simultaneously.

Table 8.8 Indicators of the Taiwan Economy: 2000-2004

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production of manufacturing as</td>
<td>26.5</td>
<td>25.6</td>
<td>26.2</td>
<td>25.8</td>
<td>25.5</td>
</tr>
<tr>
<td>percentage of GDP</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The growth rate in labour</td>
<td>6.2</td>
<td>3.8</td>
<td>9.6</td>
<td>5.3</td>
<td>5.9</td>
</tr>
<tr>
<td>productivity in manufacturing*</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unemployment Rate</td>
<td>2.99</td>
<td>4.57</td>
<td>5.17</td>
<td>4.99</td>
<td>4.44</td>
</tr>
</tbody>
</table>

Note: * percentage change from previous year.

(iii) Applying Hsieh’s Model

In Hsieh’s model, there are three indices used to examine whether a country finds itself in a situation of de-industrialisation. According to United Nations Conference on Trade and Development (UNCTAD) statistics, Taiwan has long been a net FDI
outflow country (see Table 8.9). Therefore, the first index, the net value of FDI flows, is negative. The second index is the unemployment rate. Taiwan’s level of unemployment rose to 5.17 per cent in 2002 and then gradually declined to 4.44 per cent in 2004 (see Table 8.8). The unemployment rate showed no significant rise in this period. The third index is the proportion of manufacturing as a percentage of the GDP. It displayed a slow downward tendency (see Table 8.8). Combining the three indices, it is found that the rapid outflow of investment did not have the effect of confronting Taiwan with a situation of de-industrialisation because only two of the three examination indices satisfied the requirement specified.

Given the above three examinations, it may be argued that massive outward investment to China did not cause de-industrialisation in Taiwan. From the economic perspective, Taiwan has a small-sized export-orientated economy, which depends heavily on international trade. Trade and investment in China are part of an economic development strategy in line with Porter’s distinguished theory of the four basic stages of national competitive development (Porter, 1998). Taiwan has moved from the factor-driven stage to the investment-driven stage, and is gradually moving towards the innovation-driven and the wealth-driven stages. When a country completes the transition from the labour-driven to the investment-driven stage, it will generate outward investments towards lower-waged countries in labour-intensive manufacturing, and will thus attract inward FDI in capital and intermediate goods industries (Ozawa, 1992). This is exactly the path of Taiwan’s economic development.
Table 8.9
Taiwan’s Foreign Direct Investment

<table>
<thead>
<tr>
<th>FDI/Year</th>
<th>1990-2000 average</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inward</td>
<td>1,774</td>
<td>4,928</td>
<td>4,109</td>
<td>1,445</td>
<td>453</td>
<td>1,898</td>
<td>1,625</td>
</tr>
<tr>
<td>Outward</td>
<td>3,777</td>
<td>6,701</td>
<td>5,480</td>
<td>4,886</td>
<td>5,682</td>
<td>7,145</td>
<td>6,028</td>
</tr>
<tr>
<td>Net Inward</td>
<td>-2,003</td>
<td>-1,773</td>
<td>-1,371</td>
<td>-3,441</td>
<td>-5,229</td>
<td>-5,247</td>
<td>-4,403</td>
</tr>
</tbody>
</table>


Taiwan’s economy has benefited from inward investment in technology-intensive and advanced high-technology industries in the post-World War Two economic development (Mowery and Oxley, 1995). In the past few decades, Taiwan’s economy has enjoyed a high growth rate, driven by production and export manufacturing, and financed by foreign investment. Due to the fact that inward FDI brings capital and technology, Taiwan has been able to diversify its economy, moving from the traditional exportation of processed foodstuffs products to more high-tech and higher-value-added industries. Meanwhile, while the economic structure has been transformed, some traditional labour-intensive industries have moved abroad to search for a comparative advantage. As many researchers point out, Taiwan’s export to China is a FDI-driven consequence, underpinned by huge investments made by Taiwanese companies over the past decades (Lin, 1997: 180; Kao and Wang, 1999: 82-85; Tung, 2002b: 31). In this regard, the transformation of the Taiwanese economic structure is driven by the domestic economic situation and facilitated by Taiwan’s investment into China.

(b) Industrial Upgrading

Accompanying the query over the phenomenon of industrial hollowing out, the question of whether Taiwan has upgraded its industrial structure under the situation of
massive capital outflow abroad, especially to China, has often been raised. There are three tangible indices that apply to measuring Taiwan’s industrial upgrading, as stated in ‘The Index of Manufacturing Industrial Upgrading’ published by the Ministry of Economic Affairs (MOEA) (Tung, 2000: 93). The three key indices are used to examine industrial upgrading, as listed in Table 8.10. Index A reflects the ratio of the output of heavy industries to total manufacturing output. Index B presents the export contribution of heavy-chemical and technology-intensive industries to overall manufacturing exports. Index C illustrates the productivity of every employee involved in manufacturing industries.

According to Taiwan’s official statistics, Index A increased over the years from 54.31 per cent in 1990 to 80.77 per cent in 2004 (see Table 8.10). Index B also showed a tendency towards growth, although the index declined slightly in 1993. Index B increased from 59.93 per cent in 1990 to 84.38 per cent in 2004. Index C increased from $22,400 in 1990 to $34,300 in 2004, while in 1998 the figure dropped slightly to reflect the economic difficulty of the 1998 Asian financial crisis, and in 2001 the global economic slowdown. However, the overall trend maintained upward movement. Taken as a whole, the three indices suggest that Taiwan’s industries have upgraded progressively over time.

The momentum of Taiwan’s industrial upgrading originated in the industrial transformation, which drove it from a labour-intensive industry to capital- and technology-intensive industries. In the context of industrial transformation, Taiwan’s manufacturing sector has followed the pattern of the ‘Flying-Geese Paradigm’ of abandoning relatively low-end products by moving their production offshore and constantly shifting to higher-value-added production in Taiwan in the past few
decades.\textsuperscript{20} Because the emergence of the new industry has replaced the original labour-intensive industry, the migration of production lines to China has not caused a serious negative impact on Taiwan’s industrial structure, nor has it caused de-industrialisation (Kao, 2001). Interviewee I5 agreed with this point, and made the additional remark by saying: ‘[I]f those labour-intensive industries did not move abroad, Taiwan would have insufficient resources, such as labour, land, energy, and capital, to support the industrial upgrade momentum’. Interviewee I5 suggested that ‘[i]nvestment in China has not caused an industrial “hollowing out” effect in Taiwan, but, instead, it has become an impetus for Taiwan’s successful economic transformation’.

Table 8.10  
Indices of Manufacturing Industrial Upgrading: 1990-2005

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Index A</td>
<td>54.31</td>
<td>55.32</td>
<td>57.12</td>
<td>59.69</td>
<td>61.45</td>
<td>65.25</td>
<td>66.02</td>
<td>68.66</td>
</tr>
<tr>
<td>Index B</td>
<td>59.93</td>
<td>60.04</td>
<td>61.07</td>
<td>56.99</td>
<td>58.37</td>
<td>69.87</td>
<td>71.37</td>
<td>73.44</td>
</tr>
<tr>
<td>Index C</td>
<td>22.4</td>
<td>24.4</td>
<td>26.8</td>
<td>25.8</td>
<td>26.9</td>
<td>28.7</td>
<td>29.7</td>
<td>29.5</td>
</tr>
<tr>
<td>Period</td>
<td>1998</td>
<td>1999</td>
<td>2000</td>
<td>2001</td>
<td>2002</td>
<td>2003</td>
<td>2004</td>
<td>2005</td>
</tr>
<tr>
<td>Index A</td>
<td>70.28</td>
<td>71.78</td>
<td>75.05</td>
<td>74.83</td>
<td>76.83</td>
<td>78.35</td>
<td>80.77</td>
<td>81.93</td>
</tr>
<tr>
<td>Index B</td>
<td>74.08</td>
<td>76.08</td>
<td>79.01</td>
<td>78.66</td>
<td>81.17</td>
<td>82.57</td>
<td>84.38</td>
<td>85.26</td>
</tr>
<tr>
<td>Index C</td>
<td>26.2</td>
<td>29.0</td>
<td>31.4</td>
<td>28.2</td>
<td>30.2</td>
<td>31.4</td>
<td>34.3</td>
<td>37.6</td>
</tr>
</tbody>
</table>

Unit: %; US$1000

Note: (1) Index A: the ratio of the output of heavy industries to total manufacturing output (%)

Index B: the export contribution of heavy-chemical and technology-intensive industries to overall manufacturing exports (%)

Index C: Productivity of Manufacturing Industry (at 2001 price, $1000).

(2) The heavy chemical and technology-intensive industries include the production of chemical raw materials and products, rubber and plastic products, basic metals, metal products, machinery, electronics, electric appliances, transportation vehicles, and precision instruments.

Source: Department of Statistics, MOEA, Economic Statistical Indexes, Table D-1: The Index of Manufacturing Industrial Upgrading,


\textsuperscript{20} Economists use the ‘Flying-Geese Paradigm’ to explain FDI-driven economic relations among Asian countries, which are led by Japan and followed by the newly industrialised economies (NICs) and South-east Asian countries, as well as by China (Fukushima and Kwan, 1995; Blomqvist, 1996; Jung, 1999).
(c) Capital Crowding-out Effect

As shown in Table 8.4, about 66 per cent of Taiwan’s approved outward investment in 2003 was flowed into China. In the same year, investment in Taiwan diminished. Taiwan’s investment ratio hit a 40-year low in 2003 by dropping to 16.86 per cent (DGBAS, 2006). The issue of whether the investment in China has created a ‘crowding out’ effect on domestic investment has become a widely argued debate in Taiwan. Taiwanese officials frequently raised serious concerns over asymmetrical, one-way investment moving from Taiwan to China. They asserted that the consequences have generated a negative capital crowding-out effect on Taiwan’s economy (LT, 2001b; CT, 2005b). Conversely, some researchers suggest that no crowding-out effect on domestic economic development could be found within Taiwanese investment into China. They also argue that cross-Strait interaction may in the long run act as a stimulus to upgrading the structure of Taiwanese industries (e.g., Cheng and Kang, 2002; Yin, 2004: 108-110). As yet, no convergent conclusion on this debate has been reached.

For Interviewees A4 and I1, from the viewpoint of businessmen, they argue that profit is the most fundamental reason for them to conduct investment domestically and internationally. Capital both leads and follows to the place that creates profit. In this respect, some Taiwanese businessmen and Taiwanese professionals in China, when they were interviewed by the author in June and July 2004, have made an almost consensual comment that they would consider returning to Taiwan for investment and

21 Investment ratio is the gross domestic investment divided by the gross domestic product.
22 The question of capital ‘crowding out’ effect in the context of the correlation between investments abroad and at home has not reached a convergent conclusion in the preceding literature. For literature concluding that outward FDI will generate a capital ‘crowding-out’ effect, see Stevens and Lipsey (1992) and Belderbos (1992). For literature supporting the existence of crowding-out effect that varies among industries, see Braunerhjelm and Oxelheim (2000).
work when Taiwan’s economic situation improved.\textsuperscript{23} Their comment has implicitly confirmed that the ‘deterioration of Taiwan’s economic environment’ has been one of the factors influencing investors to consider against investing in Taiwan, as was discussed above.

As matter of fact, while Taiwan’s entrepreneurs were investing heavily overseas, some of them also simultaneously expanded their domestic investment. For example, the Hon Hai Precision Industry Co., the Cheng Uei Precision Industry Co., and the Ditel Taiwan Limited have invested in China, to establish overseas manufacturing bases.\textsuperscript{24} Meanwhile, in 2003, they made new investments in Taiwan’s newly-established Dingpu Science Park of NT$12 billion, NT$5 billion, and NT$27.8 billion respectively to establish their respective global research headquarters with the aim of cooperating with the government’s proposal to upgrade Taiwan’s industry to a high-tech and knowledge-based one (Epoch, 2003). In this context, the argument over investment in China resulting in capital crowding-out effect is not necessarily valid.

Furthermore, when examining the money supply in Taiwan’s banking system, it found that the banking system suffered from too much idle money deposited in the system because of few borrowers. The annual interest rate (AIR) and annual rate of change in loans and investments (ARCLI) revealed this fact. The AIR fell from 4.625 per cent in 2000 to 1.375 per cent in 2003, then rose to 1.75 per cent in 2004. The very low interest rate was unable to encourage investment. The ARCLI experienced negative growth of -0.8 per cent in 2001 and of -2.5 per cent in 2002. The annual rate of change in M2 rose over the same period, to 4.4 per cent in 2001 and 2.6 per cent in

\textsuperscript{23} For example, Interviewees E1, E2, G6, and H4.

\textsuperscript{24} Hon Fu Jin Precision, Hon Hai’s China subsidiary, in Shenzhen, was China’s largest exporter in 2005, with $14.47 billion-worth of exports, according to China’s Ministry of Commerce (ZOOM, 2006).
2002 (CEPD, 2005: 19). All of those figures illustrate that the low domestic investment was not caused by a lack of money or the high cost of investment. Consequently, it is not convincing to claim that investment in China has crowded-out capital from investing in Taiwan. Taiwan's low investment during the period 2000 to 2004 results from the absence of confidence in Taiwan's economic environment due to the unstable political situation, as discussed above.

8.4.2 The Impact of Cross-Strait Trade on Taiwan's Economic Development

Adam Smith saw clearly that a country could gain by trading with other countries within the framework of division of labour and laissez-faire free trade. Ricardo also argued that trade offers each country the opportunity of specialising in its most comparatively advantageous production and then gaining from trading with other countries. According to international trade theory, the direction of the industrial development of a country is in the light of its relative abundance of factors. The notable Heckscher-Ohlin theorem (H-O theorem) notes that a country's advantage in production is on the basis of its relative factor abundance (Södersten and Reed, 1994: 59). Consequently, a country's industry will adjust towards the direction corresponding to its relatively most intensive abundant factor so as to maintain economic competitiveness.

Taiwan's economic and trade relations with countries world-wide and with China in particular are conducted in accordance with the tendency of international economics. As discussed above, Taiwan's export structure has changed gradually since Taiwan

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25 M2 is a larger definition of money supply, which includes the total of all physical currency and accounts at the central bank which can be exchanged for physical currency, plus the amount in demand accounts, plus most savings accounts, money market accounts, and certificate of deposit accounts.
26 On this point, Kao (2003b: 45) shares the same view.
began investing heavily abroad in the 1980s. Similarly, the composition of the elements of Taiwan’s trade with China has also been shaped by Taiwanese investment in China. The establishment of TIEs in China has not only accommodated Taiwan’s manufacturing industries, but also has generated massive trade activities across the Taiwan Strait. There are three types of trade effect, namely, the trade promotion effect, the trade substitution effect, and the trade re-direction effect, that involve the cross-Strait division of labour generated by investment activities. However, effects vary among different industries. Some industries create a negative substitution effect, while others have a positive creation effect.

(a) Trade Promotion Effect: Showing a Declining Trend

While the source of investment decides the pattern of FDI, the trade promotion effect has been created between home and host countries in the process of investment (Kojima, 1973). With investing abroad, firms can sustain competitiveness on the one hand, while also creating trade opportunities on the other. The trade effect induced by the outward investment brings a significant economic development in the home country (Ozawa, 1992). Taiwanese firms, principally SMEs, started to make substantial direct investment in South-east Asia and China at the end of the 1980s (MOEA, 2004b). In the wake of the change in domestic macroeconomic conditions, Taiwanese enterprises attempted to retain their export markets and competitiveness in the industries by developing offshore investment, which has in turn developed trade between Taiwan and FDI host countries. With regard to the cross-Strait economic relations, as Taiwan’s investment into China increases, TIEs in China begin importing more capital goods (machinery and equipment) and intermediate inputs from Taiwan for assembly and processing. This has both led to a change in Taiwan’s pattern of exports and boosted Taiwan’s exports to China (Kao, 1997a: 82-85).
These FDI-driven exports have over recent years speeded up the cross-Strait trading exchange. In the early 1990s, TIEs imported about one-half of raw material inputs and three-quarters of capital goods (machinery and equipment) from Taiwan (Kao and Lin, 1993). This trade creation effect has been confirmed in various works of research for the 1990s (e.g., Chung, 1997; Mai et al., 1998; 2000). This has suggested that Taiwan’s outward FDI to China and TIEs play a significant role in the creation of trade relations across the Taiwan Strait. As an aggregate, in 1998 more than 57 per cent of Taiwan’s total exports to China were intermediate and capital goods (MOEA, 1999: 33-34; 50-51). In 2000, the FDI-driven import from Taiwan was 56.22 per cent of Taiwan’s total exports, according to China’s official statistics (Hsu and Liu, 2004: 212). In 2004, the top ten major export goods from Taiwan to China were components and parts, accounting for 84.4 per cent of Taiwan’s total export to China in the year (TIER, 2004: 23).

However, such FDI-driven export from Taiwan to China varies among different industries. The trade-creation effect is larger in the industries where inter-industry vertical integration with the parent company in Taiwan is involved, while the effect is smaller in an industry with horizontal integration into cross-Strait economic cooperation (Lin, 2004: 2-7; 2-8). Furthermore, the logistic relations between overseas branches and parent companies in Taiwan have generally changed over time, when overseas subsidiaries or affiliates can obtain suppliers in host countries or when the industrial clustering was formed locally (Hsia, 2004: 30-31; MOEA, 2001b: 128). On this point, the share of inputs that TIEs import from Taiwan has declined gradually since the middle of the 1990s (Chung, 1997). For example, 52.5 per cent of parts and semi-finished products and 50.3 per cent of raw materials that TIEs in China required were imported from Taiwan in 1998 (MOEA, 1999). In
comparison, 46.11 per cent of parts and semi-finished products and 39.32 per cent of raw materials that TIEs in China required were provided by Taiwan in 2003 (MOEA, 2004a). This is a result of some vertical integration industries also establishing their manufacturing bases in China and forming a local supply chain in China. By sourcing necessary inputs from suppliers in China, TIEs can not only save transportation costs and time, but also establish partnerships with local suppliers (Liu et al., 2005). Thus, the trade-promoting effect declines.

On the other hand, due to commercial confidentialness and their strategy of business operation, TIEs continue to import some important parts and key components from their parent company or cooperative companies in Taiwan. In spite of the fact that TIEs have gradually bought some low-end machinery as well as parts and components from local suppliers in China, they have also imported some machinery and semi-finished products with a higher context of technology and value from parent companies or suppliers in Taiwan (Hsia, 2004: 31; MOEA, 2001b: 129). Furthermore, because the production scale of TIEs is expanding, the scale of inputs is also increasing. Therefore, although the ratio of imports from Taiwan as a percentage of overall inputs needed by TIEs has decreased, exports from Taiwan to TIEs in China have, in financial terms, grown. For example, the year-on-year growth rate of the top ten major export goods among overall exports from Taiwan to China decreased from 27.8 per cent in 2004 to 18.4 per cent in 2005. Nevertheless, the exports in financial terms were $37.95 billion and $44.43 billion respectively (TIER, 2004: 23; TIER, 2005c: 23). Thus, the cross-Strait trade creation effect still exists and supports Taiwan's capability of profit generation.
(b) Trade Substitution Effect

As early in 1957, Mundell argued that investment and trade between countries would create a trade substitution effect (Mundell, 1957). In Taiwan's case, some products formerly exported to China and to world-wide markets have been replaced by products manufactured by TIEs in China. Such a trade substitution effect is created by market competition between products made in China, and products made in Taiwan. For example, TIEs in China gradually source their input materials from local suppliers in China after the formation of industrial clustering and thus lessen imports from Taiwan. Since the late 1980s, following Taiwanese FDI flows into China, the amount of intermediate and capital goods exported from Taiwan to China has increased, on the one hand, while Taiwan's exports of labour-intensive commodities to developed countries have declined (Fukushima and Kwan, 1995; Gangopadhyay, 1998). Gradually, the share of Taiwan's exports of labour-intensive commodities in the world market has been replaced with exports by TIEs in China and in other manufacturing centres. As shown in Table 8.11, Taiwan's market share of exports in the US and Japanese markets witnessed a gradual decline.

Table 8.11 Taiwan's and China's Market Share of Exports in the US and Japanese Markets: 1994-2004

<table>
<thead>
<tr>
<th>Period</th>
<th>Taiwan's Market Share</th>
<th>China's Market Share</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>In US Market</td>
<td>In Japan Market</td>
</tr>
<tr>
<td>1994</td>
<td>4.02</td>
<td>3.91</td>
</tr>
<tr>
<td>1995</td>
<td>3.90</td>
<td>4.27</td>
</tr>
<tr>
<td>1996</td>
<td>3.78</td>
<td>4.28</td>
</tr>
<tr>
<td>1997</td>
<td>3.75</td>
<td>3.69</td>
</tr>
<tr>
<td>1998</td>
<td>3.62</td>
<td>3.65</td>
</tr>
<tr>
<td>1999</td>
<td>3.43</td>
<td>4.13</td>
</tr>
<tr>
<td>2000</td>
<td>3.33</td>
<td>4.71</td>
</tr>
<tr>
<td>2001</td>
<td>2.92</td>
<td>4.06</td>
</tr>
<tr>
<td>2002</td>
<td>2.77</td>
<td>4.03</td>
</tr>
<tr>
<td>2003</td>
<td>2.51</td>
<td>3.74</td>
</tr>
<tr>
<td>2004</td>
<td>2.36</td>
<td>3.67</td>
</tr>
</tbody>
</table>

The trade substitution effect can also be observed from the contribution made by TIEs to China’s exports into world-wide markets. Kao estimates that TIEs contributed for China about $4.01 billion trade income in 1995, which accounted for 2.7 per cent of China’s total exports in the year (Kao, 1997b). According to a report published by MOEA, in 1999, 45 to 52 per cent of TIEs products were shipped to third countries, including the US (MOEA, 2000a: 494; 591). In 2002, about 80 per cent of ICT commodities exported from China to the US were produced by TIEs (Chiu, 2003). According to the OECD reports, China has become the largest exporter of ICT goods amounting to $180 billion, taking the lead in 2004 in Notebook, mobile phone and digital camera sales in the world (OECD, 2005). China’s massive exports cannot be achieved without TIEs. According to news released by China’s Ministry of Commerce, thirty-seven TIEs were listed among China’s top 200 exporters. The thirty-seven TIEs, all in the information-technology sector, created in 2005 total exports valued at $71.3 billion, 9.4 per cent of China’s exports of $762 billion (Zoom, 2006). All of these figures suggest that TIEs have created an export capability for China, on the one hand, yet unavoidably, on the other, squeezed out Taiwan’s export market. The export substitution effect has been created.

Nevertheless, such a trade substitution effect was, in fact, generated by the ‘Taiwan taking order, China producing’ business practice between TIEs in China and parent companies in Taiwan (Liu et al., 2003: 114). The impact of this business arrangement on industries varies among different industries. Some industries have moved all their production lines out of Taiwan, while others have not only remained in operation but have also enlarged their production scale in Taiwan. Examples are found in the electronic, chemicals, and basic metal industries (Kao and Wu, 2003: 69-70). Although Taiwan lost its market share in exports of consumer goods and low-end
finished products, Taiwan has improved its market share in high-end knowledge-based products and technology-intensive goods (see Table 8.12). This being the case, the trade substitution effect is a phenomenon that is in line with the transformation of the economic structure. It is not all bad for economic development as long as industries can maintain growth when they out-source part of their production to overseas manufacturing bases.

Table 8.12 Taiwan’s Export by Product Category: 2000-2004

<table>
<thead>
<tr>
<th>Year</th>
<th>Agricultural</th>
<th>Food Processing</th>
<th>Heavy Chemical Industry Products</th>
<th>Non-heavy Chemical Industry Products</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>0.2</td>
<td>1.2</td>
<td>71.8</td>
<td>26.8</td>
</tr>
<tr>
<td>2001</td>
<td>0.2</td>
<td>1.3</td>
<td>71.5</td>
<td>26.9</td>
</tr>
<tr>
<td>2002</td>
<td>0.3</td>
<td>1.3</td>
<td>73.6</td>
<td>24.9</td>
</tr>
<tr>
<td>2003</td>
<td>0.3</td>
<td>1.2</td>
<td>75.9</td>
<td>22.6</td>
</tr>
<tr>
<td>2004</td>
<td>0.2</td>
<td>1.1</td>
<td>77.9</td>
<td>20.7</td>
</tr>
</tbody>
</table>


(c) Trade Re-direction Effect

The trade re-direction effect is an expected outcome of the division of labour and comparative advantage. As a country’s comparative advantage in products changes, the context of exports and the major market will also change. The trade re-direction effects between Taiwan and China are evident, as can be observed from the change in Taiwan’s market share of its two largest trading partners, the US and Japan. Taiwan’s US import market share has over time shown a steady decrease (see Table 8.11). In the Japanese market, the share of Taiwan’s products in the Japanese market fluctuates. In contrast, China’s export market share in the US has risen continuously since 1990 (see Table 8.11). In financial terms, the value of products exported by China to the US increased 6.4-fold from $16.96 billion in 1993 to $124.95 billion in 2004, according
While Taiwan gradually lost its toehold in the US market, Taiwan’s exports to China have continued to grow. China in 2002 replaced the US market as Taiwan’s largest export destination. Figure 8.3 illustrates how Taiwan’s exports to the US market have gradually shrunk since the end of the 1990s, while exports to the Chinese market have steadily progressed over the period. As a matter of fact, due to China’s integration into the system of global division of labour and the growing trend towards regional economic cooperation, the trade re-direction situation has been witnessed in most of the East Asian countries. Their shares of exports to the US and Europe countries declined over time as they have re-directed their exports to the intra-regional countries, especially to China (Chung and Hung, 2003). Such a situation demonstrates the way in which the Chinese market has become a major battle between it, on the one hand, and Taiwan and other regional competitors working for market share, on the other. If Taiwan can retain competitiveness in the Chinese market, it may continue to enjoy a trade surplus from the Chinese market, and thus sustain its economic prosperity.

Figure 8.3

Source: TIER (2006: 25, 56-57); edited by the author.
8.4.3 The Cross-Strait Economic Interdependence and Implication of Economic Security

(a) Trade Dependence

In the past two decades, the cross-Strait economic interdependence has grown rapidly. The asymmetrical levels of investments made by Taiwan in China further expanded through Taiwan’s brisk FDI in China. As shown in Index A2 of Table 8.6, Taiwan was for a long period highly dependent on the Chinese market. The share of Taiwan’s exports to China as a percentage of Taiwan’s total exports accounted for 5.03 per cent in 1989 and increased to 25.83 per cent in 2004 (see Table 8.6: A2). In comparison, China’s dependence on the Taiwan market is declining. Its share of imports from Taiwan rose from 5.63 per cent in 1989 to the peak of 15.77 per cent in 1997, and then gradually declined to 8.01 per cent in 2004 (see Table 8.6: B2).

The decrease of China’s import dependence on Taiwan may be caused by at least two factors. Firstly, there was an increase in the number of TIEs integrating themselves into the Chinese market by buying production materials from local suppliers in China, which thus lessened their imports from Taiwan. The other reason was because China’s economy and foreign trade have shown rapid improvement in recent years. The Chinese market, especially its accession into the WTO in 2001, has gradually opened to the outside world for both luxury commodities and semi-finished manufacturing goods for supplying foreign-invested enterprises (FIEs) in China. This has broadened China’s overall imports in terms of monetary value and commodity categories. According to China’s Customs statistics, the year-on-year import growth rate in 2004 was 36 per cent with $561.2 billion. In comparison, Taiwan’s overall exports in 2004 totalled $174 billion, equating to 20.7 per cent growth over the level of imports in 2003. Taking the greater total value of imports as a basis, it is hardly surprising that
the figures reflecting China’s significant dependence on Taiwan was smaller or even in a declining trend. Furthermore, while the export dependence rate of Taiwan on China rose over time, Taiwan’s exports to the Chinese market supported Taiwan’s economic growth, constituting Taiwan’s capability for prosperity generation.

With the gradual de-regulation of economic policies with respect to Chinese commodities, Taiwan’s imports from China increased significantly. The share of Taiwan’s import from China as a percentage of its total imports rose from 1.12 per cent in 1989 to 9.93 per cent in 2004 (see Table 8.6: A3). Regarding China’s export dependence on the Taiwan market, China finds that it is proportionately less so (see Table 8.6: B3). The figure increased from 1.12 per cent in 1989 to 2.81 per cent in 2004. There were two major reasons for this result. First, China’s scale of increase in overall exports in monetary terms was much larger than the scale of its increase in exports to Taiwan. For example, while China’s exports to Taiwan increased to $5.7 billion in 2004, China’s total exports to the world market amounted $155 billion in the same period. Secondly, WTO members de-regulated trade barriers and established export-oriented operating centres in China after China’s accession into the WTO. Both factors have accelerated China’s exports to world markets. In 2002, more than 50 per cent of China’s exports were created by foreign-invested enterprises (FIEs) (TIER, 2002: 67). With the export contributions made by the FIEs, China could export massive quantities all over the world. Thus, China’s export dependence on Taiwan grew moderately.

Overall, Taiwan’s economy is gradually shifting towards China. The share of Taiwan’s trade with China, in terms of both imports and exports, as a percentage of total foreign trade, rose from 3.31 per cent in 1989 to 10.46 per cent in 1995, and to 18.03 per cent
in 2004 (see Table 8.6: A1). The trade dependence has grown steadily in the past two decades, except for a slight downturn in 2000. Overall, the cross-Strait two-way trade scale in post-2000 was much greater than it was in the 1990s. In comparison, China’s trade dependence on Taiwan saw an upward trend in the first half of the 1990s. Nevertheless, the rate has since 1997 gradually decreased: from 3.51 per cent in 1989 to 8.21 per cent in 1996 and then to 5.34 per cent in 2004 (see Table 8.6: B1). Due to a continuing economic boom in recent years, China was rapidly emerging as an economic superpower, with the total amount of imports and exports reaching $1,154.5 billion in 2004. The year-on-year growth rate was 35.7 per cent in 2004. In comparison, Taiwan made 26 per cent of total foreign trade growth in 2004 totally $3419.0 billion (TIER, 2005b: 54). China’s international trade scale was about 3.3 times as much as was that of Taiwan’s. Consequently, with a different trade base, China’s trade dependence on Taiwan was much smaller than that of Taiwan vis-à-vis China.

The above figures showed clearly that Taiwan’s trade dependence on China grew, yet China’s trade dependence on Taiwan decreased. This suggests that if bilateral trade relations were disrupted, the impact on Taiwan would be much more severe than on China. Taiwan’s heavy dependence on the Chinese market may possibly make Taiwan relatively vulnerable in response to any economic impact caused by China. Within the cross-Strait economic interdependence, the economy of Taiwan will unavoidably be influenced by the consequences of a variation in China’s economy. For example, the issue of the re-valuation of the Chinese currency, the RMB, is not only China’s economic problem, but is also an important economic concern in Taiwan. It is closely associated with the export competitiveness of TIEs, and is thus linked indirectly to their imports from Taiwan (Kao, 2005: 3-4). Similarly, if China’s industries are under
any form of trade friction with other economies, TIEs would definitely be affected by such ‘chain reaction’ in trade relations.

Nevertheless, trade dependence is not necessarily a threat to Taiwan’s economy. The trading experiences of Taiwan’s export-led economies with the US and Japan showed that asymmetrical trade and investment relations cause market dependence or trade imbalances, but would not necessarily lead to economic insecurity. Taiwan has a long-term trade deficit with Japan and enjoys a trade surplus with the US, but rarely seems concerned about economic insecurity deriving from trade dependence. Therefore, a higher trade dependence on the Chinese market only suggests a higher potential impact that Taiwan must bear once China’s economy faces challenges. Given that cross-Strait trade was driven by FDI in China and TIEs remain dependent on Taiwan’s suppliers for some crucial machinery and key components, the high dependence rate did not necessarily imply negative consequences. While Taiwan’s dependence on trade with China surges against the backdrop of China’s rapidly ascending economic development, Taiwan’s importance in the global commodity chain, from the viewpoint of TIEs in China, is stable, as are the cross-Strait economic ties. As long as Taiwanese products can remain competitive in the global system of the supply chain, high dependence can become a guarantee in the trading arrangement.

Furthermore, the cross-Strait economic linkage is one of mutual interdependence, rather than that one depends solely on the other. Although the figures indeed show that the Taiwanese economy depends more heavily on the Chinese economy, the situation is not necessarily one that will undermine Taiwan’s economy. This can be argued from two perspectives. Firstly, due to the difference in factor endowment and
an evident disparity in technology and levels of economic development, the trade creation effect in the context of cross-Strait linkage involves intra-industrial and inter-industrial division of labour (Hsia, 2004: 34). Within this business engagement, Taiwan’s export competitiveness in the Chinese market has been assured. Secondly, given the law of comparative advantage, the trade re-direction effect has pulled and pushed Taiwan to engage more intensively in the Chinese market in terms of a steady increase in the bilateral trading amount. According to Taiwan’s official statistics, Taiwan’s total international trade has shown a roughly increasing trend over years. This means that the Taiwanese companies were capable of dealing with trade re-direction effect. Although Taiwan’s market share in the US diminished, Taiwanese enterprises have gained a significant market share in the Chinese market. In summary, Taiwan’s high economic dependence represents Taiwan’s competitiveness and capacity to gain market share in China. Enterprise can maintain the Chinese market at a competitive level while, simultaneously, the cross-Strait trade exchange supports Taiwan’s economic growth and prosperity.

(b) Contribution of Cross-Strait Trade to Taiwan’s GDP Growth Rate

Taiwan has a small yet open economy, which is highly dependent on international trade. The country’s trade dependency (total trade/GDP) is usually very high. Thus, exports and imports contribute appreciably to Taiwan’s GDP growth rate (see Table 8.13). For example, Taiwan’s GDP growth rate in 2004 was 5.7 per cent, while the contribution of exports of goods and services to the GDP growth rate was at 8.9 per cent, and the trade dependency was at 112 per cent. These figures suggest that Taiwan depends heavily on international trade for its national wealth accumulation and prosperity. With the export direction shifting to China and the lack of momentum of domestic consumption in recent years, especially after 2001, exports to China became
an important impetus supporting Taiwan's GDP growth. In this respect, cross-Strait economic integration enhances Taiwan's economic security in terms of strengthening Taiwan's capability of generating prosperity. Consequently, from the economic perspective, trade interdependence with China benefits Taiwan's economic security.

Table 8.13  
Taiwan's Trade Dependency: 1999-2004

<table>
<thead>
<tr>
<th></th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP growth rate</td>
<td>5.3</td>
<td>5.8</td>
<td>-2.2</td>
<td>3.9</td>
<td>3.3</td>
<td>5.7</td>
</tr>
<tr>
<td>Export Contribution to GDP growth rate</td>
<td>5.4</td>
<td>8.8</td>
<td>-4.4</td>
<td>5.3</td>
<td>5.9</td>
<td>8.9</td>
</tr>
<tr>
<td>Import Contribution to GDP growth rate</td>
<td>2.2</td>
<td>6.8</td>
<td>-7.0</td>
<td>2.6</td>
<td>3.1</td>
<td>8.9</td>
</tr>
<tr>
<td>GDP Amount</td>
<td>286.5</td>
<td>307.8</td>
<td>279.4</td>
<td>281.5</td>
<td>386.0</td>
<td>305.4</td>
</tr>
<tr>
<td>Export Amount</td>
<td>121.6</td>
<td>148.3</td>
<td>122.9</td>
<td>130.6</td>
<td>144.2</td>
<td>174.0</td>
</tr>
<tr>
<td>Import Amount</td>
<td>110.7</td>
<td>140.0</td>
<td>107.2</td>
<td>112.5</td>
<td>127.2</td>
<td>167.9</td>
</tr>
<tr>
<td>Export Dependency</td>
<td>42.4</td>
<td>48.2</td>
<td>44.0</td>
<td>46.4</td>
<td>37.4</td>
<td>57.0</td>
</tr>
<tr>
<td>Import Dependency</td>
<td>38.6</td>
<td>45.5</td>
<td>38.4</td>
<td>40.0</td>
<td>33.0</td>
<td>55.0</td>
</tr>
<tr>
<td>Trade Dependency</td>
<td>81.1</td>
<td>93.7</td>
<td>82.3</td>
<td>86.4</td>
<td>70.3</td>
<td>112.0</td>
</tr>
</tbody>
</table>

Note: 1. Export dependency = total export of goods and services / GDP  
2. Import dependency = total import of goods and services / GDP  
3. Trade Dependency = total export and import of goods and services / GDP  
Source: 1. (CEPD, 2005: 4; 17-18); calculated by the author.

Lin in his research programmes a formula to calculate the contribution of cross-Strait trade to Taiwan’s GDP growth rate (Lin, 2004). Following Lin’s research, Table 8.14 illustrates the contribution of cross-Strait trade to Taiwan’s GDP growth rate. The trade contribution coincided with the actual trade exchange between Taiwan and China. In both 1998 and 2001, Taiwan’s overall trade with China declined on the year-on-year basis and so did the trade contribution rate. In 1991-1993 the trade contribution gained from trade with China was more than a quarter of Taiwan’s overall GDP growth rate. After a negative contribution of 0.94 per cent in 1998, the figure increased to 7.23 per cent in 1999 and consequently. In 2002, the percentage of the contribution of cross-Strait trade to Taiwan’s GDP growth rate was at the dramatically high level of 72.33 per cent. This figure reflects the impression that trade with China is the major source of Taiwan’s economic recovery in 2002 (see Table
Table 8.14 illustrates the significance of trade with China in that it supports Taiwan’s substantive economic growth. Those figures suggest that Taiwan’s investment in China has introduced massive exports from Taiwan to China, which have in turn contributed to Taiwan’s economic growth. Meanwhile, those figures also illustrate that Taiwan has depended considerably on the Chinese market, although it is arguable whether this can be classified as ‘too much’. Disregarding political concerns over the cross-Strait political antagonism and China’s united front strategy over Taiwan, from an economic perspective, once China’s economy encounters any unfavourable incidents, Taiwan may not be able to retain its distance from the affair. On this point, Taiwan’s investors would be well advised to consider the consequence of putting all of their eggs into one basket.

Table 8.14  The Contribution of Cross-Strait Trade to Taiwan’s GDP Growth Rate

<table>
<thead>
<tr>
<th>Year</th>
<th>Real GDP Growth Rate (a)</th>
<th>Contribution of trade with China to Taiwan’s GDP growth rate (b)</th>
<th>Contribution of trade with China as of percentage of GDP Growth Rate (c)=b/a</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>5.39</td>
<td>0.73</td>
<td>13.54</td>
</tr>
<tr>
<td>1991</td>
<td>7.55</td>
<td>2.65</td>
<td>35.10</td>
</tr>
<tr>
<td>1992</td>
<td>7.49</td>
<td>2.03</td>
<td>27.09</td>
</tr>
<tr>
<td>1993</td>
<td>7.1</td>
<td>2.04</td>
<td>29.17</td>
</tr>
<tr>
<td>1994</td>
<td>7.11</td>
<td>0.43</td>
<td>6.06</td>
</tr>
<tr>
<td>1995</td>
<td>6.42</td>
<td>0.79</td>
<td>12.30</td>
</tr>
<tr>
<td>1996</td>
<td>6.10</td>
<td>0.50</td>
<td>8.27</td>
</tr>
<tr>
<td>1997</td>
<td>6.68</td>
<td>0.27</td>
<td>4.10</td>
</tr>
<tr>
<td>1998</td>
<td>4.57</td>
<td>-0.94</td>
<td>-20.60</td>
</tr>
<tr>
<td>1999</td>
<td>5.42</td>
<td>0.39</td>
<td>7.23</td>
</tr>
<tr>
<td>2000</td>
<td>5.86</td>
<td>0.65</td>
<td>11.02</td>
</tr>
<tr>
<td>2001</td>
<td>-2.18</td>
<td>-0.85</td>
<td>38.90</td>
</tr>
<tr>
<td>2002</td>
<td>3.59</td>
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<td>1.03</td>
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Source: Cited in Lin (2004, 2-13).
Note: 1. Contribution of trade with China to Taiwan’s GDP growth rate (b) = [(growth rate of export to China) * (Taiwan’s export to China as percentage of Taiwan’s total export) * (Taiwan’s total export as percentage of GDP)] - [(growth rate of import from China) * (Taiwan’s import from China as percentage of Taiwan’s total import) * (Taiwan’s total import as percentage of GDP)]
8.5 Conclusion

Given that the unpleasant political dispute between Taiwan and China has pushed the cross-Strait political relations into a tight corner, the economic and trade engagements across the Taiwan Strait continue vigorously. The two sides have striven in the competition for sovereign right and legal identity. However, in the meantime, they have also wanted to gain economic benefit through bilateral economic exchange. Under the security and economic concerns, Taiwan has formulated a self-constraining economic approach towards China, aiming to defend inflexible national security as well as economic security in the context of pursuing economic growth and national prosperity. The trade-off between security, on the one hand, and economic development, on the other, is a task that has challenged the flexibility and capacity of the Taiwanese government since it decided in 1985 to commence engagement in economic ties with China.

The economic exchange between Taiwan and China in the past decades was conditioned by political factors while encouraged by the objective of economic interests within global economic integration. Taiwan's self-constraining economic approach has distorted the nature of economic engagement between the two sides. It has, nevertheless, also unexpectedly driven Taiwanese businessmen to create a business *modus vivendi* in responding the cross-Strait political rivalry. With increasingly asymmetric levels of FDI flowing from Taiwan to China, the FDI-driven exports create massive trade effects to support Taiwan's GDP growth, while Taiwan's trade dependence on China has also continued to increase. China became Taiwan's largest source of trade surplus, largest trading partner, and the largest FDI recipient. At the same time, China has also benefited materially from the fact that the TIEs' economic contribution supports its economic growth. China has become Taiwan's

300
economic growth momentum, and *vice versa*. As a result, Taiwan and China are moving increasingly closer together in terms of economic integration, although no sign has emerged that political antagonism and diplomatic struggles between the two have moderated.

With Taiwan’s investment in China and the fact that Taiwan and China each possesses different comparative advantages in the international economic system, the cross-Strait economic exchange was constructed within the dynamic global economic network. The two parties have also established a mechanism of division of labour within the global operation. As a result, both Taiwan and China are becoming more closely integrated into the global economy with broad global interdependence. Within the cross-Strait economic cooperation, Taiwan has gradually transformed its economic structure from that of labour-intensive industry to technology-intensive industry and is further moving to knowledge-based industry in accordance with its comparative advantage. The consequence of increases in the technological content of export products helps to accelerate Taiwan’s economic transformation and industrial upgrading, as well as maintaining Taiwan’s leading edge in the commodity supply chain in the global economic system. At the same time, the FDI-driven cross-Strait logistics mechanism has facilitated Taiwan’s exports to China, guaranteeing Taiwan’s export competitiveness in the Chinese market. On this point, the cross-Strait economic engagement has strengthened Taiwan’s economic dimension of security.

On the other hand, with a growing amount of investment from Taiwan into China, concerns of economic security with respect to issues such as industrial upgrading, the industrial ‘hollowing-out’ effect, the capital crowding-out effect, and levels of employment have attracted much attention in Taiwan. On these issues, this chapter
has argued that cross-Strait economic exchange has made a positive contribution to Taiwan's economic development. Cross-Strait economic exchange has not led to an industrial hollowing-out and has not necessarily caused the capital crowding-out effect that would shrink the domestic investment in Taiwan. In addition, the cross-Strait economic exchange has contributed to Taiwan's balance of payments in terms of trade surplus and industrial upgrading. From an economic perspective, the cross-Strait economic exchange has not only affected the distribution of economic interests in the context of trade and investment between Taiwan and China, but has also influenced the re-structuring of Taiwan's internal economic system. On this point, Taiwan's economic security within the cross-Strait economic exchange has been promoted, despite there being no significant sign showing that economic ties can provide enough momentum to moderate the political stalemate between Taiwan and China. Taiwan's investment in China is an economic strategy to sustain economic security towards both extending economic development and supporting nationally secure employment. With economic growth and prosperity, Taiwan can maintain the freedom of choice to formulate a national agenda, and the freedom of action to pursue a national security agenda. Overall the cross-Strait economic integration has made a positive impact on Taiwan's economic dimension of security in the context of Taiwan's capability of generating prosperity, and of the integration of the economic system.
This thesis has argued that the role of economic security is one of the pillars of national security strategy in contemporary international relations. Aside from military security measures, adopting peaceful economic engagement and economic measures can be an alternative security policy choice through which a state may achieve its national security agenda. Given such grounds, this thesis has taken Taiwan as a case study through which to evaluate the economic security of Taiwan within the context of long-lasting, complex and hostile cross-Strait relations. The research aims of this study are three-fold. Firstly, the study aims to provide a comprehensive conception of economic security in order to emphasise the significant role of the economic factor in the pursuit of national security within international politics. Secondly, the study aims to examine how small states practise an economic security policy to fulfil their respective security agendas and national interests. Thirdly, the study aims to examine economic security from the perspective of how states use economic measures in the diplomatic arena and on the occasions of their economic engagement with political rivals.

To bridge the knowledge of the role of economic security in international relations, the thesis has in Chapter Two reviewed the course of the concept of security in international relations over the years since the onset of the Cold War. The chapter has demonstrated how the concept of security has mutated in response to the changing international security environment. The chief characteristic of this change has been a
move away from the pursuit in a nation’s security policy of absolute military superiority over all possible rivals towards embracing an economic policy as a form of security. It has confirmed that economic security is one aspect of the security paradigm on the national security agenda. Meanwhile, economic engagements and economic measures can be an alternative security policy choice for a state to sustain its respective security agenda.

Based on the developments addressed in Chapter Two, Chapter Three has examined the practicality of economic security for national security objectives. It has outlined the concept of economic security in international relations. It has illustrated how states utilise economic power and policy both to protect the security of economy and to support the national security agenda within the international system. A state may develop economic power not only to counteract economic aspects of the challenge of retaining national prosperity, but also to use it as a substitute for or complement to military and political means for achieving national security objectives. Meanwhile, by gathering all analyses of the perception of economic security together, the chapter has submitted a working definition of economic security in order to provide a framework within which to proceed with the other research aims set out in this thesis. Accordingly, the working definition of economic security is given as ‘the protection of a core value from all forms of potential or actualised threat by using economic measures and policies’. The core value refers to national interests and security objectives. Given the distinctive features of national capacities and different levels of political and economic development, states facing different security challenges and national interests will initiate different economic security agendas. Within this context, the core value can be subdivided into such interests as those of ‘the economic dimensions of security’ and those of ‘the non-economic dimensions of security’. By
the same token, the core value can also be found in outward-oriented or inward-oriented national interests and security agenda.

Chapter Four has analysed Taiwan’s security within the complex and dangerous cross-Strait rivalry. The chapter has illustrated that in the past half-century both Taiwan and China have been dominated by their strong political ideologies in the struggle for their respective national security agendas. The evolution of Taiwan’s antagonism vis-à-vis China in which the major cross-Strait conflict has shifted from military confrontation to political antagonism and economic engagement has been demonstrated. Given that the environment of a threat to Taiwan’s security is generated by China’s movement towards isolating Taiwan internationally and complicated by growing cross-Strait economic ties, Taiwan’s core value of national security is to break through China’s containment politically and diplomatically, as well as to safeguard domestic economic prosperity in order to sustain Taiwan’s sovereignty and de jure existence. The outward-oriented security interest of Taiwan is to maximise all possible political and diplomatic assistance and forms of recognition provided by the international community, especially by the United States. Taiwan seeks national security at the international level by defending its international recognition and its right to international participation. The inward-oriented security interest is to sustain the ability of the government to protect Taiwan’s physical security and to ensure Taiwan’s continued prosperity in the face of a growing Chinese threat. With Taiwan’s unique international status and the paradoxical situation of cross-Strait political hostility vis-à-vis growing economic ties, economic measures become an important element utilised by Taiwan in its pursuit of inward- and outward-oriented national security objectives in the context of Taiwan’s rivalry with China.
Following the working definition of economic security, Chapters Six to Eight have been designed to explore economic security from the perspective of how Taiwan uses economic measures in the diplomatic arena and on the occasion of economic engagement with its rival, China. This case study intends to answer three categories of questions. Firstly, how large is the cost to Taiwan of pursuing economic security vis-à-vis China, and what is Taiwan's capability to afford such cost? Secondly, what factors would contribute to or undermine Taiwan's efforts in practising economic security, and to what extent? Thirdly, do cross-Strait economic ties strengthen or weaken Taiwan's economic security with respect to its economic performance, and to what extent?

Regarding the first research question, Chapter Six has demonstrated Taiwan's diplomatic difficulties and its efforts in utilising economic power as a measure for its pursuit of security ends in the diplomatic arena. The chapter has revealed that the cost of the diplomatic tug-of-war between Taiwan and China is a war of attrition. Taiwan has invested massive economic resources, such as financial loans and financial aid, as powerful weapons towards sustaining existing diplomatic ties, on the one hand, and to gain new diplomatic relationships, on the other. Meanwhile, Taiwan has also striven for admittance to international organisations, and the establishment of Free Trade Agreements (FTAs) within the environment of interference from China. Supported by Taiwan's good economic foundation, Taiwan could in general afford the employment of an economic security strategy. Nevertheless, while China's capabilities and external influence resulting from its own high economic growth rates and increasing involvement in the international community, Taiwan's capabilities in competing with China by providing attractive economic measures to support its diplomatic struggle vis-à-vis China have suffered some degree of degeneration. Although Taiwan could
still afford such an economic security policy, the unpleasant domestic economic situation has become a crucial challenge hindering the merits of economic security. This finding underscores the importance of economic superiority within the national security framework, as well as illustrating the significance of the economic dimension of security to the economic security policy.

Similarly, Chapters Seven and Eight have also illustrated the cost of the trade-off between employing economic security statecraft, and securing economic interests within the cross-Strait economic and political engagements. The major defect was that the cross-Strait economic engagement had never been able to be conducted normally. To some extent, such abnormal disturbance in economic activities has hindered Taiwan's economic development and thus its competitiveness in attracting foreign direct investment to Taiwan. The emphasis of political interests outweighing economic concerns has forced Taiwan to formulate a self-constraining economic policy towards China, in which Taiwan's capability of prosperity-generation has been hampered. Furthermore, the Taiwanese government had also put itself at the risk of damaging its relations with economic élites. On this point, this research has suggested that Taiwan should put greater effort into maintaining its domestic economic health so as to sustain its freedom of action and freedom of choice in facing any challenge from China.

Regarding the effectiveness of Taiwan's practising economic security vis-à-vis China, this research could not offer a decisive conclusion, because certain external factors were as important as the economic security policy itself. For example, both China's leverage of the power of veto in the UN Security Council and the national profiles of Taiwan's allies have shaped the result of the employment of economic security.
Chapter Six has raised this concern. Moreover, economic affordability is also crucial to the performance of economic security. Taiwan’s struggle with China in the diplomatic tug-of-war as well as in the political resistance, as analysed in Chapters Six and Seven, would need a sound economic foundation for its support. On this point, Taiwan’s National Financial Stabilisation Fund is the most evident example of this argument. The fund is an economic instrument through which the government may stabilise political power and national security through, in turn, the stabilisation of the economy.

Given that the macro-economic level of economic security is important in supporting Taiwan’s national security - not only for the support of foreign policies and for the cross-Strait politico-economic manoeuvres, but also for continuing economic development and national prosperity - concern over the impact on Taiwan’s economic security of cross-Strait economic ties with respect to Taiwan’s economic performance has drawn much awareness. Chapter Eight has examined Taiwan’s economic security with respect to its economic structure and also to the economic strength and capability of generating prosperity when it conducts economic engagements with China. It has found that Taiwan’s self-constraining economic policies have failed to restrain the growth of cross-Strait trading activities and the enlargement of investment flowing out of Taiwan into China. Given that Taiwan has a deep and extensive security consciousness regarding China’s united front tactics of ‘using business to encircle politics’ and ‘using the public to pressure officials’, this research argued that Taiwan’s government has retained the freedom of action and freedom of choice to determine those economic measures through which to tackle China’s economic impact, and China’s intention of using of economic inducements and business pressure to urge political concessions from Taiwan. The cross-Strait economic ties have in this respect
failed to undermine Taiwan’s economic security.

From an economic perspective, Taiwan has benefited materially from its own economic security. Although the debate over the consequence of rapid and massive cross-Strait trade and economic ties has reached no consensus, statistics have illustrated that the trade surplus generated from the cross-Strait trade has contributed to Taiwan’s balance of payments and supported Taiwan’s economic growth. Taiwan’s investment in China has, to some extent, brought momentum for Taiwan’s industrial upgrading. Although many arguments have asserted that China’s ‘magnetic’ economic effect has weakened Taiwan’s domestic investment, this research has argued that Taiwan’s economic difficulty was caused by domestic political friction between the ruling party and opposition parties. Political uncertainty undermined confidence in investment and thus in Taiwan’s economic performance. Therefore, Taiwan’s material economic insecurity was not necessarily caused by its economic links with China. On the contrary, Taiwan’s economic security with respect to its economic structure as well as its economic strength and capability of generating prosperity when it conducts economic engagements with China under the given cross-Strait relations has been advanced.

Although strong political ideology dominated the struggle between Taiwan and China persistently, the economic and trade engagements across the Taiwan Strait have continued vigorously over the years. The two sides have striven in the competition for sovereign right and legal identity, on the one hand; furthermore, they have, on the other, wished to gain economic benefit through bilateral economic exchange. Given such political concerns and economic interests, Taiwan has gradually relaxed its economic policies towards China, and vice versa. The policy implications of the
change in economic policies towards the counterparts on the two sides of the Taiwan Strait indicates that the pursuit of economic security with respect to national prosperity is an important objective of the national security agendas of both China and Taiwan within the context of cross-Strait antagonism. The governments in Taipei and Beijing have shared a common view of ensuring the continued growth of their respective national economy. The substantial presence and operation of Taiwan-invested enterprises in China has revealed the fact that economic growth and prosperity is a common shared interest of both Taiwan and China. While the FDI-driven exports to China have created massive trade effects in support of Taiwan's economic growth, China, too, has benefited materially from Taiwan-invested enterprises' economic contribution in the context of supporting China's leverage in the international market. The growing cross-Strait economic ties have thus provided Taiwan with a ground on which to formulate its economic security policy and to sustain economic security towards both extending economic development and supporting national security employment. Although it is too early accurately to predict the future development of cross-Strait relations, it is certain that economic exchange between Taiwan and China is a feasible measure that can be utilised by Taiwan in fulfilling its objectives of economic security. In such a context, this thesis would suggest that both Beijing and Taipei should value the economic contribution made by Taiwan-invested enterprises in China. Both Taiwan and China shall make good use of the mechanism of the division of labour to support their respective economic security agendas.

In conclusion, this thesis has demonstrated that economic security is a plausible choice through which a state may achieve its national security agenda. Given the distinctive features of national capacities and different levels of political and
economic development, states facing different security challenges and national interests will initiate different economic security agendas. Small states can also formulate economic security to serve their respective security agendas, as was analysed in the case study of Taiwan. Taiwan has employed economic security as a form of protective barrier in the pursuit of Taiwan’s national security agenda in the context of cross-Strait antagonism. The national economic foundation is the basic factor that supports such employment. Nevertheless, other external factors can also be important determinants that affect the effectiveness and the success of such an economic security policy.

Taken as a whole, this thesis can be viewed as having made a contribution to the study of the notions of economic security, and of the role of economic security in the national security strategy in international relations. Although the methodological and theoretical frameworks employed in the case study may not be able to provide a generalised form in research, it is hoped that the case study of Taiwan has helped to provide an example and body of reference relevant to the study of international politics. Meanwhile, the case study has helped to bring the study of international relations and international political economy into the same framework, from which it has demonstrated that politics and economics - as well as security - are interwoven in international politics.
### Appendix I

**Interview Questions**

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<tr>
<td>1.</td>
<td>Do you think that cross-Strait relations have improved since 1988? If they have, to whom do you attribute this improvement? (請問您是否會覺得自1988年以來，兩岸關係日趨緩和，雙方交流互動亦有所改善；若果如此，則何方應居首功？)</td>
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<td>2.</td>
<td>Which have been the most important events in cross-Strait relations since 1988? (自1988年以來，兩岸交流互動關係中最為重大之事件爲何？)</td>
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<td>3.</td>
<td>What does the growth in trade between Taiwan and China since 1988 tell us about the changing relationship between Taipei and Beijing? (自1988年以來，兩岸貿易往來穩定成長，此種互動交流對於臺北當局與北京政權間之關係變化進程上，有何種程度之影響力？)</td>
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<tr>
<td>4.</td>
<td>Has cross-Strait ties enhanced or weakened Taiwan’s economic security? (海峽兩岸間之互動交往關係，對於臺灣之經濟安全上來說，係屬正面強化之助力，亦或為負面衝擊之阻力？)</td>
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<tr>
<td>5.</td>
<td>Does the importance of trade and economic relations outweigh the importance of military security and political ideology in Taiwan and China? (對於臺灣與中國大陸來說，商貿往來及經貿互動關係，是否足以超越軍事安全或政治意識形態之影響力，進而左右政局之發展？)</td>
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<td>6.</td>
<td>How has membership of the World Trade Organization affected cross-Strait relations? (海峽兩岸參加世貿組織，同時取得會員國身份後，對於兩岸關係所產生之衝擊爲何？)</td>
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<td>7.</td>
<td>Have cross-Strait economic relations given Beijing greater political influence over Taipei’s policies since 1988? (自1988年以來之兩岸經貿往來關係，是否足以提供北京政權，使其掌握影響臺北當局政策之操作基點？)</td>
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<td>8.</td>
<td>How have domestic political developments in China affected cross-Strait relations? (中國大陸內部之政治發展對於兩岸關係會產生怎樣的衝擊與影響？)</td>
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<tr>
<td>9.</td>
<td>Which have been the most important external event affecting cross-Strait relations since 1988? (自1988年以來，衝擊兩岸交流互動關係，最為重大之國際外在事件爲何？)</td>
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<td>10.</td>
<td>What impact has 9/11 had upon cross-Strait relations? (請問9/11事件對於兩岸關係曾經產生過怎樣的影響與衝擊？)</td>
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Appendix II

The details of the interview schedule

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<th>ID Code</th>
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