

THE EVOLUTION OF CROSS-STRAIT ECONOMIC RELATIONS
IN THE FIRST CHEN SHUI-BIAN ADMINISTRATION

CHEN-YUAN TUNG

Assistant Professor

Sun Yat-Sen Graduate Institute of Social Sciences and Humanities

College of Social Sciences, National Chengchi University

E-mail: ctung@jhu.edu

*Prepared for the Conference on the First Chen Shui-bian Administration, sponsored by the Harvard University and the University of London, Annapolis, Maryland, USA, May 5-8, 2005.

First of all, this paper elaborates the current status of cross-Strait economic exchange. Secondly, this paper analyzes both policies of Taiwan and China with respect to cross-Strait economic relations after 2000. Thirdly, this paper discusses two important issues of cross-Strait economic relations in the era of the first Chen Shui-bian administration: the cross-Strait chartered flights arrangement and China's sanctions against Taiwan's businesspeople. Finally, this paper concludes with five salient features and prospects for cross-Strait economic relations.

I. THE STATUS OF CROSS-STRAIT ECONOMIC EXCHANGE

A. TRADE RELATIONS BETWEEN TAIWAN AND CHINA

Taiwan's Mainland Affairs Council (MAC) of the Executive Yuan estimates that Taiwan's exports to China are equal to transit trade plus the difference between Taiwan's exports to Hong Kong and Hong Kong's imports from Taiwan. This estimate should be better than the figures from customs services of Taiwan and China because the Taiwan and China figures do not take different types of Taiwan exports to China into account and thus underestimate the total amount.

Based on the MAC's estimates, Taiwan's indirect trade with China via Hong Kong was \$25.8 billion in 1999 and \$46.3 billion in 2003, increasing by 79.5% in four years. In addition, Taiwan has enjoyed a continuous and large trade surplus with China. In 1999, Taiwan ran a trade surplus of \$16.8 billion, with \$21.3 billion of exports to, and \$4.5 billion of imports from, China. In 2003, Taiwan ran a trade surplus of \$24.4 billion, with \$35.4 billion of exports to, and \$11 billion of imports from, China.

Since 1993 China has become Taiwan's third largest trading partner, after the United States and Japan. In addition, since 1993 China has also become Taiwan's

second largest export market, following the United States. In 2002, for the first time, China became Taiwan's largest export market. According to the MAC's estimate, in 2002, Taiwan's exports to China (excluding Hong Kong), the United States, and Japan were \$29.4 billion, \$26.7 billion, and \$12 billion, respectively.

In comparison, between 1990 and 1999 Taiwan was China's fourth largest trading partner, following Japan, the United States, and Hong Kong. Between 2000 and 2003 Taiwan was China's fifth largest trading partner, following Japan, the United States, Hong Kong, and Korea. In 2003, China's trade with Japan, the United States, Hong Kong, Korea, and Taiwan was \$133.6 billion, \$126.3 billion, \$87.4 billion, \$63.2 billion, and \$58.4 billion, respectively. In addition, since 1993 Taiwan has become China's second largest supplier (Japan has been its largest supplier). In 2003, China's imports from Japan and Taiwan were \$74.2 billion and \$49.4 billion, respectively.

B. FINANCIAL RELATIONS BETWEEN TAIWAN AND CHINA

According to Taiwan's official figures, in 1991 Taiwan's outward foreign direct investment (FDI) into China was only \$17 million. Since 1992, however, China has become the largest recipient of Taiwan's outward investment. By the end of 1999, Taiwan's cumulative FDI in China was 14.5 billion; by the end of 2003, Taiwan's cumulative FDI in China was as high as \$34.3 billion, or 47 percent of total Taiwan's outward FDI. Parenthetically, the 2003 figure included make-up registration of Taiwan's previously unregistered investments to China. According to Taiwan official statistics, there were 28 thousand cases of make-up registration between 2001 and 2004.

Nevertheless, Taiwan's official figures considerably underestimate the extent of Taiwan's "real" investment in China. For instance, Perng Fai-nan, governor of

Taiwan's Central Bank, estimated that by the end of 2002 the real figure of Taiwan's cumulative investment in China was about \$66.8 billion.¹ As a result, China's official data on Taiwan's investment in China seems more accurate because it is mandatory for Taiwanese businesspeople to register their investment with the Chinese government. By the end of 1999, Taiwan's realized FDI in China was 23.9 billion; as of June 2004, Taiwan's realized FDI in China was \$38.4 billion, or 7.2 percent of total realized FDI received by China. Taiwan was the fourth largest source of FDI in China, next to Hong Kong (43.7 percent), the United States (8.7 percent), and Japan (8.3 percent).

However, Chinese figures might also underestimate Taiwan's "real" investment in China because many Taiwan businesspeople began in the mid-1990s to invest in China through their holding companies in third tax-exempt countries, such as the Virgin Islands and the Cayman Islands (British Central America, BCA).² Taiwan's investment in BCA increased from \$370 million in 1995 to \$1.36 billion in 1999 with the share of Taiwan's total outward investment doubling from 15 to 30 percent. By August 2004, Taiwan's cumulative investment in BCA was \$15.2 billion and its share to Taiwan's total outward FDI was 19.1 percent. By comparison, the Virgin Islands' outward investment to China increased from \$304 million in 1995 to \$2.7 billion in 1999, with the share of China's total FDI growing from 0.8 percent to 6.6 percent. By June 2004, the Virgin Islands was the fifth largest investor in China, with cumulative realized FDI of \$34 billion or 6.4 percent of China's total FDI.

Regarding other capital flows between Taiwan and China, the Taiwanese government began to compile statistics on individual remittances to China (including

¹ Pei-xiou Liu, "The Central Bank: Capital Remitted to Mainland Is About \$70 Billion," *Gongshang Shibao* [Commerce Times], November 10, 2000.

² Chen-yuan Tung, *China's Economic Leverage and Taiwan's Security Concerns With Respect to Cross-Strait Economic Relations*, PhD Dissertation (Baltimore, M.D.: Johns Hopkins University, 2002), pp. 25-26.

household remittance, donation, and other transfer payments, but excluding travel expenditures) on 21 May 1990, and on both Taiwan business remittances to China and remittances from China to Taiwan on 29 July 1993. In 1999, Taiwan remitted a cumulative \$4.5 billion to China and China remitted a cumulative \$1.3 billion to Taiwan. As of August 2004, Taiwan had remitted a cumulative \$22 billion to China and China had remitted a cumulative \$19.4 billion to Taiwan.

Nevertheless, the Taiwanese government's figures hardly tell the truth of capital flows across the Taiwan Strait. For example, Taiwan's Central Bank estimated in late 2000 that Taiwan's total capital flow to China was around \$70 billion, of which \$40-50 billion was Taiwan's FDI in China. That is, in 2000 Taiwan might have remitted as much as \$20-30 billion non-FDI capital flow to China, including portfolio flows to China.³

II. TAIWAN'S POLICY OF CROSS-STRAIT ECONOMIC RELATIONS

Strategically speaking, the Chen Shui-bian administration's policy of cross-Strait economic relations serves two goals: constructing its normal relationship with China as well as developing Taiwan's economy. In his White Paper on China policy unveiled on November 15, 1999, Democratic Progressive Party (DPP) presidential candidate Chen Shui-bian stressed the need to establish normal relationship between Taiwan and China, while the normalization of cross-Strait ties should begin with economic and trade relations. He suggested that developing cooperative economic and trade relations between Taiwan and China should be based upon three principles: balance between national security and economic interest, a comprehensive strategy of

³ Pei-xio Liu, "The Central Bank: Capital Remitted to Mainland Is About \$70 Billion," *Gongshang Shibao* [Commerce Times], November 10, 2000.

economic security and development by replacing passive policy with active management, and negotiation with China over cross-Strait economic issues.⁴

Specifically, Chen Shui-bian suggested the principle of proportionate mutual benefit by opening the Kaohsiung and Keelung harbors to Chinese vessels in exchange for the opening of ports at Guangzhou, Dalian, Shanghai, Qingdao and Tianjin in China. In addition, he proposed a “one-way direct flight” formula, under which all air services between Taiwan and China would be operated by Taiwan airlines, with the profits shared equally by the two sides. Furthermore, he suggested strengthening review measures of Chinese investment in Taiwan’s telecommunications, power, mass media, financial, securities and semiconductor sectors. Finally, he advocated that both sides sign investment protection agreements in the short term and allow for each side to set up trade representative offices in the medium term.

After Chen Shui-bian was elected president in March 2000, the most salient feature of Taiwan’s cross-Strait economic policy is the so-called “integration theory.” On December 31, 2000, President Chen pronounced that the integration of bilateral economies, trade, and culture across the Taiwan Strait should be a starting point for gradually building faith and confidence in each other. This, he suggested, could be the basis for a new framework of permanent peace and political integration.⁵

President Chen explained the “integration theory” on many occasions over the next three years. For instance, on May 10, 2002, President Chen reiterated that the normalization of cross-Strait relations must begin with the normalization of economic and trade relations. He emphasized that the first step toward political integration

⁴ “Kua Shiji Zhongguo Zhengce Baipishu”[Across-Century China Policy White Paper], in Mainland Affairs Council, Executive Yuan, Republic of China (ed.), *Zhengfu Dalu Zhengce Zhongyao Wenjian* [Important Documents of the Government’s Mainland Policy] (Taipei: Mainland Affairs Council, 2004), p. 157.

⁵ “President Chen’s Cross-century Remarks,” Mainland Affairs Council, <http://www.mac.gov.tw/english/english/macpolicy/ch9001e.htm>, accessed May 7, 2004.

across the Taiwan Strait was economic and cultural integration.⁶ On January 1, 2003, President Chen urged both sides to strive towards building a framework of interaction for peace and stability. Particularly, he stressed consultation and promotion of direct transportation links, as well as exchange on other relevant economic issues, which could constitute a first step forward and set the stage for further economic and cultural interaction.⁷

Since the second half of 2003, Taiwan has indicated an increased commitment to the negotiation of direct transportation links. On August 13, President Chen pledged to resume direct links with China by the end of 2004. Two days later, the Taiwanese government issued a policy paper called “The Assessment of the Impact of Direct Cross-Strait Transportation.” The assessment stressed that the effects of cross-Strait direct transportation links would be extensive and far-reaching; there would be advantages and disadvantages. The assessment concluded that both parties should sit down and negotiate on the direct transportation links as soon as possible in order to maximize advantages and minimize disadvantages for Taiwan.⁸

On October 9, 2003, Taiwan’s parliament, the Legislative Yuan, passed the revisions to the Statute Governing the Relations between the People of the Taiwan Area and the Mainland Area. According to the revisions, the Taiwanese government must draft bylaws concerning the opening of direct cross-Strait transportation links within 18 months. More importantly, government agencies will be able to entrust, on their behalf, private organizations to engage in cross-Strait negotiation. That is, Taiwan has agreed to China’s preferences for the negotiation channel through private organizations over direct transportation links.

⁶ “President Chen’s Remarks During His Stop on Titan Island,” Office of the President, Republic of China, May 10, 2002.

⁷ “President Chen’s New Year Day’s Message (excerpt: cross-strait relations),” Mainland Affairs Council, <http://www.mac.gov.tw/english/english/macpolicy/ch9211e.htm>, accessed May 7, 2004.

⁸ “Trade and Economic Category,” Mainland Affairs Council, <http://www.mac.gov.tw>, accessed on April 16, 2005, p. 1.

With respect to Taiwan's outward investment to China, the Chen Shui-bian administration discarded the long held "no haste, be patient" policy and adopted a new policy of "proactive liberalization with effective management" after the consensus reached in the Economic Development Advisory Conference (EDAC) on August 26, 2001. Key conclusions reached during the meeting include:⁹

1. "Taiwan first," "global management," "mutual benefits," and "risk control management" are the pivotal principles regarding trade and commercial activities across the Taiwan Strait;
2. Adopt a "proactive liberalization with effective management" policy to replace the previous "no haste, be patient" policy regarding China-bound investment;
3. Set up flexible mechanisms to monitor movements of capital between the two sides;
4. Introduce Chinese capital to Taiwan's property and real estate market at the first stage, the manufacturing sector at the second stage, and the financial market at the third stage.
5. Establish the three links (direct trade, postal, and transportation links between Taiwan and China);
6. Gradually expand Chinese imports to Taiwan;
7. Under the principle of national security, actively open up the local tourist market to Chinese visitors.

The following will list the opening measures of the cross-Strait economic policy by the first Chen Shui-bian administration between mid-2000 and mid-2004.

⁹ "Jingfahui Lianganzu Zungjie Baogao" [Conclusion Report of the cross-Strait Session at the EDAC], , in Mainland Affairs Council, Executive Yuan, Republic of China (ed.), *Zhengfu Dalu Zhengce Zhongyao Wenjian* [Important Documents of the Government's Mainland Policy] (Taipei: Mainland Affairs Council, 2004), pp. 25-28.

A. Mini Three Links

On January 1, 2001, the Chen Shui-bian administration opened up the “mini three links,” which legalized trade and travel between Taiwan’s offshore islands, Quemoy (Kinmen) and Matzu, and adjacent ports in China. Thereafter, Taiwan has been gradually expanding bilateral flows of commodities, people, ships and financial exchange. In the beginning, China disagreed that Taiwan liberalized mini three links without negotiation with China and thus did not cooperate with Taiwan. Nevertheless, the Chinese government gradually adopted a cooperative attitude toward these measures after January 4, 2001.

As a result, cross-Strait exchange through the mini three links increased exponentially over the last four years. Based on Taiwan’s statistics, the number of Taiwan’s ships to China increased from 137 in 2001 to 1,221 in 2004; the number of Taiwan’s people to China increased from 11,729 in 2001 to 202,371 in 2004. In addition, the number of China’s ships to Taiwan increased from 45 in 2001 to 1,808 in 2004; the number of China’s people to Taiwan increased from 1,041 in 2001 to 12,409 in 2004. (See Table 1)

Table 1. Mini Three Links between Taiwan and China

Period	2001	2002	2003	2004	Total
Taiwan's Ships to China	137	435	776	1,221	2,569
Taiwan's People to China	11,729	28,087	81,759	202,371	323,946
China's Ships to Taiwan	45	158	567	1,808	2,578
China's People to Taiwan	1,041	1,358	3,760	12,409	18,568

Source: Mainland Affairs Council, <http://www.mac.gov.tw>, accessed on April 19, 2005.

B. Liberalizing Chinese imports to Taiwan

Taiwan has gradually but surely come to relax its regulation on China's exports to Taiwan after 2000. For December 2000 only 53.9 percent of trade commodities were permitted as imports from China to Taiwan whereas this figure jumped to 77.5 percent by September 2003 and 78.2 percent by October 2004.

C. Liberalizing Taiwan's Investment to China

After the EDAC, the Taiwanese government relaxed restrictions on Taiwanese investment in China's high-tech industry, except for items like wafer and upstream petrochemical products. It also did away with the investment ceiling of US\$50 million. Instead, it established a review commission with clear standards on investment projects of over US\$20 million and Taiwanese investing an amount lower than US\$200,000 may register by declaration procedures. Finally, it allowed Taiwanese enterprises to directly engage in China's investment.

D. Opening Up Chinese Investment to Taiwan

Taiwan has put forward a three stage schedule that allows for China's investment in Taiwan: Taiwan has first allowed China's capital for investment in the real estate sector for the first stage on August 8, 2002. In addition, Taiwan plans to open up to Chinese investment in some service industries and the manufacturing industry for the second stage, and in the capital market for the third stage.

E. Expanding Offshore Transshipment Center

The Taiwanese government continued its support for the offshore transshipment center of Kaohsiung harbor after 2000 and further announced the Cross-Strait Sea

Freight Facilitation Measures on May 7, 2004. The Facilitation Measures made appropriate adjustments to the function of the Offshore Transshipment Center to enable more convenient and faster transportation of cargo across the Strait. In addition, the government expanded the application of the Facilitation Measures from Kaohsiung harbor to Taichung harbor and Keelung harbor. The amount of offshore transshipment increased from 365,879 cargos in 1999 to 674,775 cargos in 2004. (See Table 2.)

Table 2. The Operation of the Offshore Transshipment Center of Kaohsiung Port

Unit: cargos

Period	Unloading	Loading	Total Loading/Uploading Operation	Growth rate
1998	151,872	120,893	272,765	n.a.
1999	204,047	161,832	365,879	34.1%
2000	227,682	204,986	432,668	18.3%
2001	270,318	237,924	508,242	17.5%
2002	282,123	292,328	574,451	13.0%
2003	312,159	318,179	630,338	9.7%
2004	343,469	331,306	674,775	7.1%

Source: Mainland Affairs Council, <http://www.mac.gov.tw>, accessed on April 19, 2005.

F. Facilitating Air Links

Taiwan and China reached agreements on chartered passenger flights during the lunar new-year holidays in both 2003 and 2005. For 2003, it was operated by Taiwan's airlines, two routes between Taipei and Kaohsiung on the Taiwan side and Shanghai on the China side, and a stopover in Hong Kong. For 2005, it was operated

by Taiwan and China airlines, multiple airports between Taiwan and China, and nonstop between Taiwan and China. The arrangement negotiation will be elaborated in detail in the section below.

In addition, the Taiwanese government announced the policy on Cross-Strait Air Freight Facilitation Measures on September 10, 2003. It promoted one-way (Taiwanese carriers operate the flights first) “restricted” and “indirect” cargo chartered flights to solve the urgent demand of Taiwan businesspeople for freight transportation. On January 2004, President Chen announced that Taiwan would expand the current uni-directional cargo chartered flights into bi-directional chartered flights through bilateral negotiation.

G. Facilitating Financial Transaction

After July 2001, Taiwan allowed offshore banking units (OBUs) of Taiwanese banks to engage in direct trading with Chinese financial institutions. Between July 2001 and August 2004, financial transaction across the Strait through OBUs amounted to \$110.4 billion.

G. Allowing Taiwan’s Financial Sectors to Establish Branches in China

Since 2001, Taiwan has gradually allowed Taiwan’s banks, securities firms and insurance companies to set up branch offices or subsidiaries in China. As of mid-2004, Taiwan’s Ministry of Finance has approved 17 securities firms, 15 family insurance companies, and 10 banks to set up offices in China.

Furthermore, on April 19, 2004, Taiwan allowed Taiwan’s insurance companies to invest in Chinese local companies. On March 3, 2005, Taiwan allowed overseas subsidiaries of Taiwan’s financial holding companies to establish representative offices in China.

H. Opening Chinese Tourists to Taiwan

Since January 1, 2001, Taiwan allowed 600 and 80 Chinese people to visit Kinmen and Matsu for sightseeing everyday, respectively. However, by mid-2004, there were only 165 and 283 Chinese people traveling to Kinmen and Matsu as tourists due to China's restriction on its people. By the end of September 2004, the Chinese government began to allow people from Fujian Province to traveling to Kinmen and Matsu for sightseeing.

In addition, since January 1, 2002, Taiwan allowed category-3 Chinese people, which refer to those residing abroad, to visit Taiwan for sightseeing. The second-phase relaxation was implemented on May 10, 2002, which allowed Chinese people who have resided abroad for at least four years and who have acquired a work permit at his place of residence abroad, and their spouse and direct relatives to visit Taiwan for sightseeing. This relaxation also automatically applied to the residents of Hong Kong and Macao and Chinese people who have been approved to go abroad for sightseeing or for business trips. From the start of the trial implementation to the end of October 2004, the number of Chinese people visiting Taiwan for sightseeing amounted to 29,599.

I. Expanding Chinese Businesspeople and Technical Professionals to Taiwan

Since January 2002, Taiwan has significantly simplified and relaxed measures for applications of businesspeople and technical professionals from China to Taiwan. In particular, the total period of stay for a Chinese technical specialist applying to come to Taiwan to participate in technical research was extended from three years to six years. Moreover, in November 2004, Taiwan further relaxed the restrictions of Chinese people coming to Taiwan to engage in commercial activities and thus

promote normal business exchanges between Taiwan and China.

III. CHINA'S POLICY OF CROSS-STRAIT ECONOMIC RELATIONS

Before mid-2000, China insisted that Taiwan accept the one-China principle before the two sides could discuss the three links. Nevertheless, after August 2000, Chinese Vice Premier Qian Qichen began to emphasize that establishing the “three links” did not mean that the two sides needed to resolve political issues first. As long as the links were regarded as the internal affairs of one country, he stressed, this issue could be solved through private-to-private, industry-to-industry, and company-to-company channels. Qian added that neither side could display flags on its ships involved in cross-Strait exchanges because flags are symbols of sovereignty.¹⁰

In July 2002, Qian Qichen further clarified that the three links could be implemented as soon as possible without referring to the political meaning of the one-China principle, as long as they were considered the internal affairs of one country.¹¹ In this way, Beijing de-emphasized the political significance of the three links, and the one-China principle was no longer the prerequisite for the negotiation of the three links.

Nevertheless, China's proposal was quickly rejected by Taiwan. President Chen argued that the phrasing “internal affairs of one country” was equivalent to “one China,” which localized and marginalized Taiwan. As a result, Qian put forward a new statement in October 2002, defining cross-Strait air and sea links as “cross-Strait routes.”¹²

¹⁰ “Qian Qichen: Mainland and Taiwan Belong to One China,” *Lienho Bao* [United Daily], August 26, 2000, p. 4.

¹¹ Jia-wei Luo, De-huei Zhou, Pei-fen Chiou, “Qian Qichen: Talks on the Three Direct Links, No Involving One China,” *Lienho Bao*, July 6, 2002, p. 1.

¹² The interview group of the *Lienho Bao*, “Qian Qichen: Promoting the Three Direct Links Has

On December 17, 2003, China issued a policy paper to reiterate its flexible position on the negotiation of the three links. The paper said that the three links was purely an economic matter and political differences should be shelved. It defined the three links as cross-Strait affairs and internal affairs of “Chinese people” on both sides of the Strait. It reiterated that negotiation concerning the three links was not political negotiations and might be carried out through non-governmental trade organizations beyond the political implications of one China.

After Taiwan’s March 2004 presidential election, however, Beijing issued a statement on May 17, stating that the three links would be established as long as Taiwan recognizes the one-China principle. This statement created some speculation that China had been changing its previous flexible political position on the three links. On May 24, Beijing clarified that China still treated the three links as an economic issue. As long as regarding direct links as internal affairs of one country, Beijing hoped that both sides would not politicize it and would continue promoting economic exchanges.

Nevertheless, Beijing mentioned “internal affairs of one country” instead of “cross-Strait routes” referring to direct links. On June 30, requested by Taipei, Beijing further reassured its previous political position made by former Vice Premier Qian Qichen in October 2002. Without the precondition of the one-China principle, negotiation on the three links is still Beijing’s priority on cross-Strait relations.¹³

Chinese scholars and officials in the Taiwan affairs system predominantly believed that Taiwan needed the three links more than China did. They thought Taiwan would benefit more from the links, whereas China’s need for them was not

Nothing To Do with the Next Presidential Election,” *Lienho Bao*, October 17, 2002, p. 4.

¹³ Meeting notes with two senior scholars in Beijing and two senior scholars in Shanghai, April-May 2004. Meeting notes with two senior scholars in Shanghai, July 2004. Meeting notes with a senior Chinese official, July 7, 2004.

urgent.¹⁴ In addition, Beijing believed that President Chen's advocacy for the links was only pre-election posturing and he did not really want them enacted. As a result, they argued that the three links would not succeed in the short run.¹⁵

Since China believed that Taiwan needed the three links more, and the probability of success in the short term was not significant, why has China been actively promoting the idea? Why did China adopt a more flexible approach to rescind the one-China principle as the prerequisite for negotiation of the three links, and define cross-Strait air and sea links as "cross-Strait routes"?

In general, there are four reasons why China actively promotes the three links. First, Chinese leaders hope for a great historical achievement—instituting the links, a proposal that has been put forward since 1979—in order to help consolidate their status within the Party.¹⁶

Second, China believes that the three links are favorable steps toward both unification and prevention of Taiwan's continual moves toward independence. Beijing expects that closer economic exchanges will create more favorable public opinion toward unification in Taiwan because both sides will have common economic interests.¹⁷

Third, the three links would help China solve its present economic predicament and continue its economic development.¹⁸ In the early 2000s, notwithstanding its

¹⁴ A person involved with Taiwan in Shanghai, author's conference notes, October 9, 2002. A senior person involved with Taiwan, interview with author, November 2002. Two senior scholars of Taiwan studies in Beijing, interview with author, November 2002.

¹⁵ Two senior persons involved with Taiwan in Beijing, interview with author, November 2002. A senior scholar of Taiwan studies in Beijing, November 2002. Two scholars of Taiwan studies in Shanghai, interview with author, November 2002. A senior person involved with Taiwan in Beijing, interview with author, March 2003. A scholar of Taiwan studies in Shanghai, interview with author, March 2003.

¹⁶ A person involved with Taiwan in Shanghai, author's conference notes, October 9, 2002. A senior scholar of Taiwan studies in Shanghai, interview with author, November 2002.

¹⁷ A senior scholar of Taiwan studies in Shanghai, interview with author, November 2002.

¹⁸ A scholar of international relations in Beijing, interview with author, July 12, 2001. A senior economist at the Xiamen University, July 8, 2002. A senior scholar of Taiwan studies in Beijing, interview with author, July 8, 2002. Several senior scholars of Taiwan studies in Beijing, interview

outstanding economic growth rates, China's internal economic, social, and political problems continued to be severe, such as ailing financial system, poor-performed state-owned economy, stagnated agricultural and rural development, increasing income and regional inequality, and serious political corruption.

After joining the WTO at the end of 2001, China has faced even more thorny economic problems. The only way for China to solve or control internal problems is to keep the economy effectively growing at 7-8 percent annually to provide sufficient employment opportunities.¹⁹ For instance, in 2003, when economic growth rate was 9.1 percent, the net total of urban jobs increased by 8.59 million. In 2004, the Chinese government aimed at keeping the urban registered unemployment rate below 4.7 percent by creating 9 million net-additional urban jobs. That is, the Chinese government had to maintain at least 9 percent of economic growth rate in 2004.²⁰

For instance, during internal meetings in Beijing in 2002, Premier Zhu Rongji did not mention any policy achievements, emphasizing that China still had enormous problems to be solved. He had a clear picture of China's overall situation, which led him to be less optimistic than previously.²¹ At a press conference in March 2002, Premier Zhu even argued that if the Chinese government had not adopted a proactive fiscal policy and prudent monetary policy between 1998 and 2002, "China's economy would probably have collapsed."²²

Fourth, Beijing maintains that the three links can promote the stability and development of cross-Strait relations and thus allow China to concentrate on its

with author, July 9 and 16, 2002.

¹⁹ Chen-yuan Tung, *China's Economic Leverage and Taiwan's Security Concerns with Respect to Cross-Strait Economic Relations*, Ph.D. Dissertation, Johns Hopkins University, 2002, pp. 294-365. A senior economist in Tianjin, conversation with author, November 2002. A senior economist in Beijing, conversation with author, November 2002.

²⁰ Chen-yuan Tung, "Assessment and Prospects of China's Economic Development: 2004-2005," *China Economic Analysis Yearly Report*, Cross-Strait Prospect Foundation, December 2004, p. 4.

²¹ A senior scholar of Taiwan studies in Beijing, interview with author, July 9, 2002.

²² "Comparison – Xinhua Reports on Premier Zhu Rongji News Conference" (in Chinese), Beijing Xinhua Domestic Service, March 15, 2002, in FBIS, *Daily Reports/China*, March 15, 2002.

economic development.²³ In July 2002, explaining cross-Strait relations to a visiting delegation of the Mountain Alliance, a political group from Taiwan, Vice Premier Qian pointed out that there were still many difficulties facing China; he cited peace and stability as the most important matters.²⁴

To sum up, for Chinese leaders, promotion of the three links brings little risk, has a high probability of success, is a relatively-easy-to-accomplish policy achievement on the Taiwan Strait issue, and thus elevates their status within the Party. As a result, Chinese leaders would continue to place the priority of their Taiwan policy on promoting the three links.

IV. CROSS-STRAIT CHARTERED FLIGHTS ARRANGEMENT

In late October 2002, Taiwanese legislators proposed lunar new-year chartered flights between Taiwan and China to both governments. In response, China's spokesman for the Taiwan Affairs Office (TAO) of the State Council said that China would consider the application of chartered flights based on the actual situation with a hope that airlines of both sides could participate in the business.

On November 12, Taiwanese Premier Yu Shyi-kun said that the opening of cross-Strait direct air links, such as point-to-point chartered flight services, was technically feasible anytime and only required negotiations. MAC Vice Chairman Chen Ming-tong said that Taiwan welcomed cross-Strait negotiations and was ready to begin talks anytime on the chartered flights arrangement with China. Without bilateral official negotiations, Chen said, Taiwan would only allow its airlines to file

²³ A senior scholar of Taiwan studies in Beijing, interview with author, November 2002. A senior scholar of American studies in Beijing, interview with author, November 2002.

²⁴ Jia-wei Luo and Pei-fen Chou, "Qian Qichen Affirms the Function of the Two Associations," *Lienho Bao*, July 6, 2002, p. 1.

applications with the Chinese government to obtain permission for indirect chartered flights between Taiwan and China by stopover in Hong Kong or Macao during lunar new-year holidays in early 2003.

However, China requested Taiwan negotiate with China through authorized private organizations on the details of chartered flights as well as reach an agreement that the arrangement should be reciprocal two-way flights the next year. In response, Taiwan emphasized that Taiwan was ready to send representatives of the Strait Exchange Foundation (SEF) to negotiate with their counterparts of the Association of Relations Across the Taiwan Strait (ARATS). But China refused to resume SEF-ARATS dialogues.

Without Taiwan's authorization of private organizations to negotiate with China, on January 7, 2003, China finally approved the first indirect chartered flights by six Taiwanese airlines to China. Nevertheless, China's TAO Director Chen Yunlin stressed that China reserved its right to have reciprocal flights from China to Taiwan the next time.

In mid-November 2003, Beijing announced that its position on the 2004 new-year chartered flights was "direct, nonstop and reciprocal." In response, Taipei said that official negotiations were necessary if Chinese air carriers wanted to operate chartered flights between Taiwan and China during lunar new-year holidays. Nevertheless, Beijing insisted that both sides authorize airline companies to negotiate with each other.

Without Taiwan's agreement on the negotiation model and reciprocal flight arrangements from China to Taiwan, China even proposed to allow Taiwanese airlines to operate direct chartered flights to China in 2004 as long as Taiwan agreed to allow

two-way chartered flights in 2005.²⁵ At the end, Taiwan did not agree upon China's proposal and thus there were no chartered flights across the Taiwan Strait during the 2004 lunar new-year holidays.

In early October 2004, Taiwan sharply changed its policy position toward China with respect to the 2005 chartered flights arrangement. Premier Yu instructed the MAC to actively promote the chartered flights arrangement based on the following principles -- "bilateral, reciprocal, and non-stop" with a flexible negotiation approach. In fact, Taiwan agreed upon all China's previous conditions on the arrangement.

However, China added one more political condition on the chartered flights arrangement that Taiwan had to obey the principle of internal affairs of one country and China accused that Taiwan did not follow the principle. Furthermore, Beijing asked Taipei to authorize a private organization to negotiate the chartered flights arrangement. In turn, Taipei reiterated its previous position and welcome China to authorize appropriate persons to negotiate with Taiwan.

On November 10, President Chen proposed a concrete negotiation model to China that both sides across the Taiwan Strait should follow the Taiwan-Hong Kong aviation right model to settle passenger and cargo chartered flights. The model meant that, without any precondition, Taiwan authorized a private association with official participation to negotiate with Hong Kong's counterpart on Taiwan-Hong Kong aviation right in 2002.

However, China's ARATS pointed out that functional talk across the Strait had to insist on the one-China principle. In addition, China's TAO accused that President Chen's statement "China is not our country, but an enemy" created tensions and thus China would not like to negotiate with Taiwan on the chartered flights. Finally, China

²⁵ Ted Anthony, "China Offers Taiwan Unlimited Charter Flights to Mainland – With Conditions," Associated Press, December 31, 2003.

defined chartered flights as internal affairs of one country. Generally speaking, China was very passive and not supportive regarding the chartered flights negotiation until the end of 2004.

Suddenly, on January 2, 2005, Beijing changed its policy position. In an interview by the Xinhua News Agency, the TAO spokesman emphasized that China would work hard to promote the launching of chartered flights across the Taiwan Strait during the lunar new-year holidays. Beijing suggested that airlines across the Strait communicate directly over technical and business details and make arrangements. In the interview, the TAO spokesman neither mentioned the one-China principle as a precondition of the talk, nor defined the chartered flights arrangement as internal affairs of one country.²⁶

On January 4, Taipei immediately authorized the Taipei Air Transportation Association (TATA) to conduct talks on the chartered flights arrangement with Beijing. Three days later, the TATA president met in Macau with Pu Zhaozhou, a senior official of the General Administration of Civil Aviation of China and executive director of the China Civil Aviation Association. Nevertheless, China ruled out the participation of Taiwan's MAC officials and SEF people in the chartered flights negotiation, but was acceptable to other Taiwanese officials.

On January 15, within just two hours, both sides reached agreement on the chartered flight issue based on the two-way, reciprocal, and non-stop principle by Taiwan's Chang Kuo-cheng, director of Civil Aeronautic Administration, and China's Pu Zhaozhou. Forty-eight flights would connect Taipei and Kaohsiung on the Taiwan side with Beijing, Shanghai, and Guangzhou on the China side from January 29 to February 20, 2005.

²⁶ "Chinese Mainland to Work for Launching Charter Flights Across Straits," Xinhua General News Service, January 3, 2005.

Negotiation over the chartered flights serves a very good example for both sides to gradually work out a feasible negotiation model on bilateral economic issues. In the very beginning, Taipei wanted to exploit the negotiation on cross-Strait chartered flights arrangement as leverage to force Beijing to accept the resumption of SEF-ARATS dialogues. Despite wanting to reach an agreement on bilateral reciprocal flights arrangement, Beijing only accepted negotiation by “private” organizations authorized by both sides other than the SEF and the ARATS.

In early 2003, China conceded to accept Taiwan’s unilateral chartered flights to China and hoped Taiwan would accept reciprocity of chartered flights from China to Taiwan the following year. However, Taiwan did not accept China’s proposal and thus China declined to offer one more trial of chartered flights arrangement for 2004 lunar new-year holidays.

In late 2004, Taiwan accepted China’s previous conditions on the chartered flight arrangements and a flexible negotiation model with official participation from both sides. Then, China set up two extra political conditions for the negotiation: the one-China principle and internal affairs of one country. At the end, Taipei did not concede and Beijing pragmatically accepted Taipei’s proposal. Both sides swiftly reached the agreement on the chartered flights arrangement for 2005 lunar new-year holidays. Particularly, both sides gradually realized that additional political conditions for the negotiation on chartered flights arrangement would break down the bilateral agreement and so both sides adopted a very pragmatic approach to resolve the issue.

V. CHINA’S SANCTIONS AGAINST TAIWAN’S BUSINESSPEOPLE

On March 10, 2000, Chen Shui-bian revealed his list of advisors for national policies, including Stan Shih, chairman of the Acer Group; Shi Wen-lung, chairman of

the Chi Mei Group; Chang Yung-fa, chairman of the Evergreen Group; and Ying Qi, president of the Continental Engineering Corporation. Zhang Zhiqun, director of Shanghai Taiwan Affairs Office, soon summoned representatives of these companies to Shanghai, and expressed China's concerns about their support for Chen Shui-bian.²⁷

One month later, although reassuring Taiwan-invested enterprises (TIEs) in China that China would continue to protect their legitimate interests in China, Li Bingcai, TAO deputy director, said, “[V]ery particular individual important Taiwan businesspeople openly clamor for ‘Taiwan independence’ and advocate the ‘Lee Teng-hui’ line, which preaches the break up of the motherland. Meanwhile, they scabble for profits by engaging in business and economic operations on the Mainland. Such a situation will not be allowed to continue.”²⁸

Li Bincai's remarks incited anxiety among TIEs and Beijing tried to play down the anxiety of TIEs. On April 24, ARATS Vice Chairman Tang Shubei emphasized that for the majority of TIEs, Beijing welcomed and encouraged them to invest in China and protected their important interests. However, Tang pointed out, China had some opinions on only “very particular individual” TIEs, who publicly supported Taiwan independence.²⁹

On May 7, one month from his previous remarks, Li Bincai reassured TIEs that China would continue to obey “Jiang's eight-point proposal” and effectively protect all legitimate interests of TIEs. He also clarified that Beijing was concerned only with “very particular individual” TIEs, who publicly supported Taiwan independence. On

²⁷ Bin-zhong Song, “China Warns Taiwan Businesspeople who support Taiwan Independence,” *Zhongguo Shibao* [China Times], April 9, 2000.

²⁸ “On the Current Development of Cross-Strait Economic Relations: Questions Answered by the Leader of the Central Taiwan Affairs Office and the State Council Taiwan Affairs Office,” *Renmin Ribao* [People's Daily], April 10, 2000, p.1.

²⁹ Le-yi Yuan, “Tang Shubei: Mainland Never Agrees One China with Different Interpretation,” *Zhongguo Shibao*, April 25, 2000.

September 23, Li Bincai reassured TIEs that cross-Strait political divergence should not interfere with economic exchange and cooperation. He promised that China put TIEs in a very important position and would protect various interests of TIEs under any circumstance.³⁰

In early March, 2001, Chi Mei Group Chairman Shi Wen-lung's controversial comments about Taiwanese comfort women serving Japanese military persons during the World War II were published in a comic book, *Taiwan Discourse*, by Japanese cartoonist Yohinori Kobayachi. As a result, on March 10, the Chi Mei petrochemical plant in Zhenjiang, Jiangsu Province, was reportedly forced to shut down under pressure from Beijing. In addition, China launched several rounds of tax probes at Chi Mei's Zhenjiang plant, which were widely seen as Beijing's retaliation for Shi's comments.³¹

Nevertheless, on the same day, both the Chi Mei Group and Chinese authorities denied reports that the Chi Mei's plant in Zhenjiang had closed. In addition, the TAO issued a statement that China would protect the legitimate rights of Taiwanese investors in China. The next day, a TAO spokesman reiterated China's opposition to anyone making money in China while at the same time advocating independence in Taiwan. However, he also said that China would protect the rights of Taiwanese companies in China, but would also take relevant measures against anyone who broke the law.³²

³⁰ Le-yi Yuan, "Taiwan Affairs Office Reassure Taiwan Businesspeople," *Zhongguo Shibao*, May 8, 2000. Cuo-zhong Wang, "China Actively Integrate Taiwan Business Associations," *Zhongguo Shibao*, September 24, 2000.

³¹ Sofia Wu, "Mainland Official Denies Chi Mei Plant Closure," Central News Agency, March 11, 2001. Huei-xing Wang, "Chi Mei Builds An Empire of Petrochemical Industry," *Zhongguo Shibao*, March 11, 2001.

³² "China to Close Plants Belonging to Taiwan Independence Supporter: Report," Agence France Presse, March 10, 2001. Sofia Wu, "Mainland Official Denies Chi Mei Plant Closure," Central News Agency, March 11, 2001. Jun-wei Lian and Zhang-rong Kang, "China Reportedly Demand Chi Mei's Plant in Zhenjiang Closed," March 11, 2001, *Gongshang Shibao* [Commerce Times], March 11, 2001. "Taiwan Chi Mei Denies China Plants Closed by Mainland Gov't," Deutsche Presse-Agentur, March 11, 2001, 6:07 Central European Time.

Although Shi Wen-lung did not explicitly support President Chen's re-election campaign in 2003-2004, a TAO spokesman stated after the 2004 election that China did not welcome the "green Taiwanese businesspeople." He clarified that "we do not welcome those Taiwan businessmen who earn money from the mainland and support Taiwan independence when they return to Taiwan."³³ In editorial comments of the *Renmin Ribao* [People's Daily], China called Shi Wen-lung a "Big-shot for Taiwan independence." China accused that Shi was President Chen's major financial provider behind the scenes.³⁴

By mid-2004, the Chi Mei group was the world's largest manufacturer of important plastic material ABS and China was its major market. It has established a petrochemical complex and invested US\$170 million in Zhenjiang of Jiangsu Province since 1996. After the completion of the expansion project in Zhenjiang, the total investment would reach US\$600 million and production capability would exceed the group's Taiwan facilities.³⁵ In addition, the Chi Mei group planned to invest more in high-tech information industry in China. In short, the Chi Mei group had a very high stake in its investment interest in China.

As a matter of fact, the Chinese government has moderately sanctioned the Chi Mei group for Shi's Taiwan independence stance by constantly probing tax issues and harassing its cooperative companies in both upstream and downstream companies. Consequently, the Chi Mei group faced significant pressure to drop its political stance.³⁶

Finally, on March 26, 2005, right after China's passage of the anti-secession law

³³ "Beijing Taiwan Affairs Spokesman's News Conference on 24 May," BBC Worldwide Monitoring, May 24, 2004.

³⁴ Gang Cheng, "We Do Not Welcome Green Taiwan Businesspeople," *Renmin Ribao*, overseas edition, May 31, 2004.

³⁵ "Xu Wenlong Neidi Jidi Tancha" [Exploring Xu Wenlong's Mainland Projects], *Zhongguo Jingying Bao* [China Business Daily], June 7, 2004, p. 4.

³⁶ Jia-hong Chen, "Shi Wen-long's Stance Was Manipulated by China," *Zhongguo Shibao*, March 30, 2005, p. A4.

(ASL) toward Taiwan, Shi Wen-lung released a retirement statement indicating that he felt “comfortable” with the ASL. He further elaborated that Taiwan independence would only push Taiwan into war and bring disaster to the people. He said in his statement that his ancestors came from China’s southern Fujian Province and believed that “both Taiwan and the mainland belong to one China.”³⁷ Particularly, his statement was very significant because it coincided with the day that Taiwan’s one-million people demonstration against China’s ASL.

Shi Wen-lung’s case has created a strong impact on TIEs’ political stance with respect to cross-Strait relations, since Shi was regarded as an obstinate supporter for Taiwan independence in the past. For instance, following the “Shi Shock,” the Acer Group’s Chairman Stan Shih declined to accept President Chen’s invitation as his advisor. He said, “I have kept politically neutral and refrained from choosing sides all along.” The declared excuse by Shih was to “avoid misunderstanding from the other side of the Taiwan Strait.”³⁸ Parenthetically, the Evergreen Group’s Chairman Chang Yung-fa quit the position as President Chen’s advisor in May 2002.

In essence, China’s tactics was mainly economic inducement, not economic sanctions. Economic sanctions involve the threat or act by a sender to disrupt customary economic exchange with the target in order to punish the target or force change in the target’s policies. Economic inducements involve commercial concessions, technology transfers, and other economic carrots that are extended by a sender in exchange for political compliance on the part of a target. “Economic inducements” are also called “positive sanctions.”³⁹ Generally speaking, despite punishing green Taiwan businesspeople by probing tax issues or other administration

³⁷ “Taiwanese Tycoon Vows Support for Beijing’s One China Policy,” *China Post*, March 26, 2005.

³⁸ Xiou-ming Zou, “Stan Shih: No More State Advisor,” *Lienho Bao*, April 1, 2005. p. A1.

³⁹ Chen-yuan Tung, *China’s Economic Leverage and Taiwan’s Security Concerns With Respect to Cross-Strait Economic Relations*, PhD Dissertation (Baltimore, M.D.: Johns Hopkins University, 2002), pp. 97-98.

harassment from time to time, China mainly relied on its potential market and investment opportunities to induce TIEs to comply with China's political stance.

VI. CONCLUSION AND PROSPECTS

During the first term of the Chen Shui-bian administration, there were five salient features of cross-Strait economic relations. First, Taiwan has been adopting an increasingly opening approach on its economic relations with China in terms of two-way mobility of commodities, capital, people, and other facilitation arrangement. Particularly, with respect to Taiwan's outward investment to China, Taiwan replaced the "no haste, be patient" policy with a "proactive liberalization with effective management" policy.

Second, both Taiwan and China attached strategic significance on bilateral economic relations, particularly direct links. From Taipei's perspective, economic integration should be a starting point of cross-Strait normalization and the basis for a new framework of permanent peace and political integration. Particularly, negotiation over direct links and chartered flights arrangement should be the first step. From Beijing's perspective, economic integration are favorable steps toward both unification and prevention of Taiwan's continual move toward independence.

Third, both sides across the Strait had divergent short-term political motives advocating bilateral economic exchanges, but finally had to compromise. Taipei would like to utilize negotiations over direct links and other economic arrangement to resume SEF-ARATS dialogues and thus stabilize cross-Strait relations. By contrast, Beijing would like to achieve its political goals by imposing political conditions on these negotiations. Nevertheless, both sides stepped back after the other's strong resistance. At the end, Beijing could no longer impose political conditions on the

negotiations over economic issues while Taipei had to accept a flexible negotiation model with official participation.

Fourth, Beijing has successfully imposed moderate economic sanctions and inducements against TIEs over the past four years. Beijing has imposed sanctions very carefully against very particular individual TIEs to control the collateral damage. In the future, TIEs will keep a low profile in terms of their political stance on cross-Strait relations. Particularly, TIEs will not explicitly support Taiwan independence or pro-Taiwan independence political parties in Taiwan.

Finally, the progress of cross-Strait economic negotiation was influenced, but at most delayed, by political agendas on both sides. For instance, before January 2005, China's response to Taiwan's proposal to negotiate on chartered flights arrangement was extremely cold and suddenly changed after Taiwan's legislative election of December 2004.

Currently, after China enacted the ASL on March 14, 2005, Taiwan has yet to respond to China's invitation to negotiate on both passenger and cargo chartered flights, which Taiwan has been advocating since late 2003. Nevertheless, Taiwan has neither rejected China's invitation nor changed its "proactive liberalization with effective management" policy. That is, Taiwan reserves its decision to resume dialogue on economic issues after the disruptive impact by the ASL.

As a matter of fact, since mid-2004, the MAC has proposed a long list of economic issues to negotiate with China: currency clearance, investment protection, financial supervision, avoidance of double taxation, product importation, protection of intellectual property rights, judicial assistance, commercial arbitration, fisheries dispute arbitration, personal security, chartered flights and direct transportation links, tourism, repatriation of illegal migrants, joint crime prevention, marine pollution, and

fisheries labor negotiations.⁴⁰

Similarly, China has recently proposed several economic issues to negotiate with Taiwan. In early March 2005, Chinese President Hu Jintao responded to Taiwanese President Chen's proposal that both sides could gradually develop cross-Strait passenger chartered flights during festivals into a regular practice as well as negotiate the issue of cross-Strait cargo chartered flights through private civil aviation organizations. Ten days later, Chinese Premier Wen Jiabao proposed negotiations with Taiwan over passenger chartered flights, Taiwan's agricultural exports to China, and China's fishery workers to Taiwan. By the end of April, the Chinese government has sent two invitation letters through an authorized private organization to the Taiwanese government seeking a quick resumption of talks on cross-Strait cargo and holiday chartered flights arrangements.

Despite current cross-Strait stalemates over the ASL, based on the experience of cross-Strait interactions over the past four years, it is highly possible that dialogue on chartered flights will resume after a certain period, as the negative impact of the ASL subsides. In turn, the negotiation might serve well as a trigger for the further development of cross-Strait relations in the next stage, particularly for direct links negotiations. To sum up, the evolution of cross-Strait economic relations will be self-sustained in a positive direction, even spilling over to the political arena of cross-Strait relations during the second Chen Shui-bian administration.

⁴⁰ Jaushieh Joseph Wu, "The Opportunity for Cross-Strait Chartered Flights Talks: Reflections and Prospects on the Sixth Anniversary of the Koo-Wang Talks," Mainland Affairs Council, Executive Yuan, Republic of China, October 14, 2005, <http://www.mac.gov.tw/english/english/macpolicy/wu931014.htm>, accessed April 20, 2005.