

Cross-Strait Trade and Investment: Economic and Security Implications for the Republic of China*

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This study examines the impact of security considerations on the Republic of China's (ROC's) economic policy, and focuses on trade and investment in the context of its relationship with the People's Republic of China (PRC). It demonstrates how considerations arising from the recognition of the crucial role of economic growth and prosperity in security have had a major impact on the ROC's economic policy and constrained its options in addressing grave politico-military security concerns.

The ROC is faced with a multifaceted security environment involving both economic and politico-military threats, largely emanating from the PRC. The ROC's prioritization of economic growth and prosperity has encouraged policies designed to contribute to the success of its business sector, including exports and foreign investment which have resulted in increasing dependence on the PRC.

Keywords: security; economics; trade and investment; Taiwan/ROC; the PRC

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The traditional conception of security within both the policy and academic communities has focused on considerations of power as well as the protection of states and their institutions, territory, and population from external attack. This realist view of "national" security has accorded salience to the political and military issues commonly referred to as "high politics."

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The consideration accorded to economic issues within this analytical framework has thus occurred in the context of their impact on military security. This instrumentalist approach views economic factors as means to security ends, particularly the development and maintenance of the resources required by military establishments.¹ This approach to understanding the security implications of economic issues was succinctly summed up by the Medicis of Renaissance Florence, who followed the creed "Money to get the power, power to keep the money."²

In recent years, this view has been subject to sustained challenges from several quarters, as interest has shifted from the economics of national military security to what has been termed "national economic security." An expanding body of academic scholarship has argued that economic factors are important to security other than in terms of their relation to military power.³ One fascinating area of inquiry focuses on the importance of economic growth and prosperity for security. David Baldwin and Helen Milner argue that "economic well-being of the citizenry is almost always one of the core values of a state."⁴ However, often in the past such considerations have generally been subordinated to "high politics" concerns and have not been considered in security terms.

Interest in the security implications of economic growth and prosperity has developed concomitantly with the progressive integration of the international economic system which has characterized the post-World War II period. In producing the first truly global economic system, this process has subjected individual national economies to an unprecedented degree of external influence, potentially threatening the livelihoods of their populations while limiting the regulatory scope of states.

¹See, for instance, Edward Mead Earle, "Adam Smith, Alexander Hamilton, Friedrich List: The Economic Foundations of Military Power," in *Makers of Modern Strategy: From Machiavelli to the Nuclear Age*, ed. Peter Paret (Princeton, N.J.: Princeton University Press, 1986), 217-61; and Klaus Knorr, "Military Strength: Economic and Non-Economic Bases," in *Economic Issues and National Security*, ed. Klaus Knorr and Frank N. Trager (Lawrence, Kansas: Regents Press of Kansas, 1977), 183-99.

²Quoted in Murray Weidenbaum, "Economics and National Security," *The Washington Quarterly* 11, no. 4 (1988): 39.

³See, for example, Jim Leitzel, ed., *Economics and National Security* (Boulder, Colo.: Westview Press, 1993); and Frans A. M. Alting von Geusau and Jacques Pelkmans, eds., *National Economic Security: Perceptions, Threats, and Policies* (Tilburg, The Netherlands: John F. Kennedy Institute, 1982).

⁴David A. Baldwin and Helen V. Milner, "Economics and National Security," in *Power, Economics, and Security: The United States and Japan in Focus*, ed. Henry Bienen (Boulder, Colo.: Westview Press, 1992), 39.

The Republic of China (ROC)⁵ is an important subject for the consideration of the relationship of economic growth and prosperity to security. Given its relative lack of natural resources and small population, it has had little alternative but to adopt an outward-looking economic focus, participating as fully as possible in the international economic system. For over three decades, it has pursued a strategy of export-oriented industrialization as a means of promoting economic development. This has involved a high degree of integration into, and resultant sensitivity to, developments in the international economic system.

This study will examine the impact of security considerations on the ROC's economic policy, focusing on trade and investment in the context of its relationship with the People's Republic of China (PRC). It will demonstrate how considerations arising from the recognition of the crucial role of economic growth and prosperity for its security have had a major impact on ROC government policy toward the increasingly extensive and intensive international commercial activities of Taiwan firms on which the ROC's economic development has been based. It will argue that the importance of these activities to the ROC's security constrains its policy options in addressing more traditional politico-military security concerns.

Security and Economics

The issue areas of economics and foreign policy were generally perceived as distinct entities in the past,⁶ although this has become increasingly untenable with the progressive politicization of economic issues, and the growing economic interdependence and processes of domestic political development in which populations in general—and interest groups in particular—have been able to exert more influence on policymakers.⁷ In fact, the end of the Cold War superpower rivalry suggested to a number of scholars the likelihood of a continuation of this trend to the point where economic matters

⁵The term "Republic of China" is used in this paper in referring to the country and ruling state authorities, while the terms "Taiwan" and "Taiwanese" are applied to the island, which constitutes the bulk of the ROC, its population, and its business sector.

⁶Recognition of the existence of a relationship between international economic and security issues can be traced back to Thucydides, however. See Beverly Crawford, "The New Security Dilemma Under International Economic Interdependence," *Millennium* 23, no. 1 (1994): 27 n. 2.

⁷Klaus Knorr, "Economic Interdependence and National Security," in Knorr and Trager, *Economic Issues and National Security*, 5-6.

would come to dominate international relations.⁸

Considerable scope for the interrelation of security and economics is provided by the overlapping of international markets and international political boundaries. Even with the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organization (WTO), there are relatively few standard rules and regulations governing international trade and investment. The considerable variation evident in economic relations between different regions, members of multilateral economic regimes, individual trading partners, and even between different economic sectors reflects the dissimilar patterns of state intervention. The postwar climate of increasing interdependence through an unprecedented expansion of international economic ties, including trade, investment, and transnational production, has also contributed to this.

Interdependence involves what Beverly Crawford refers to as an "economic security dilemma."⁹ While international economic integration is recognized as necessary for economic development, it entails negative aspects through increased dependence on other states for goods, raw materials, and services.¹⁰ This renders states increasingly vulnerable to economic disruptions from external sources, both resulting from deliberate state efforts to apply pressure through economic instruments and systemic factors such as changes in markets and trade patterns, conflicts, and natural calamities.¹¹ The more "open" the economy, the greater is the need for resilience in order to absorb and adapt to disruptive external pressures.¹²

A security view which focuses on politico-military concerns encourages state intervention in order to offset what are perceived to be serious faults inherent in the international economic system. Economic imperatives are seen as encouraging activities which, if not addressed, undermine national security. Such activities include the diffusion of critical military technologies and the loss of critical resources (natural and otherwise) through trade. This approach focuses on threats emanating from the deliberate actions of other state actors. Consistent with the realist understanding of the international system, states are assumed to possess conflicting and mutually incompatible interests which

⁸Stuart Harris, "The Economic Aspects of Security in the Asia-Pacific Region," *Journal of Strategic Studies* 18, no. 3 (1995): 33.

⁹Crawford, "The New Security Dilemma," 26.

¹⁰*Ibid.*, 27.

¹¹Knorr, "Economic Interdependence and National Security," 5.

¹²*Ibid.*, 7.

generate efforts to influence or undermine each other. Economic relations are one arena where such conflicts are waged.¹³

States whose primary security concerns are politico-military in nature generally endeavor to reduce vulnerability and strengthen their economic positions relative to those of other states, including maintaining a favorable balance of trade, through policies of mercantilism and economic autarky and striving to ensure the survival of what are considered "strategic" industries (often defined in terms of high-technology-oriented military industries). As Gautam Sen notes, "Conflicts will habitually arise with its [the state's] international obligations, i.e., commitment to the liberal international order and its key component, 'free trade'."¹⁴

A security view which prioritizes economic growth and prosperity produces an outlook which is very different in that the material well-being of the population is promoted.¹⁵ This is recognized as crucial to political legitimacy and stability, and encourages participation in the international economic system, but does not necessarily require the insulation of critical economic sectors from external influences. State intervention to offset some of the negative effects of economic internationalization is not unknown, but is much less common, and where such measures are instituted, they take on a much more defensive form referred to by Robert Gilpin as "benign mercantilism," which "safeguards the values and interests of a society; [while] it enables a society to retain domestic autonomy and possess valued industries. . . ."¹⁶

The literature which employs this approach is neither very extensive nor very well developed, and is particularly weak with regard to how such a security view is operationalized. Jacques Pelkmans recognizes the importance of national economic security and notes that "the quantity, composition, and quality of consumption and the nature of the economic order in which to strive for this material welfare have gradually acquired the status of high-ranking values in a great many societies."¹⁷ He fails to consider the implications of this, however. Klaus Knorr notes the trade-off between vulnerability and

¹³Penelope Hartland-Thunberg, "National Economic Security: Interdependence and Vulnerability," in von Geusau and Pelkmans, *National Economic Security*, 51-52.

¹⁴Gautam Sen, *The Military Origins of Industrialisation and International Trade Rivalry* (London: Pinter Publishers, 1984), 186.

¹⁵Bernard K. Gordon, *Politics and Protectionism in the Pacific*, Adelphi Paper no. 228 (London: International Institute for Strategic Studies, 1988), 7.

¹⁶Robert Gilpin, *The Political Economy of International Relations* (Princeton, N.J.: Princeton University Press, 1987), 404.

¹⁷Jacques Pelkmans, "The Many Faces of National Economic Security," in von Geusau and Pelkmans, *National Economic Security*, 6.

economic success and writes that "there is no reason why economic values and particular patterns of economic life cannot be regarded as vital [to national security]."¹⁸ He is amiss, however, in arguing that such concerns will invariably drive governments "in the direction of assuming greater control of economic life."¹⁹

The work of Stuart Harris reveals some openness to this security perspective, but he is unsure as to which threats to economic welfare comprise security threats.²⁰ He recognizes the political and security impact of socio-economic disparities,²¹ but his consideration of economic welfare in terms of access to resources such as food and energy supplies leads him to focus on state vulnerability to restrictions on external sources of supply.²²

More useful is the work of Mark Herander, who recognizes the salience of economic factors, particularly trade, in terms of both approaches to security outlined above. He devotes more attention to traditional views of the relationship between trade and security, but provides some consideration of the impact of economics in terms of economic growth and prosperity:

If material well-being is considered to be a societal value, it follows from this definition that any event that interferes with the flow of trade and so reduces a trading nation's economic welfare constitutes a threat to its national security. Equivalently, any action that liberalizes trade and generates national gains from trade enhances national security.²³

The promise of Herander's work is limited by its realist basis, however. While he recognizes the importance of "income maximization" and "material well-being" to security, his state-centric view fails to consider the threats emanating from sources other than deliberate state actions; his view is firmly rooted within the realist approach in concentrating on the objectives of state foreign economic policies and how these impact on their bilateral political relationships.²⁴ Herander also fails to examine the relationship between prosperity and the various forms of international economic activity in any depth.

In his examination of economic security and growth, József Bognár provides what is perhaps the best definition of economic security: "Economic

¹⁸Knorr, "Economic Interdependence and National Security," 8-9.

¹⁹*Ibid.*, 9.

²⁰Harris, "The Economic Aspects of Security," 38.

²¹*Ibid.*, 42-43.

²²*Ibid.*, 39.

²³Mark Herander, "International Trade Relations, Trade Policy, and National Security: The Role of Economic Analysis," in Leitzel, *Economics and National Security*, 91.

²⁴*Ibid.*, 96-102.

security essentially means adequate employment, comparative welfare, socio-economic equilibrium, and a sufficiently promising outlook to enterprises and individuals and the kind of socioeconomic policy and means by which these can be ensured."²⁵ This provides a basis for considering the limits within which decisionmakers must operate in order to achieve their security objectives, though Bognár focuses on how the international environment affects considerations of economic security.

Trade, Investment, and ROC Security

The ROC must contend with a range of politico-military and economic threats which largely emanate from the PRC. Politically, the PRC is recognized as the legitimate government of China by most states, including every major state. It has not renounced the use of force to impose reunification on its own terms and can back up this threat with a military establishment which dwarfs that of the ROC. In economic terms, the PRC, with its massive economy and favorable factors of production, has the capacity to dominate the markets on which the ROC depends for its economic livelihood, at least in terms of less technologically advanced goods at the present time. The PRC has posed an economic threat to the ROC since the early 1960s, but the nature of this threat has changed and its degree heightened since the PRC's adoption of more liberal economic policies in the late 1970s. Not only has this shift been instrumental in improving the PRC's position as an exporter, but it has also led to growing economic integration with the ROC.

Growing economic integration between the PRC and the ROC has entailed serious but unequal consequences for both states. The negative impact has been notably less severe in the case of the PRC, which is far less dependent on the cross-Straits relationship: while trade with Taiwan has expanded greatly in the 1990s, it still constitutes less than 10 percent of its total trade.²⁶ The PRC's dependence on the ROC as a source of investment has been more significant, as by the early 1990s, Taiwan had emerged as the fourth largest source of investment funds.²⁷ The export-oriented nature of many of the in-

²⁵József Bognár, "Economic Growth and Security," in von Geusau and Pelkmans, *National Economic Security*, 101.

²⁶Tse-kang Leng, *The Taiwan-China Connection: Democracy and Development Across the Taiwan Straits* (Boulder, Colo.: Westview Press, 1996), 120.

²⁷Y. Y. Kueh, "Foreign Investment and Economic Change in China," in *The Chinese Economy*

dustries which have attracted Taiwanese investment magnifies the impact of any potential disruption of these ties.²⁸

The ROC's dependence on the mainland, both as an export market and as a site for investment, is more marked. As noted in table 1 (see below), exports to the PRC have grown exponentially, to the point where it constitutes one of Taiwan's largest markets. It would be difficult to replace this market in the event of its loss, given its distinct nature: the relative lack of development in the PRC has created a demand for less sophisticated consumer and industrial goods which contrasts sharply with the standards demanded in most other markets.

In fact, the needs of the mainland market have encouraged Taiwan manufacturers to continue to produce goods which would be difficult to market elsewhere, which has exacerbated the potential impact of any serious disruption of economic ties with the PRC, at least in the short term. The ROC's long-term economic success would likely be enhanced by less effort in the unsophisticated PRC market and more in developing products and services which will be competitive in more sophisticated markets, such as Western Europe and North America.

Investment in the PRC has become important, but not crucial, to the ROC's economic development. The PRC has attracted massive investment from Taiwan because of its proximity and similarities in terms of language and culture, in addition to its relatively inexpensive labor and service costs. However, there is considerable scope for other countries, such as Indonesia and Vietnam, to supplant the PRC as a site for Taiwan investment, and indeed, the ROC government has encouraged greater investment in Southeast Asia.

Extant scholarship on economic relations between the ROC and the PRC recognizes the security implications of such ties, but tends to reflect realist analysis. N. T. Wang considers economic relations between the two sides of the Taiwan Strait significant in their potential for enhancing the PRC's military capabilities, though he recognizes that "a smaller economy is likely to be affected to a larger degree than a larger economy."²⁹ Tse-kang Leng considers

Under Deng Xiaoping, ed. Robert F. Ash and Y. Y. Kueh (Oxford: Clarendon Press, 1996), 200.

²⁸Tzong-Biau Lin, "Economic Nexus Between the Two Sides of the Taiwan Straits: With Special Emphasis on Hong Kong's Role," in *Economic Development of the ROC and the Pacific Rim in the 1990s and Beyond*, ed. Lawrence R. Klein and Chuan-Tao Yu (Singapore: World Scientific Publishing, 1994), 229.

²⁹N. T. Wang, "Taiwan's Economic Relations with Mainland China," in *Taiwan's Enterprises in Global Perspective*, ed. N. T. Wang (Armonk, N.Y.: M. E. Sharpe, 1992), 63.

the ROC's economic security in terms of its vulnerability to direct pressure from the PRC.³⁰ Denis Fred Simon considers ROC-PRC economic relations in terms of the former's need to avoid dependency on the latter.³¹

The ROC has responded to its multifaceted security environment by adopting a range of strategies designed to address the various threats involved. The ROC's post-1949 security policy featured two economic security-related objectives: (1) to build up Taiwan as a model province for the reconstruction of all China; and (2) to base Taiwan's further growth on a sound and prudent economic program.³² While recent domestic political developments in the ROC suggest that the first of these objectives may have been abandoned, the latter objective clearly continues to constitute a major pillar of the ROC's security policy.

Since the early 1960s, the ROC has recognized the crucial role of exports in the attainment of its economic security objectives; investment abroad has been added to this in recent years. With the increasingly close linkage between investment, production, and trade, the question of foreign investment has acquired increased importance as increased international competition resulting from the entry of new producers onto the market, including the PRC, while problems in Taiwan, such as shortages of labor, land, electricity, and water,³³ have forced manufacturers to relocate production of low-technology products to other areas where they were able to take advantage of lower costs. A similar dynamic has since affected high value-added product areas such as consumer electronics. The importance attached to trade and investment relations has been reflected in the degree to which the ROC has intervened to promote its interests. As Denis Fred Simon notes, "Recognizing that economic development is a requirement for survival, the government has taken a very active role in structuring economic relationships."³⁴

Economic relations with the PRC were initially regarded as "tantamount to aiding the enemy and high treason."³⁵ The PRC has since come to figure

³⁰Leng, *The Taiwan-China Connection*, 123.

³¹Denis Fred Simon, "Taiwan's Political Economy and the Evolving Links between the PRC, Hong Kong, and Taiwan," *AEI Foreign Policy and Defense Review* 6, no. 3 (1986): 42-51.

³²Tun-hwa Ko, "The Interests and Policies of the Republic of China," in *National Security Interests in the Pacific Basin*, ed. Claude A. Buss (Stanford, Calif.: Hoover Institution Press, 1985), 273-74.

³³See, for example, Emily Thornton, "Greener Pastures: Taiwan's Chip Makers Look for New Ground," *Far Eastern Economic Review*, December 21, 1995, 64.

³⁴Simon, "Taiwan's Political Economy," 43.

³⁵Wang, "Taiwan's Economic Relations with Mainland China," 54.

Table 1
ROC Dependence on the PRC Market

Year	Percentage of Total ROC Exports
1981	7.19
1982	5.93
1983	5.51
1984	5.79
1985	7.27
1986	6.31
1987	6.66
1988	8.19
1989	9.61
1990	11.62
1991	15.15
1992	17.85
1993	20.78
1994	21.83
1995	21.49

Source: Tse-kang Leng, *The Taiwan-China Connection: Democracy and Development Across the Taiwan Straits* (Boulder, Colo.: Westview Press, 1996), 120.

prominently in the ROC's foreign economic relations as the two sides of the Taiwan Strait have developed into major trading partners and the PRC has become a major destination of Taiwanese investment. In what has been referred to as "mainland fever," many Taiwan firms have sought to exploit the opportunities provided by the PRC's cheap labor and abundant natural resources. Cross-Strait economic ties have also been reinforced by traditional Chinese patterns of working through ethnic business networks.

Cross-Strait trade and investment relations were initially indirect, largely conducted via Hong Kong. More direct ties have developed since the mid-1980s, and the ROC lifted currency restrictions in 1987, but major legal and bureaucratic obstacles, particularly on the ROC's part, continue to restrict cross-Strait economic relations. Despite this, the ROC's dependence on the PRC has been growing (see table 1), as trade with it has increased and Taiwan firms have relocated manufacturing operations to provinces such as Guangdong and Fujian. Trade with the PRC grew from 3.54 percent of the ROC's total trade in 1981 to 12.27 percent in 1995, while by comparison, its trade with the United States slipped from 36.1 percent to 21.91 percent over the same period.³⁶

³⁶Leng, *The Taiwan-China Connection*, 121.

Considerable support for economic linkages with Taiwan has been evident on the PRC's part. As early as 1979, the Standing Committee of the National People's Congress proposed "three exchanges" (trade, transport, and postal) and "four flows" (economic, cultural, scientific, and sports) in the hopes of eventual reunification of the two sides.³⁷

Since 1979, a series of practical measures designed to facilitate the development of economic ties with the ROC have been implemented. The process involved has been far from linear, however. There have been a number of policy reversals, such as that which occurred in late 1988, but the past two decades have seen a progressive opening to economic relations with the ROC.³⁸ There is strong evidence that the PRC's enthusiasm for economic relations with Taiwan is motivated by political as well as economic considerations. At a National Work Conference on Taiwan Affairs held in 1990, for instance, references were made to "promoting political integration through economic exchange" and that such relations were "leading to the unification of the motherland." In 1993, Premier Li Peng wrote that the PRC's main objective in economic interaction was to use it to support unification on its own terms.³⁹ Furthermore, the PRC has displayed a willingness to exploit economic relations for political purposes. During ROC President Lee Teng-hui's June 1995 visit to the United States, for example, a number of Taiwan firms' operations were subject to apparently politically-motivated harassment when they were "besieged" by inspectors, police, and auditors "looking to find something wrong."⁴⁰

The ROC has found it difficult to formulate economic policy toward the PRC due to its need to satisfy both politico-military and economic security concerns and coordination problems resulting from the involvement of the various government bodies concerned. Its resulting policies toward the PRC have been described as "murky" and a "twilight zone."⁴¹ Its policies have also suffered from their largely reactive nature; as Leng notes, the ROC has been "chasing" the market mechanism, not "governing" it.⁴² The resulting policies have thus endeavored to promote the development of economic ties perceived

³⁷Wang, "Taiwan's Economic Relations with Mainland China," 55.

³⁸For a comprehensive list of pertinent PRC policy initiatives, see Chi Schive, *Taiwan's Economic Role in East Asia* (Washington, D.C.: Center for Strategic and International Studies, 1995), 24.

³⁹Leng, *The Taiwan-China Connection*, 125.

⁴⁰"Harassed Business," *Far Eastern Economic Review*, August 17, 1995, 12.

⁴¹Wang, "Taiwan's Economic Relations with Mainland China," 73.

⁴²Leng, *The Taiwan-China Connection*, 127.

Table 2
Trade Between the ROC and the PRC via Hong Kong

Year	ROC to PRC (in HK\$ million)	Growth (%)	PRC to ROC (in HK\$ million)	Growth (%)
1978	0.2	n.a.	218.9	n.a.
1979	106.5	53,150.0	279.2	27.5
1980	1,205.4	1,031.8	390.5	39.9
1981	2,182.3	81.0	426.6	9.2
1982	1,263.9	-42.1	546.1	28.0
1983	1,226.5	-3.0	698.3	27.9
1984	3,327.5	171.3	998.7	43.0
1985	7,697.3	131.3	904.0	-9.5
1986	6,328.4	-17.8	1,124.9	24.4
1987	9,556.9	51.2	2,253.7	100.3
1988	17,489.3	82.8	3,773.8	65.7
1989	22,592.6	29.2	4,577.8	22.6
1990	25,570.4	13.2	5,969.8	30.4
1991	36,403.8	42.4	8,782.3	47.1

Source: Tzong-Biau Lin, "Economic Nexus Between the Two Sides of the Taiwan Straits: With Special Emphasis on Hong Kong's Role," in *Economic Development of the ROC and the Pacific Rim in the 1990s and Beyond*, ed. Lawrence R. Klein and Chuan-Tao Yu (Singapore: World Scientific Publishing, 1994), 217.

as useful while attempting to pursue mercantilism in key sectors and prohibit most direct linkages.⁴³ The sections which follow will examine the ROC's policies toward trade and investment relations with the PRC.

Trade

There are two main aspects in which the PRC figures in considerations of trade and the ROC's security. The first involves trade with the PRC itself, and the second is the need to ensure access to other international markets which provide the basis for the ROC's economic growth and prosperity.

Trade between the ROC and the PRC via Hong Kong grew astronomically after 1978, as table 2 demonstrates. The ROC's trade policy toward the PRC has had to take conflicting security concerns into account: it is difficult to ignore the potential of the massive Chinese market, which Taiwan firms are uniquely positioned to exploit, but on the other hand, there are fears over what such trade relationships may entail. Concern has been expressed over the possibility that too great a dependence on exports to the PRC could impede efforts

⁴³Ibid., 106.

to reorient Taiwan's economy toward more high-technology product areas, by removing the incentive for firms to abandon marginal product areas.⁴⁴

In addition, the ROC is concerned with the politico-military security implications of trade with the PRC. There are fears that too great a dependence on exports to the PRC will produce vulnerability to manipulation by the PRC for political purposes.⁴⁵ By the mid-1980s, ROC officials were worried that trade would grow too fast or become too public.⁴⁶ As noted above, such fears were well-founded.

The ROC has endeavored to satisfy both sets of security requirements simultaneously. Despite its reservations over the long-term effects of increased trade with the PRC, the ROC at first tolerated and then gradually began to support exports to that country. In 1984, the first relaxation of restrictions on indirect exports to the PRC was announced, and further measures designed to promote exports have been implemented since then.⁴⁷ One of the more notable recent initiatives in this regard has involved efforts to develop direct cross-Strait trading links. While the ROC still bans direct trade with the PRC, as of April 1997, shipping links exist between Xiamen in Fujian and Kaohsiung in Taiwan. For the present, only goods destined for transshipment to third countries are involved.⁴⁸ This shipping link, as limited as it is, is the product of several years of concerted efforts on the ROC's part. The measure of importance attached to it may be judged by the fact that the ROC government took the surprising step in 1996 of deleting references to the "Republic of China" from shipping documents in order to facilitate PRC acceptance of shipments originating in the ROC.⁴⁹ Arrangements were also arrived at which permitted continued ROC-Hong Kong shipping links following Hong Kong's reversion to Chinese sovereignty.⁵⁰ It is important to note that some of the measures required to secure such ties, including agreeing to have ROC-registered vessels fly the flag of the Hong Kong Special Administrative Region and de-emphasizing the independent political status exercised by the ROC government in shipping documents, have undercut concurrent policies

⁴⁴Simon, "Taiwan's Political Economy," 48.

⁴⁵*Ibid.*, 47-48.

⁴⁶*Ibid.*, 48.

⁴⁷Schive, *Taiwan's Economic Role in East Asia*, 25.

⁴⁸Julian Baum, "Calm Passage: Mainland-Taiwan Shipping Links Open Quietly," *Far Eastern Economic Review*, May 1, 1997, 47.

⁴⁹"Strait Labels," *ibid.*, February 1, 1996, 57.

⁵⁰"Shipping Pact Sealed," *ibid.*, June 5, 1997, 13.

being pursued on the world diplomatic stage, which is indicative of the importance the ROC has attached to economic growth and prosperity.

The ROC is endeavoring to satisfy both its economic and politico-military security requirements by encouraging a shift in exports to other areas, which could provide for continued economic growth and prosperity while reducing the dangers of undue dependence on the PRC market. Efforts in this regard have been most evident in terms of encouraging greater exports to the United States and Southeast Asia. The form these measures have taken has differed according to the nature of the difficulties involved in exporting to each particular market. In the case of the United States, which is a well-established market for Taiwanese exporters, efforts have concentrated on increasing the competitiveness of Taiwan exports. In 1993, for example, the ROC's Central Bank intervened to depreciate the New Taiwan dollar (NT\$) against the U.S. dollar with this in mind.⁵¹ At the same time, considerable effort has been devoted to avoiding U.S. imposition of punitive economic measures due to U.S. concerns about its growing trade deficit. In order to secure continued access to the critical U.S. market, the ROC has made many concessions in opening up sectors of its economy which formerly were effectively barred to American penetration; in doing so, the ROC has sought to make the minimum level of concessions necessary to protect the position of its exporters.

In the meantime, efforts to promote a "southward" orientation for Taiwanese exporters have concentrated on enhancing receptivity to Taiwan exports at the political level. Senior political as well as economic officials from the ROC have visited many Southeast Asian states to discuss cooperation and promote closer economic ties, thereby paving the way for increased exports from Taiwan.⁵²

Despite the obvious need to maintain, if not increase, exports to the PRC, at least until exports to other regions have increased to the point where the mainland market is secondary to the ROC's growth and prosperity, politico-military security concerns have restricted the nature of exports to the PRC. For example, concerns over the technological upgrading of armaments fielded by the People's Liberation Army have inspired efforts to restrict the export of what are regarded as "sensitive" items to the PRC. Thus, the ROC still pro-

⁵¹Leng, *The Taiwan-China Connection*, 121.

⁵²Milton D. Yeh, "Ask a Tiger for Its Hide? Taiwan's Approaches to Economic Transactions Across the Strait," in *Southern China, Hong Kong, and Taiwan: Evolution of a Subregional Economy*, ed. Jane Khanna (Washington, D.C.: Center for Strategic and International Studies, 1995), 67.

Table 3
ROC and PRC Shares of the U.S. Market

	(Percentages)								
Year	1986	1987	1988	1989	1990	1991	1992	1993	1994
ROC	5.37	6.12	5.67	5.20	4.62	4.75	4.68	4.35	4.04
PRC	1.29	1.55	1.95	2.56	3.10	3.90	4.87	5.47	5.86

Source: Leng, *The Taiwan-China Connection*, 124.

hibits the export of high-technology products to the PRC.⁵³ It is interesting to note, however, that there are no effective control mechanisms in place to support such prohibitions. This relative lack of effort in controlling high-technology exports to the PRC has resulted from the ROC's recognition of its inability to do so, both for economic reasons and the technical difficulties involved.⁵⁴

The PRC is an increasingly important market for the ROC, but is more important in terms of security by virtue of its potential to supplant the ROC as an exporter in other markets.⁵⁵ The PRC's economic development has been far slower than that of the ROC and has experienced a number of major reverses, such as the Great Leap Forward and the Cultural Revolution, but since the 1960s, ROC decisionmakers have been faced with the specter of their rival dominating the export-oriented industrial activities which have provided the basis for the ROC's economic growth and prosperity. Recent years have also seen the development of particularly intense competition for the American and Japanese markets.

The PRC's export successes of recent years suggest that the ROC has good grounds for concern. Between 1986 and 1993, Taiwan firms experienced decreases in competitiveness compared to the PRC in many product areas, including precision instruments. By 1993, the ROC maintained a clear lead only in leather and fur, wood and bamboo, and electric and electronic capital products. In most other areas, the two sides were tied.⁵⁶ Table 3 illustrates the impact of this trend. The ROC's response has included encouraging local firms to export more to key markets such as the United States, as noted above.

⁵³Leng, *The Taiwan-China Connection*, 107.

⁵⁴Yeh, "Ask a Tiger for Its Hide?" 61-62.

⁵⁵Wang, "Taiwan's Economic Relations with Mainland China," 68-69.

⁵⁶Leng, *The Taiwan-China Connection*, 124.

The ROC has also striven to ensure continued access to international markets at a more general level, as has been reflected in its determined efforts to become a WTO member. It is pursuing membership in this organization despite the probable negative implications for a number of its domestic economic sectors.⁵⁷

Moreover, the need to ensure the continued competitiveness of Taiwan exports in order to support economic growth and prosperity has been reflected in the ROC's drive to promote local technological development. Technological development has been a common objective of states—developed and developing alike—in the postwar period, but the form that it has taken in the ROC indicates that it has been driven by a distinctive view of security. Technological development in the ROC has not followed the path taken in most other developing countries, where it has been geared to local military requirements. This common approach is short-term in nature, as nonmilitary technological development, whenever it is actually planned for, is relegated to a secondary position which is met (eventually) by "spin-offs" from the application of technology to military requirements.

In the ROC, however, military-oriented technological development has been consistently subordinated to broader economic development requirements. The emphasis has been on general technological development applicable to a wide range of applications. This long-term approach enables the attainment of both nonmilitary and military technological requirements, but in an environment such as Taiwan's, where the private sector is in a position to apply technological developments in the most profitable manner, this invariably results in an emphasis on the civil sector. It is important to note that the ROC government itself, while supporting applied military technological development in selected areas, has avoided prioritizing this, instead emphasizing basic research. The objective of this approach is to maintain a lead over the PRC in terms of core export activities by staying "a few jumps ahead in technology" and continuing to "produce goods and services beyond the reach of her opponent."⁵⁸ Pains have been taken to monitor the PRC's economic development, forecast likely future market trends, and encourage Taiwan firms to develop along lines that would see them concentrate on activities in which the PRC would be poorly placed to compete, regardless of its ongoing economic development. The focus is on long-term patterns of development, as

⁵⁷"Racing with China," *Far Eastern Economic Review*, October 3, 1996, 12.

⁵⁸Janne E. Nolan, *Military Industry in Taiwan and South Korea* (Houndmills: Macmillan Press, 1986), 49.

opposed to being geared toward short-term export successes.⁵⁹ In the 1960s, this strategy was reflected in government support for a shift away from unsophisticated consumer goods such as footwear and textiles which had previously constituted the core of manufacturing activities.⁶⁰ Since 1972, the emphasis has been on skill-intensive industries, with an initial emphasis on electronics which has since been supplemented by aerospace and biotechnology. This strategy has been adhered to despite the obvious need to meet military industrial requirements, which has been largely met through importation. This is true even of many armaments which are well within the capacity of local firms to develop and produce, such as wheeled armored vehicles.

By strengthening indigenous technological capabilities in general areas, the ROC has laid the basis of its present economic growth and security. The success of firms such as the computer giant Acer is due in no small part to this approach, and has proven the wisdom of leaving the private sector to its own devices in developing marketable products which will ensure continued international competitiveness.

Investment in the PRC

It is essential for the ROC's industries to invest abroad if they are to overcome domestic limitations which are the inevitable by-product of Taiwan's advance to the ranks of the developed industrial states. Taiwan firms have thus located production and research activities in numerous locations in Europe, North America, and East Asia.

The PRC has developed into one of the most important sites of investment for Taiwan firms. In addition to the various factors which have made the PRC attractive to foreign investors in general over the last decade and a half, investors from Taiwan can add physical proximity and similarities of language and culture. The PRC has encouraged ROC investment since 1983, and in 1988 the State Council announced a package of twenty-two measures, some of them applicable only to Taiwan investment, to encourage investment.⁶¹ In 1988-89, a number of provinces and local authorities also implemented their own policies, including establishing "Taiwan investment zones."⁶²

⁵⁹J.D. Kenneth Boutin, "Technology Policy in the Republic of China: The Impact of Security Concerns," *East Asia Forum* 3 (1994): 123-24.

⁶⁰*Ibid.*, 123.

⁶¹Leng, *The Taiwan-China Connection*, 121, 123.

⁶²Xiamen, Fuzhou, Guangzhou, and Shantou established policies encouraging Taiwan investment, while Beijing, Hainan, Hebei, Wenzhou, and Pudong established "Taiwan investment zones." Wang, "Taiwan's Economic Relations with Mainland China," 58.

Table 4
ROC Investment in the PRC

Unit: US\$ billion				
1991	1992	1993	1994	1995
0.472	1.053	3.139	3.391	3.162

Source: Julian Baum, "Chafing at the Bit: Taiwanese Firms Dismiss Warnings About China," *Far Eastern Economic Review*, November 7, 1996, 91.

Data is sparse and probably inaccurate,⁶³ but Taiwanese investment in the PRC has clearly grown dramatically in recent years. One recent estimate puts the number of Taiwan firms operating in the PRC at 35,000, ranging from very small family-owned firms to major corporations, with the PRC now constituting the primary destination for Taiwanese investment.⁶⁴ The precise scope of Taiwanese investment in the PRC is difficult to ascertain due to widespread investment contrary to the rules and regulations laid down by the ROC government. Investment in the PRC by Taiwan firms predated official condonation, and efforts are still being made by the ROC government to determine its true extent. In 1991, the ROC government conducted a survey of firms which saw some 2,750 voluntarily register their activities with the government.⁶⁵ In 1993, the ROC's Investment Commission registered another 8,067 projects worth US\$2.02 billion which had previously gone unrecorded until reporting procedures were revised in 1992.⁶⁶ A recent survey of Taiwan manufacturers with foreign investments by the ROC Ministry of Economic Affairs shows that in 1996, no less than 73 percent had invested in the PRC, while only 13 percent had invested in the United States.⁶⁷ Table 4 provides an indication of the scope of investment in the PRC.

This trend is worrisome for the ROC government, which sees the growing list of investments in the PRC as a security threat due to their potential for exploitation as an instrument of political leverage. Andrew Yang of the Chinese Council for Advanced Policy Studies argues that "[t]he political as-

⁶³Figures on Taiwanese investment in the PRC have probably been exaggerated by PRC officials seeking to advertise their particular regions, and underestimated by Taiwanese businesses involved in unapproved investment projects. See Simon Long, "Regionalism in Fujian," in *China Deconstructs: Politics, Trade, and Regionalism*, ed. David S.G. Goodman and Gerald Segal (London: Routledge, 1994), 211-12.

⁶⁴Julian Baum, "Mainland Attraction: Firms Ignore Politics to Invest in China," *Far Eastern Economic Review*, April 17, 1997, 28.

⁶⁵Lin, "Economic Nexus," 215-16.

⁶⁶Long, "Regionalism in Fujian," 212.

⁶⁷"Rise in Mainland Deals," *Far Eastern Economic Review*, May 29, 1997, 65.

pects of these investments are unique to Taiwan. . . . No other country faces such risks with its investment projects."⁶⁸ Investment is also worrisome in that it has involved a progression from areas such as footwear and textiles to more high-technology product areas.

Until the early 1990s, the ROC's general view was that all investment in the PRC, be it direct or indirect, should be prohibited.⁶⁹ However, recognizing its importance to Taiwan's economic growth and prosperity, the ROC government informally sanctioned investment in the PRC in 1991, official sanction followed in 1993, and in the following year, firms owned by the ruling Kuomintang (KMT, Nationalist Party) were permitted to invest in the PRC, though in fact some had already done so.⁷⁰ The ROC government has thus attempted to support investment while channelling it in directions which minimize security risks. Nevertheless, such investment remains the subject of considerable concern. As one presidential staff member stated recently, "Economists tell us we can't restrict capital movements in a free market. . . . But issues of national security and our de facto autonomy is involved, and the business community doesn't understand this."⁷¹

The ROC government's initial guidance of the Taiwan private sector came in the form of the "Regulations Governing Investments and Technical Cooperation with Mainland China," which were announced in 1993, which set the requirements for indirect investment: investment conducted through a branch of a Taiwan firm located in a third country, investment in another firm located in a third country, investment through a firm in a territory outside China, or investment through indirect remittance.⁷² This had the effect of imposing a buffer in the form of another political actor between the ROC and the PRC. If the PRC were to attempt to exert pressure via any investment which was structured in such a manner, the repercussions resulting from the impact on the third party involved would thus constitute an effective deterrent.

The ROC government has attempted to restrict investment in the PRC both in terms of the size of individual projects and the nature of the project involved. Approval is granted to investment projects only if they meet the

⁶⁸See note 64 above.

⁶⁹Wang, "Taiwan's Economic Relations with Mainland China," 75.

⁷⁰For official sanction for investment, see Lin, "Economic Nexus," 228; for KMT investment, see Leng, *The Taiwan-China Connection*, 93.

⁷¹Julian Baum, "Fat Chance: Taiwan Seeks Diplomatic Leverage in Cross-Strait Policy," *Far Eastern Economic Review*, August 29, 1996, 62.

⁷²Leng, *The Taiwan-China Connection*, 107.

following criteria: (1) they do not compete with the ROC's domestic industries in the international market; (2) they are labor-intensive; (3) they use raw materials produced in the PRC; and (4) the business involved would not be competitive if the projects remained in Taiwan.⁷³ These requirements encourage investment conducive to the ROC's economic growth and prosperity while minimizing any threat to the competitiveness of critical product areas.

In contrast, investment in high-technology and defense projects, and activities such as banking, securities, and futures have been prohibited in order to control business activities and financial flows to the PRC. There are allowances for "special cases," but on the condition that they do not have any negative impact on the ROC's national security or economic development.⁷⁴ In early 1994, the government issued "Regulations Governing Business Activities in Mainland China," which revised and simplified the investment screening process. In June 1996, the guidelines allowing Taiwan securities firms and certain other businesses such as funeral parlors and department stores to begin operations in the PRC were finally relaxed.⁷⁵ Since then, a number of developments have run counter to the trend of investment liberalization, as limited as it has been. By 1996, the ROC government was noticeably less forthcoming in granting individual investment approvals.⁷⁶ Further restrictions on investment in the PRC were announced by the Ministry of Economic Affairs in 1997: in May, a ceiling of US\$50 million for individual investment projects was announced, and under regulations which came into effect in June, there currently is a blanket ban on investment in energy projects, property development, and transport facilities. Bans on investment in thirty-three additional industries are also under consideration.⁷⁷ The earnestness with which the ROC government has approached investment in the PRC is indicated not only by the strictness of the ROC's investment regulations, but also by the legal sanctions which have been provided for in cases where they have been contravened; provision exists for the levying of fines of up to NT\$3 million in such cases.⁷⁸

Despite these precautions, the ROC's capacity to achieve its objectives

⁷³Ibid.

⁷⁴Ibid.

⁷⁵"Rules Relaxed," *Far Eastern Economic Review*, June 20, 1996, 69.

⁷⁶Julian Baum, "Chafing at the Bit: Taiwanese Firms Dismiss Warnings About China," *ibid.*, November 7, 1996, 90.

⁷⁷"Squeezing China," *ibid.*, June 19, 1997, 75.

⁷⁸Leng, *The Taiwan-China Connection*, 113.

regarding investment in the PRC is actually quite limited. Although strict guidelines have been established, they are unenforceable in practice. The damage to the business sector which would result from the imposition of fines to ensure compliance would have an adverse effect on the ROC's economic growth and prosperity, particularly in cases of major corporations involved in major investment projects. Stringent controls or even a total ban on investment will not necessarily impact negatively on Taiwan's long-term economic development, given the availability of other locations for investment, but over the short term would have serious economic consequences. For instance, as of October 1993, the Ministry of Economic Affairs had not punished any firm for illegal investment in the PRC. Instead, the ROC government has had to rely on providing incentives and other noncoercive measures for compliance, such as offering "massive public concessions" to the business sector, including financial and regulatory incentives.⁷⁹ For example, the ROC's Central Bank gives priority to firms investing in Taiwan while limiting the amount of foreign exchange supplied to firms investing in the PRC.

Public calls for restraint and patriotic appeals have constituted another prominent instrument in the ROC's efforts to obtain compliance with its investment policies, and have generally appeared as responses to announcements of major investment projects or PRC attempts to intimidate the ROC, such as the recent missile tests near the Taiwan coast. In one prominent example, on August 15, 1996, President Lee Teng-hui appealed for restraint in investment in the PRC, proposing that Taiwan firms limit themselves to 20-30 percent of their total foreign investment and 20 percent of their investment in Taiwan.⁸⁰ In this case, food firm President Enterprises agreed to suspend plans for a US\$100 million power plant project. In another example, Y. C. Wang, the president of Formosa Plastics, announced plans in June 1990 to build a US\$5 billion petrochemical complex on Haicang Island in Fujian. This was viewed as a security threat, but the ROC government did not invoke punitive measures or coercion, and Formosa Plastics eventually withdrew its application for the Fujian development project.⁸¹

Another strategy employed to redirect investment away from the PRC has been to encourage it in other areas, as has been done with trade. In 1993,

⁷⁹See note 64 above.

⁸⁰See note 71 above.

⁸¹For President Enterprises, see "Key Investor Halts Plans," *Far Eastern Economic Review*, September 26, 1996, 75; for Formosa Plastics, see note 71 above.

the ROC government launched its "Look South" policy, which included encouraging local businesses to invest in Southeast Asia as an alternative to the PRC.⁸² This has had only limited success thus far, but in 1996 the computer firm Acer decided to expand production in Southeast Asia instead of China.⁸³

Nevertheless, the record of Taiwan businesses accepting government guidance on investment in the PRC has been mixed. While there have been some notable examples of Taiwan firms following government direction on investment, the business sector has generally shown little inclination to follow Taipei's lead. This attitude is summed up by Stanley Yang, general manager of computer firm Sunny Data Enterprises: "Taiwanese businessmen will always go where there are opportunities to make money. . . . The best thing is to separate politics and business."⁸⁴ Government calls for restraint have generally gone unheeded, and it is still the case that many firms are failing to report their investment activities.⁸⁵

A variety of strategies have been resorted to by firms in order to evade ROC government guidelines and regulations on investment in the PRC. Some firms have turned to foreign or illegal sources for the foreign exchange needed for investment.⁸⁶ Other firms have exploited the "cover" provided by other countries; in one such case, Taiwan's Ting Hsin Group established and registered a wholly-owned subsidiary, Tingyi Holding, in the Cayman Islands to serve as the vehicle for investment in the PRC.⁸⁷

However, Taiwan firms are aware of the potential negative impact of political factors on their investments in the PRC. In early 1996, Kao Ching-yuan, chairman of the ROC's Chinese National Federation of Industries, indicated that if there was no improvement in relations between the ROC and the PRC, he would consider closing his nine factories in the PRC, a threat which was also echoed by other Taiwanese food processors.⁸⁸ Kao also counselled Taiwan firms to suspend investment the year before, when the PRC was threatening the ROC with its military.⁸⁹

⁸²Michael Vatikiotis, "Big Squeeze: Taipei Overshadowed by China's ASEAN Thrust," *Far Eastern Economic Review*, June 13, 1996, 29.

⁸³See note 71 above.

⁸⁴See note 76 above.

⁸⁵Leng, *The Taiwan-China Connection*, 113.

⁸⁶*Ibid.*, 113-14.

⁸⁷Henry Sender, "Instant Oodles: Noodle Maker Tingyi Might Be the Best China Play," *Far Eastern Economic Review*, February 15, 1996, 45.

⁸⁸"Food Firms Threaten Halt," *ibid.*, March 21, 1996, 63.

⁸⁹"Investment Warning," *ibid.*, August 24, 1995, 59.

While it is clear that the PRC's domestic political environment and incidents such as its "tests" of M-9 and M-11 ballistic missiles off the Taiwan coast have induced some restraint on the part of Taiwanese investors, many Taiwan firms are still willing to take their chances there. As one Taiwan business leader stated, "Despite everything, China is still better than South-east Asia. . . . The mainland has a huge labor supply, plenty of resources, and one of the world's biggest markets. You can't ignore that."⁹⁰

The Implications of the "Securitization" of Trade and Investment

Economic matters such as trade and investment clearly play a major part in the ROC's security environment. The importance attached to economic growth and prosperity has had a major impact on the degree and nature of the ROC government's intervention in the economic field, and is one of the factors encouraging the ROC's support for multilateral trade liberalization initiatives. Its trade and investment ties with the PRC are further indicative of the salience of economic growth and prosperity. While economic growth and prosperity provide an improved base of support for the military establishment, economic ties have offered similar opportunities to the rival PRC.

The development of the ROC's economic policies over the past two decades demonstrates that while emphasis on economic growth and prosperity has not entirely supplanted concern over politico-military security issues, the latter have clearly been relegated to a subordinate position. It will be interesting to follow the cross-Strait economic relationship as it develops over the next decade, as political developments in the PRC should have a major impact on this relationship. A trend toward democratization should be reflected in the ROC abandoning the remaining barriers to economic ties, while a trend in the opposite direction will present a dilemma, as the ROC can no longer painlessly disengage from the economic integration already attained.

The fact that countries such as the ROC consider trade and investment important in security terms has major implications for international economic relations. In the ROC's case, there have invariably been conflicts between economic and politico-military security, with the often-mutually incompatible

⁹⁰Douglas Habecker, "Cool Feet: Taiwan Businessmen Rethink China Plans," *ibid.*, October 12, 1995, 150.

policy requirements involved restricting the scope for government action. In the case of states which prioritize economic growth and prosperity such as the ROC, such limits are evident in terms of politico-military security. The need to avoid disturbing the economic sector on which economic growth and prosperity is based means that important politico-military security concerns may not be addressed at all. Nowhere is this more evident than with respect to the degree of integration of national economies into the international economic system. As noted above, politico-military security requirements encourage a high degree of isolation from external economic influences. At the present time, however, such an approach is detrimental to economic progress. As a result, even states which are faced with major military security threats find it impossible to base their economic programs on traditional mercantilist or autarkic policies. Such policies, if they are to be adopted at all, must be subordinated to an approach which emphasizes overall economic integration.

This has been reflected in growing international support for trade liberalization initiatives. Many countries which have in the past sought relative isolation from the international economic order or exploited the opportunities for exports while maintaining barriers to protect their own economies, i.e., many of the newly-industrializing countries (NICs) of East and Southeast Asia, have become supporters of liberalization. The GATT has developed into the WTO and trade liberalization initiatives have proliferated in recent years, particularly in the Asia-Pacific region. Here the Asia-Pacific Economic Cooperation (APEC) forum is thus evolving along increasingly ambitious lines.