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Economic Ties Across the Taiwan Strait: Buying Time for Compromise*

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This work explores the way in which Taiwan's extensive economic interactions with the mainland affect cross-Strait relations. These economic interactions occur not only within a context of mainland-Taiwan political tension, but also within a broader environment of economic globalization wherein the international community is dependent on economic output from both sides of the Taiwan Strait. The paper begins by examining Beijing's and Taipei's views and policies toward cross-Strait economic exchanges. While Beijing sees economic exchanges as beneficial for both reunification with Taiwan and economic growth, Taipei worries that the pace of economic exchange reduces the island's security and political flexibility. The second section lays out the details of increasing trade and investment across the Taiwan Strait, while the third part looks at Taiwanese investments in the electronic sector. The final section assesses the impact of economic exchange on cross-Strait relations. This work argues that a web of investment and trade is increasingly tying Taiwan and the mainland to each other and the international division of labor. These links make disruptive political action on the part of the mainland or Taiwan increasingly costly for both primary players, as well as the international economy, and thus serve to reinforce the political status quo.

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The stalemate between mainland China and Taiwan regarding Taiwan's future is uniquely marked by economic dynamism and political frustration. The political impasse is demonstrated by very different claims regarding Taiwan's status. Beijing consistently states that Taiwan is a part of China and will be reunited—through persuasion or force—with the mainland. In a recent white paper, Beijing asserted that the current state of separation will not be allowed to continue indefinitely. On the other hand, Taiwan's former president Lee Teng-hui (李登輝), who began to move away from Taiwan's unequivocal commitment to reunification, has insisted that it is a "pernicious fiction to assert that the People's Republic of China (PRC) has any right or imperative to claim sovereignty over Taiwan," as the Republic of China (ROC) has been sovereign since 1912.[1] Thus, according to Lee, relations between the mainland and Taiwan are most accurately characterized as "special state-to-state relations," and Taiwan's future should be determined by Taiwanese. The administration of President Chen Shui-bian (陳水扁), while dropping references to "state-to-state" relations, continues to hold that the ROC is an independent and sovereign country. Further inflaming the controversy, the president's party, the Democratic Progressive Party (DPP), has explicitly called for a "Republic of Taiwan." Such disparate views in Taiwan and the mainland raise fundamental questions over both Taiwan's future and stability in the Asia-Pacific region.

However, the relationship between the mainland and Taiwan also has a thriving economic component.[2] Beginning in the 1980s, Taiwan's trade with the mainland and Taiwan's cross-Strait investments have increased exponentially. By 2000, Taiwanese firms had invested approximately US$45 billion in the mainland, while more than US$30 billion in indirect trade

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[1]Lee Teng-hui, "Understanding Taiwan: Bridging the Perception Gap," *Foreign Affairs* 78, no. 6 (November/December 1999): 9-14, quote on p. 10.

[2]For an analysis of the economic component in light of the 1995-96 crisis, see Yun-han Chu, "The Political Economy of Taiwan's Mainland Policy," in *Across the Taiwan Strait: Mainland China, Taiwan, and the 1995-1996 Crisis*, ed. Suisheng Zhao (New York: Routledge, 1999), 163-95.

took place between the mainland and Taiwan that year. While the mainland has consistently encouraged such interactions in the hope that they will contribute to reunification, Taiwan's government has attempted to slow such activities, fearful that economic dependence will give mainland China leverage over Taiwan. Thus the environment across the Taiwan Strait is characterized by high levels of political conflict coexisting with economic cooperation.[3]

This work explores the way in which Taiwan's extensive economic interactions with the mainland affect cross-Strait relations. These economic interactions occur not only within a context of mainland-Taiwan political tension and a somewhat ambiguous American role in the region, but also within a broader environment of economic globalization wherein the international community is dependent on economic output from both sides of the Taiwan Strait. The paper begins by examining Beijing's and Taipei's views and policies toward cross-Strait economic exchanges. While Beijing sees economic exchanges as beneficial for both reunification with Taiwan and economic growth, Taipei worries that the pace of economic exchange reduces the island's security and political flexibility. The second section lays out the details of increasing trade and investment across the Taiwan Strait, while the third part looks at Taiwanese investments in the electronic sector. The electronic sector is given detailed analysis because, although the industry is a high-tech area vital to the future of Taiwan's economy, many manufacturers are investing in China. This case study clearly illustrates the larger dilemmas facing Taiwan regarding economic competitiveness versus security. The final section assesses the impact of economic exchange on cross-Strait relations. The main argument is that a web of investment and trade is increasingly tying Taiwan and the mainland to each other and the international division of labor. These links make disruptive political action on the part of the mainland or Taiwan increasingly costly for both primary players, as well as the international economy, and thus serve to reinforce the political status quo.

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[3]For a thoughtful piece that examines the themes of economic cooperation and political conflict, see Suisheng Zhao, "Economic Interdependence and Political Divergence," in Zhao, *Across the Taiwan Strait*, 21-40.

The Policies of Beijing and Taipei

Beijing has consistently encouraged closer trade and investment ties with Taiwan since 1980 for both economic and political reasons. Economically, Taiwan investment and trade create jobs, transfer technology, and contribute to growth in China's gross national product (GNP). During a historical period in which Beijing is emphasizing economic growth as a primary state goal, Taiwan's contributions are vital. This is all the more true for coastal areas such as Guangdong (廣東), Fujian (福建), and Shanghai (上海) that have received the bulk of Taiwan's investments. Just as importantly, however, Beijing has hoped that investment and trade will have favorable political consequences that foster reunification. Thus, ironically, Beijing adopts liberal economic policies toward Taiwan to foster nationalistic goals. Beijing has also encouraged the establishment of direct trade, investment, and communication links across the Taiwan Strait, although recently Chinese leaders have insisted that President Chen accept the "one China" policy before they will agree to the institution of direct links.

In attempting to use Taiwanese investment and trade as a political tool, Beijing has two major goals. The first is to foster a class of businesspersons that is dependent on the mainland for its profits. This creates an influential lobby inside Taiwan that advocates closer relations with the PRC. In essence, Beijing is attempting to use the democratic process in Taiwan to foster China's own interests. Second, Beijing is seeking to make Taiwan economically dependent on China, giving the mainland leverage over the island. This strategy was revealed as early as 1985 when a Chinese Communist Party (CCP) United Front Work Department document stated that "we can definitely, step by step, lead Taiwan's industries to further rely on our market as long as we adopt well-organized and well-guided measures. Continuing to develop these efforts would effectively lead us to control the operation of Taiwan's economy that would speed up the reunification of the motherland."[4] More recently, Beijing deliberately lobbied Taiwan's busi-

[4]Hsin-hsing Wu, *Bridging the Strait: Taiwan, China, and the Prospects for Reunification* (Hong Kong: Oxford University Press, 1994), 171. Wu states that the unpublished document was obtained by the ROC's Military Intelligence Bureau.

ness community through high-level meetings and business incentives in 1996 in order to move business leaders to apply pressure to Lee Teng-hui to moderate his policies toward China.[5]

After the election of Chen Shui-bian to the Taiwan presidency, Beijing more overtly used its economic leverage over Taiwan investors for political purposes. In April 2000, Hong Kong newspapers prominently reported the remarks of Li Bingcai (李炳才), deputy director of the Taiwan Affairs Office under the PRC State Council and the CCP Central Office for Taiwan Affairs. Li stated that those Taiwanese entrepreneurs who called for Taiwan independence would no longer be able to engage in business with China. The pressure against Taiwan business leaders who supported Chen Shui-bian continued through June, with Evergreen Group's Chang Yung-fa (張榮發), Acer Group chairman Stan Shih (施振榮), and Continental Engineering Corporation president Nita Ing (殷琪) identified as high-profile targets. Petrochemical firm Chi Mei (奇美) was subject to numerous special inspections during the summer because of the support given by its chairman, Shi Wen-lung (許文龍), to both Chen and Taiwan independence. However, by June the campaign was slowing down, due in part to requests to Beijing by cadres in Fujian and Guangdong who saw Taiwan investments in their provinces slowing.[6] Nevertheless, there were reports in 2001, denied by Beijing, that Chi Mei's petrochemical plant in Zhenjiang (鎮江) had been closed down due to remarks by Shi Wen-lung regarding former Taiwanese sex slaves, indicating that Beijing may again be more closely linking business and politics.

Taiwan's government takes a very different perspective toward mainland investment and trade. This strategy is expressed in a two-pronged approach. The first approach is based on the belief that economic interactions

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[5]See Christopher R. Hughes, "Democratization and Beijing's Taiwan Policy," in *Democratization in Taiwan: Implications for China*, ed. Steve Tsang and Hung-mao Tien (Oxford, U.K.: St. Antony's, 1999), 139-40.

[6]For details on Beijing's campaign, see "Taiwan Businessmen Criticized," *Straits Times* (Singapore), April 10, 2000, at <http://straitstimes.asial.com.sg>; Jason Blatt, "Probe Launched into Independence Views," *South China Morning Post* (Hong Kong), April 20, 2000 and Willy Wo-Lap Lam, "Propaganda War 'Hurting Business'," ibid., June 14, 2000, both at <http://www.scmp.com>; and Bruce Gilley and Julian Baum, "Crude Tactics," *Far Eastern Economic Review*, June 29, 2000, 25.

will promote the "Taiwan model" of capitalism and democracy on the mainland. For instance, in June 1999 Lee Teng-hui told a delegation of Americans that "inspired by the Taiwan experience, the whole of mainland China is likely to be 'Taiwanized'."[7] The most important way this Taiwan model can be spread is through communication and economic exchange across the Strait. Therefore Lee Teng-hui's six points on reunification, first proclaimed in 1995, call for strengthened trade and economic relations between the mainland and Taiwan. President Chen has also expressed the hope that through Taiwan's information technology sector, "technology can play the role of peace ambassador, strengthening cross-Strait exchanges."[8] Thus, promoting economic exchanges is presented as part of a rational plan for Taiwan's security. Nevertheless, to a large degree this strategy is also a response to pressure from business activities. The government blesses what it cannot stop.

The second approach by Taiwan, one that is now dominant, is an effort to slow trade and investment across the Strait. Taiwanese authorities fear that if Taiwan develops too close an economic relationship with mainland China, the island's entrepreneurs will become spokespersons for the mainland, and Taiwan will become vulnerable to Chinese economic sanctions. The government is also concerned that a hollowing out of Taiwan's industrial capacity is taking place. Not only will jobs and technology be lost, but as Taiwanese firms move to the mainland, mainland exports begin to compete with Taiwan exports. This second approach has involved a mixture of nationalistic appeals, cajoling, and restrictions on investments.

Regulating trade became an issue when Taiwan's indirect trade with the mainland began to increase dramatically in 1980. Taiwan's government once hoped to limit trade with the mainland to 10 percent of the island's total trade, but that level has been surpassed. According to official Taiwan statistics, Taiwan's exports to the mainland constituted almost 18 percent of

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[7] "Entire Mainland China May Be 'Taiwanized': Lee," Central News Agency (CAN), June 24, 1999, at <http://www.taipei.org/teco/cicc/news/english/index.htm>. For a broader view of the effects of Taiwan's democratization, see Tsang and Tien, *Democratization in Taiwan*.

[8] Jason Blatt, "Chen Hoping [Information Technology] Can Help Bridge Strait," *South China Morning Post*, June 13, 2000.

total exports in 1999, dipping slightly to 17 percent in 2000.[9] In 1999, a Ministry of Economic Affairs (MOEA) report warned that Taiwan's economy was too dependent on exports to the mainland, with the paper and chemical materials industries in particular being dependent on the PRC for over 50 percent of their exports. The report further claimed that China has the ability to import alternatives to Taiwan's products from other countries, giving China a fairly low dependence on Taiwanese imports.[10] The predominant tool now in managing trade is to restrict the type of items that can be imported from or exported to the mainland.

Investments in the mainland are more complicated.[11] When Taiwan first began permitting indirect Taiwanese investments in China in 1990, investments were made subject to approval from the MOEA Investment Commission. Requirements held that ROC investments should not compete with domestic companies for exports, be labor-intensive, only use raw materials from the PRC, and be in sectors not competitive in Taiwan.[12] In order to slow investments in the mainland, however, Taiwan introduced a "go south" strategy in 1993 to promote investments in Southeast Asia. The government reasoned that encouraging investments in Southeast Asia would benefit Taiwanese manufacturers while at the same time slow investment on the mainland. This strategy was later discredited due to political turmoil in Cambodia and Indonesia, as well as because of the Asian financial crisis.

In August 1996, President Lee initiated the "no haste, be patient" (*jieji yongren* 戒急用忍) policy for investments on the mainland, calling for more investments at home and stricter rules on investments across the Strait. Lee proposed that Taiwan firms limit investments in the mainland

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[9]ROC Mainland Affairs Council statistics at <http://www.mac.gov.tw/english>.

[10]"Ministry Says Taiwan Trade Too Dependent on Mainland," *Zhongguo shibao* (China Times) (Taipei), June 19, 1999, in Foreign Broadcast Information Service (FBIS), *Daily Report: China* [hereafter *FBIS-CHI*], June 19, 1999.

[11]For a broader view of Taiwan's overall foreign investments, see Gerald A. McBeath, "Foreign Direct Investment (FDI) Management and Economic Crisis in Asia: Taiwan's Changing Strategy," *Management International Review* 39, no. 4 (Special issue) (1999): 105-35.

[12]See J.D. Kenneth Boutin, "Cross-Strait Trade and Investment: Economic and Security Implications for the Republic of China," *Issues & Studies* 33, no. 12 (December 1997): 88-89.

to 20-30 percent of total foreign investment and 20 percent of Taiwan investment. As a result of Lee's comments, Taiwan's President Enterprises and Formosa Plastics Group canceled power plant projects on the mainland, and government pressure was mounted on large companies to halt large investments there. In 1997 the MOEA further adjusted restrictions and limitations. Taiwan businesses are now prohibited from investing in major infrastructure projects and high-tech research and development. Single investments in the mainland over US$50 million are subject to special scrutiny, and firms' total investments in China should not exceed 40 percent of their net worth. In addition, Taiwanese firms have been asked to invest in countries where Taiwan seeks to gain or hold diplomatic recognition.[13]

Taiwan's government has further slowed the growth of economic ties with the mainland by forbidding direct shipping and communication links across the Strait.[14] In 1997 the ban on direct cross-Strait shipping was partially lifted with the establishment of Kaohsiung (高雄) as an offshore shipping center. However, cargo brought by mainland ships to Taiwan must be destined for a third country and cannot pass through customs into Taiwan, while cargo from Taiwan may not proceed directly to the mainland. The only mainland ports originally open to such cross-Strait shipping were Fuzhou (福州) and Xiamen (廈門). In 1998 restrictions were further eased as mainland and Taiwan shipping firms were allowed to use cross-Strait routes via a third port.

Although promising to ease restrictions on direct links and large-scale investments during the presidential campaign, President Chen's administration has been slow to take concrete steps, and has in fact sent mixed messages regarding its mainland economic policy. Since Chen's inauguration, insurance firms and banks have been allowed to set up offices in China for the first time, and the government has moved toward allowing high-tech firms to employ mainland engineers. President Chen has also demon-

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[13]See Julian Baum, "Let's Tango," *Far Eastern Economic Review*, October 9, 1997, 29-32.

[14]For the commercial opportunities of cross-Strait shipping, see Kung Chun-sheng, "Taiwan's Offshore Shipping Center and Cross-Strait Commercial Opportunities," *Issues & Studies* 33, no. 12 (December 1997): 50-69.

strated a willingness to discuss former premier Vincent Siew's (蕭萬長) proposal for a Taiwan-mainland common market, and Taiwan has indicated that it will open its doors to mainland tourists. Nevertheless, important issues are unresolved. Despite assertions that the "no haste, be patient" policy will be reviewed and promises of gradual liberalization, so far the essentials remain in place. Taiwan's government still limits local businesses from investing more than US$50 million on mainland projects without approval, while investments in high-tech and infrastructure projects continue to be restricted. Moreover, Vice-President Annette Lu (呂秀蓮) in January 2001 claimed that Taiwanese investments in China have had a "grotesque" impact on Taiwan's economic development over the past ten years.[15]

Similarly, mixed messages have been sent regarding the restoration of the "three links" (*san tong* 三通) with the mainland. In May 2000, President Chen called the ban on direct trade, postal, and transport links with the mainland "outdated, rigid, and inflexible," later claiming that setting up such links was unavoidable.[16] However, Mainland Affairs Council (MAC) chairwoman Tsai Ing-wen (蔡英文) has consistently played down suggestions that the opening of links will occur anytime soon. Nevertheless, in 2001 Taiwan instituted the "mini three links" (*xiao san tong* 小三通) program, allowing direct shipping and trade links between the mainland and islands of Kinmen (Quemoy 金門) and Matsu (馬祖). Although there are important limitations to this policy (Kinmen and Matsu may not be used as transit points for the rest of Taiwan) and Beijing has reacted coolly, this program is an important first step toward the possible establishment of broader links.

The reason policy has not changed more dramatically is that the same thorny dilemma continues to confront Taiwan. On the one hand, investment in China is necessary for the profitability of Taiwanese firms that are

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[15]Sofia Wu, "Veep Lu Blames Economic Woes on 'Mainland Fever'," CNA, January 18, 2001.

[16]Goh Sui Noi, "Chen Vows to Review 'Three Links' with China," *Straits Times*, May 22, 2000; "Direct 'Three Links' Unavoidable: President Chen," CNA, May 30, 2000; and Maubo Chang, "Premier: Shipping and Trade Links with Mainland China Inevitable," CNA, January 11, 2001.

competing in a global marketplace; in other words, market pressures are forcing Taiwanese firms to the mainland due to lower costs and the lure of the Chinese market. The government's goal of becoming a regional business hub also depends on more open policies toward the mainland. On the other hand, there are continued fears that the mainland will use Taiwanese investments as a bargaining chip against Taiwan to force reunification on Beijing's terms. Similarly, some fear that mainland investments will undermine the "Taiwanese identity" of Taiwan's business elite. Furthermore, the hollowing out of Taiwan's industries continues to be a concern. For instance, Chen Po-chih (陳博志), chairman of the Council for Economic Planning and Development (CEPD), calculates that Taiwan's savings equal 25 percent of GNP, while domestic investment accounts for 23 percent of GNP, leaving only 2 percent of excess national savings. With such a small amount of free savings, capital flows to the mainland may reduce investment in Taiwan.[17]

As a result, the election of a new administration has not resolved the fundamental tension that has led to infighting between various state institutions and the conflict between state and society in Taiwan regarding mainland economic policy.[18] In addition, restrictions on mainland economic transactions continue to be very difficult to enforce. Thus Securities and Futures Commission Chairman Tzong-yeong Lin (林宗勇) has acknowledged that "there is no way the government can control capital movement," while CEPD chairman Chen Po-chih told a Legislative Yuan committee that large sums of money from Taiwanese firms have been illegally remitted to China.[19]

Another major obstacle to Taiwan's policies is the island's likely ac-

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[17]"'No Haste, Be Patient' Policy Should Not Be Compromised: Scholar," CNA, April 22, 2000.

[18]For an analysis of these conflicts, see Chu, "The Political Economy," 163-95; and Tse-Kang Leng, *The Taiwan-China Connection: Democracy and Development Across the Taiwan Straits* (Boulder, Colo.: Westview Press, 1996).

[19]Flor Wang, "Mainland China, A Black Hole for Taiwan Investors?" CNA, September 13, 2000; and Sofia Wu, "Taiwan to Probe Channels for Capital Flow to Mainland," CNA, March 14, 2001. For a description of methods Taiwanese businessmen use to skirt regulations, see Tim Culpan, "Great Cross-Strait Sidestep," *South China Morning Post*, February 9, 2001.

cession to the World Trade Organization (WTO) shortly after the PRC. Mainland analysts claim that Taiwan will no longer be able to prevent direct investment on the mainland or direct trade, with Foreign Trade and Economic Cooperation (MOFTEC) Minister Shi Guangsheng (石廣生) threatening to eventually file a complaint with the WTO if Taiwan fails to establish the "three links." Furthermore, Beijing expects that Taiwan will no longer be able to restrict mainland investment on Taiwan.[20] Also likely is that WTO entrance will require Taiwan to open its market to mainland goods, perhaps reducing the island's trade surplus with the mainland. In addition to the legal issues, China's entry into the WTO will make the mainland a more attractive market for Taiwanese investors, as well as spur foreign investors who will provide Taiwanese firms with increased competition.

Trade and Investment Across the Strait

Despite Taiwan's efforts to limit economic exchanges, investment flows and trade across the Taiwan Strait are substantial. In 1980, mainland-Taiwan indirect trade stood at approximately US$321 million. Taiwan's exports to the mainland totaled US$242.2 million (1.2 percent of Taiwan's total exports), while Taiwan's imports totaled US$78.5 million (0.4 percent of total imports). By 1990, Taiwan's exports to the mainland were valued at US$4.4 billion (6.5 percent of Taiwan's total exports), while the island imported US$765 million worth of mainland goods (1.4 percent of imports).[21]

By 2000, Taiwan's two-way trade with the mainland reached a record high of US$31.25 billion, an increase of 21 percent from 1999. Two-way

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[20]See "Analysis of WTO's Impact on PRC, Taiwan," *Ta Kung Pao* (Hong Kong), September 21, 1999), in *FBIS-CHI*, September 22, 1999; "New Opportunity for In-Depth Development of Cross-Strait Trade and Economic Ties," *Jingji ribao* (Economic Daily) (Beijing), May 21, 1999, in *FBIS-CHI*, July 6, 1999; and Flor Wang, "WTO Framework Can Serve to Handle Cross-Strait Trade: ROC Official," CNA, June 28, 2000.

[21]Calculated from Chu-yuan Cheng, "The Role of the Republic of China in the World Economy," *Occasional Papers/Reprint Series in Contemporary Asian Studies*, no. 4-1995 (129): tables 3 and 6.

trade with the mainland totaled almost 11 percent of Taiwan's trade. More importantly, exports from Taiwan to the mainland were valued at US$25.0 billion, equaling 16.9 percent of Taiwan's total exports. Imports from the mainland equaled US$6.2 billion, 4.4 percent of total imports, but up 37.5 percent from 1999. Thus Taiwan, which has enjoyed an annual trade surplus with the mainland of at least US$10 billion every year since 1993, in 2000 enjoyed a record trade surplus with China (its second largest export market) of US$18.8 billion. This was over US$10 billion greater than Taiwan's total trade surplus for the year and equivalent to Taiwan's surplus with the United States.[22]

Most of the mainland's exports to Taiwan consist of raw materials and agricultural products. Accordingly, by 1997 the mainland had become Taiwan's largest supplier of nonmetal mineral materials.[23] Nevertheless, as of 1999 Taiwan still banned the importation of more than 4,500 agricultural products and manufactured goods from China.[24] The island exports largely machinery and production equipment, much of it to Taiwanese-owned factories on the mainland.

Taiwanese investment in China continues to expand as well, although the numbers are much more difficult to pin down. There are two main sources for data on Taiwan's investments in the mainland: Taiwan's MOEA and the mainland's MOFTEC. Neither source publishes completely reliable data. Because of the limits on Taiwanese investments in the mainland, many investments are not reported to Taiwan officials. Adding to the problem, because Taiwanese investments are funneled through a third country, unknown is how Chinese officials at the local level record Taiwanese investment. Thus, based on probable distortions in official figures, Chevalerias estimated in 1997 that between 23,000 and 59,000 Taiwanese firms had invested US$17-56 billion on the mainland.[25]

In early 2001, the *New York Times* estimated that Taiwan's invest-

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[22]ROC Mainland Affairs Council statistics at <http://www.mac.gov.tw/english>.

[23]Maubo Chang, "Mainland China Becomes Taiwan's Major Mineral Supplier," CNA, June 7, 1997.

[24]Julian Baum, "Investing on a Leash," *Far Eastern Economic Review*, March 25, 1999, 12.

[25]Philippe Chevalerias, "Taiwanese Investments in China: Squaring the Circle," *China Perspectives*, no. 17 (May/June 1998): 52-54.

ments were greater than US$40 billion, while official Chinese sources cite US$45 billion.[26] (The US$40 billion figure would make Taiwan's investments in the mainland roughly equal to 10 percent of Taiwan's gross domestic product, GDP.) Although Taiwan's investments in China dropped in 1999 (along with total investments in the mainland), a Taiwan MOEA study released in February 2000 showed that 61.5 percent of 1,627 businesspersons surveyed in the second quarter of 1999 listed the mainland as their most favored investment site, up from 55.4 percent a year earlier.[27] Even more striking, the value of Taiwanese investment projects on the mainland approved by the MOEA in 2000 more than doubled the value of all approved projects in 1999. Electronics and electrical appliance investments comprised 56 percent of the total.[28] As a result largely of Taiwan's investments, approximately 230,000 Taiwanese now work in China.[29]

More important than the absolute figures on Taiwan's investments in the mainland are the ratios of Taiwan's investments. In 1997 Minister of Economic Affairs Wang Chih-kang (王志剛) reported that 42 percent of Taiwan businesses' overseas investments were on the mainland. By 1998 the figure had risen to 47 percent,[30] although the actual number could well be higher. In early 1999, reports held that 71 percent of Taiwan manufacturers had invested in China. Over 70 percent of Taiwan's investments are reported to be in industrial manufacturing. Important sectors for Taiwanese investment include electronics and electrical appliance manufacturing, foodstuff and beverage processing, plastics, and metals—although as noted previously, electronics is now the dominant sector.[31]

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[26]Craig S. Smith, "Taiwan Boats Land in China; First Direct Legal Link Since '49," *New York Times*, January 2, 2001, at <http://www.nytimes.com>; and "Taiwan's Mainland-Bound Investment Surges 92.7 Percent in January-November," *China Daily* (Beijing), December 22, 2000, at <http://www.chinadaily.com>.

[27]"Taiwan Investors 'Still Prefer China'," *Straits Times*, February 29, 2000.

[28]MOEA Investment Commission, Republic of China at <http://www.moea.gov.tw>.

[29]"China Attracts Taiwan's Best to New Hi-Tech Industries," *South China Morning Post*, February 16, 2001.

[30]Lilian Wu, "MOEA Discusses New Mainland Investment Regs," CNA, May 2, 1997; and Maubo Chang, "New Rules Needed to Govern Investment in Mainland China," CNA, November 2, 1998.

[31]Eva Chen, "Taiwan Is Mainland China's Third Largest Source of Foreign Capital," CNA,

Electronic Sector Investments in China

One source of anxiety for Taiwan's government is the fact that the technology level of investments on the mainland is increasing, especially in the electronics and information technology sectors. The electronic sector is vital to Taiwan's economy, with two analysts claiming that "Taiwan stands out as Asia's greatest national success story in the PC era," due in part to Taiwan's industrial policy.[32] By 1998, Taiwan was the world's largest supplier of computer monitors, modems, motherboards, keyboards, power supplies, scanners, pointing devices, and desktop and notebook computers. In 2000 Taiwan notebook computer suppliers obtained an approximately 60 percent share of the world market.[33] In 1999, Taiwan's sales of computer hardware totaled nearly US$40 billion, while the integrated chip industry made US$13.5 billion in sales, an increase of almost 50 percent over 1998. By 2000, Taiwan was the world's largest producer and exporter of custom chips, with Taiwan foundries surpassing their competitors in advanced technology.[34] President Chen's vision for Taiwan as a "green silicon island" depends on continued growth in this sector.

Despite efforts by Taiwan's government to slow investment in China, however, electronics manufacturers are investing heavily on the mainland. In 1999, about 40 percent of all Taiwanese investments in China were associated with the production of electronics and electrical appliances.[35] This movement of the electronics industry to the mainland increasingly in-

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November 28, 1998; Sofia Wu, "More Taiwan Firms Export Goods from Mainland Plants," CNA, March 6, 2000; and Debbie Kuo, "Taiwan Investment in Mainland China Continues to Rise," CNA, April 29, 1997.

[32]Jason Dedrick and Kenneth L. Kraemer, *Asia's Computer Challenge: Threat or Opportunity for the United States and the World?* (New York: Oxford University Press, 1998), 146.

[33]Andrew Tanzer, "Silicon Valley," *Forbes*, June 1, 1998, 123-24; and Alice Liang, "ROC Notebook Computer Makers to Grab 60 Percent of World's Market," CNA, August 10, 2000.

[34]"Statistical Data on Taiwan's Semiconductor Industry," *Semiconductor FPD World* (Tokyo, in Japanese), June 2000, in FBIS, *Daily Report: East Asia*, June 22, 2000; Brian Cheng, "Tainan Science Park is Really 'Fab'," *Taipei Journal*, October 6, 2000, 8; and Mark Carroll, "Cashing In," *Far Eastern Economic Review*, August 31, 2000, 31.

[35]Lillian Lin, "P.K. Chiang Urges Electronics Makers Not to Go to PRC," CNA, September 30, 1999.

volves information technology. Taiwan's Information Industry Institute has calculated that in 1999, 33 percent of Taiwan's information hardware orders were manufactured on the mainland and 53 percent were produced in Taiwan. In that year, Taiwanese-owned firms on the mainland produced US$11 billion in information technology products. The Information Industry Institute estimates that in 2001, up to 51 percent of orders will be manufactured on the mainland, while only 45 percent will be made in Taiwan.[36] This shift in production is being driven by lower costs (crucial in a sector with low profit margins), the mainland's own market growth (estimated at 30 percent annually in the personal computer market),[37] as well as favorable mainland policies at both the national and local levels.

Most of the production movement to the mainland has been by downstream assemblers and manufacturers of computer peripherals. Monitor and scanner manufacturers were the earliest producers to move to China in order to reduce costs, and scanner makers have done very well in the local market. For instance, Microtek International, which produces scanners in Jiangsu (江蘇) province, has captured 40 percent of the medium- and low-level scanner market in the mainland. Overall, Taiwan computer makers have gained a 42 percent market share in China. Motherboard manufacturers have crossed the Strait, and as printed circuit board (PCB) manufacturing has moved to China, Taiwan's materials and plastics industry is following. Taiwanese desktop computer manufacturing has also moved to the mainland, with approximately half of Taiwan-produced desktop computers being produced on the mainland in 2000. Although Taiwan's government prohibits the production of notebook computers in China, manufacturers are producing components on the mainland and making preparations to move to China in anticipation of a loosening of regulations.[38]

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[36]Fang Wen-hung, "Taiwan's Information Hardware Production Continues to Move Westward," CNA, May 11, 2000; and Brian Cheng, "Profit Trail Leads Overseas in Motherboards," *Taipei Journal*, March 31, 2000, 8.

[37]Francy Fang, "Taiwan [Information Technology] Distributors Aim to Expand into [Mainland] Market," CNA, February 21, 2001.

[38]Lillian Lin, "Taiwan Electronics Industry Migrates to Mainland China," CNA, August 24, 2000; Y.W. Hu and Flor Wang, "Taiwan Computer Firms Edging into Mainland China," CNA, September 2, 2000; and Flor Wang, "Taiwan Computer Industry on Path Toward Becoming IA Giant," CNA, November 2, 2000.

As downstream assembling, components, and peripheral manufacturing have moved to the mainland, upstream semiconductor suppliers have also shown interest in crossing the Strait despite the government ban on such investments. This becomes more urgent as foreign competitors are moving into China. Several firms reportedly have plans to produce eight-inch wafers using .25 micron technology. In May 2000, reports held that Jiang Mianheng (江綿恆), vice-president of the Chinese Academy of Sciences and son of PRC President Jiang Zemin (江澤民), and Winston Wang (王文洋), son of Taiwanese tycoon Wang Yung-ching (王永慶), have agreed to form a US$6.4 billion semiconductor joint venture on the mainland that would build wafer plants in Shanghai. Japan's Oki Electric Industry is reported to be providing the necessary technology. Other Taiwan chipmakers, including Kingmax Technology and Nan Ya Technology, also have plans to invest on the mainland.[39]

Taiwan's most prominent computer firm, Acer, has Taiwan's largest investment in China to date at a 500-acre site in Zhongshan (中山), Guangdong province. Acer plans to eventually produce more than six million motherboards a year there, as well as CD-ROM drives, with a total planned investment of over US$300 million. Numerous suppliers connected with Acer have invested about US$60 million in Zhongshan too. Acer also has plants in other locations, such as a factory in Suzhou (蘇州) that produces peripherals and a plant in Fuqing (福清) city that makes computer monitors.[40] Other manufacturers that have invested on the mainland or have plans to do so include Tatung Company with an investment of US$42 million in Jiangsu province, Mosel Vitelic, Hou Hai Precision Industry, Mitac International, First International Computer, Hsin Tech, and Asutek Computer.[41] What is emerging is a system where a major Taiwanese manu-

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[39]See Christine Chan and AFP, "Jiang Son in Taiwan Deal," *South China Morning Post*, May 11, 2000; and "Chip-maker Tests Rule on Cross-Strait Spending," ibid., September 6, 2000.

[40]Details on Acer's investments are found in Mark Carroll, "Acer Ramps Up Giant Fab in China," *Electronic Engineering Times*, February 7, 2000, EBSCO host; and Josephine Ma, "Taiwan Investment Still Flowing Strongly," *South China Morning Post*, July 11, 2000.

[41]"Taiwan's Tatung Company Invests $42 Million in Jiangsu," Beijing Xinhua in English, April 24, 2000, in *FBIS-CHI*, April 24, 2000; Sunray Liu, "Taiwan Investors Warming to Mainland," *Electronic Engineering Times*, January 3, 2000, EBSCO host; Hu and Wang, "Taiwan Computer Firms"; and Cheng, "Profit Trail."

facturer moves to the mainland accompanied by its entire supply chain, fostering the development of special manufacturing zones.[42]

Apart from the political question of how cross-Strait investments affect Taiwan-mainland relations, there is also an economic issue. Similar to other newly industrialized economies (NIEs), Taiwan faces the challenge of keeping high-value activities at home while moving production offshore. With Taiwanese computer and other hardware manufacturers moving to the mainland, what is left for Taiwan? In other words, can Taiwan continue ascending the production ladder so that Taiwan itself maintains an important role in the personal computer and information industries? Currently most headquarters, research, design, and marketing continue to be done in Taiwan itself, along with some production. However, Taiwan faces a major challenge in assuring that the island continues to hold a key position in the computer industry.[43]

Economic Ties and the Cross-Strait Relationship

How do the economic exchanges between China and Taiwan affect the cross-Strait relationship? More specifically, do exchanges reduce Taiwan's political flexibility? Taiwan fears that such exchanges create a security threat, although in the long run the island's capability to credibly slow such exchanges is limited. Beijing, on the other hand, sees exchanges as leverage in achieving final reunification. Beijing, however, has been frustrated by the lack of political progress despite the deepening economic links.

Looking first from a broad strategic perspective, Taiwan survives in an international system that is unfavorable. Due to pressure from the PRC,

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[42]See Flor Wang, "Taiwan Hi-Tech Firms Relocating to Mainland China," CNA, March 23, 2001.

[43]For a discussion of this issue, see Chin Chung, "Division of Labor Across the Taiwan Strait: Macro Overview and Analysis of the Electronics Industry," in *The China Circle: Economics and Electronics in the PRC, Taiwan, and Hong Kong*, ed. Barry Naughton (Washington, D.C.: Brookings, 1997), 164-209; Dedrick and Kraemer, *Asia's Computer Challenge*, 271-73; and Julian Baum, "Dangerous Liaisons," *Far Eastern Economic Review*, March 25, 1999, 10-15.

the ROC is recognized by relatively few states and is barred from membership in most international organizations. Moreover, its chief rival is seen by the world as Asia's rising power and hence not to be offended. However, Taiwan does have several advantages. These include the island's democracy, economic importance to the mainland and the rest of the world, and unofficial but strong relationships with the United States and Japan (the last of which rest upon Taiwan's democracy and economic power, but also on strategic considerations vis-à-vis mainland China). Thus imperative is that Taiwan retain its economic competitiveness through whatever means necessary, including through deepening investments on the Chinese mainland.

Looking at trade, there are two factors that concern Taiwanese policymakers. The first is the overall export and import dependence of Taiwan on the mainland. In 2000, 17 percent of Taiwan's exports went to China. Taiwan officials fear that because such a large percentage of exports cross the Strait, Taiwan could be hurt by mainland economic sanctions. The second relevant factor is the asymmetry of export dependency. While Taiwan depends on the mainland for 17 percent of its exports, in 2000 mainland China relied on Taiwan for only 3 percent of its exports. This again seems to signal that Taiwan is vulnerable.

However, there are other aspects of the trade relationship to take into account. First, Taiwan's higher trade dependence on the mainland means that the island accumulates a surplus from cross-Strait trade, a surplus that more than offsets Taiwan's trade deficit with the rest of the world. Year after year Taiwan builds up foreign exchange reserves based on mainland trade. Second, mainland sanctions that cut off Taiwan's exports would also greatly damage the PRC's economy. Many of Taiwan's exports are semifinished materials and equipment used by Taiwanese firms for their production on the mainland. Thus, these Taiwanese exports are components in the production of goods often exported from the mainland itself,[44] making the asymmetry of export dependence much less than widely be-

[44]See Tse-Kang Leng, "A Political Analysis of Taiwan's Economic Dependence on Mainland China," *Issues & Studies* 34, no. 8 (August 1998): 143-45.

lieved. In other words, cutting off Taiwan's exports would not only invite retaliation that would end mainland exports to Taiwan, but would also reduce the Chinese exports to the rest of the world that would have been produced in Taiwanese-owned factories. A third relevant consideration in looking at Taiwan's trade with the mainland is the dependence of Taiwan on specific strategic items such as crucial minerals. The key issue here is the availability of these items in other markets.

Taiwan bans the importation of 4,500 products from mainland China in order to protect domestic industries and avoid becoming overly dependent for specific items. However, unlikely is that this ban will be sustainable once the mainland and Taiwan enter the WTO. Thus the result of WTO accession may be a more even trade balance and greater Taiwanese trade with China. While this will undoubtedly hurt some sectors of Taiwan's economy, accession should increase the economy's overall efficiency as less expensive goods from the mainland become available, some of which are produced in Taiwanese-owned factories, and Taiwan's exports to China increase even further.

The issue of investments is more complex. One can begin to approach the issue by looking at the political risk that individual companies take on when making foreign investments. Although political risk is difficult to operationalize and measure, one working definition is "the risk or probability of occurrence of some political event(s) that will change the prospects for the profitability of a given investment."[45] There are various political risks that any company must take into account when making foreign investments, including fair treatment from the government and shifting regulations that might be detrimental to the company's profits. Taiwanese companies face the additional variable of poor political relations between the mainland and Taiwan, leading in a worst-case scenario to economic sanctions or armed conflict, when assessing their risks.

One model for integrating political risk into capital budgeting for

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[45]This definition was originally provided by Dan Haendel in *Foreign Investment: The Management of Political Risk* (Boulder, Colo.: Westview Press, 1979), 5, and is quoted by Guy Leopold Kamga Wafo, "Political Risk and Foreign Direct Investment," *Lizenziatenarbeit* (University of Konstanz, Germany, 1998), 18.

firms considers the two factors of vulnerability and cost. Vulnerability refers to the probability that a detrimental political event will occur. Cost refers to the impact on cash flows if such an event does occur. The risk or level of dependency for any given event then equals the probability of the event multiplied by the cost of said event.[46] Of course the probability of an event cannot be determined precisely and thus is determined largely by the analyst's judgment. On the other hand, there is often an opportunity cost, or risk, in not investing. One may forgo lower costs, market share, and the benefits of skilled workers by refusing to invest—all advantages that competitors will take. These particular opportunity costs are more easily calculated than political risk.

Taiwan firms have evidently calculated that the opportunities of investing in mainland China outweigh the dangers. In fact, more and larger investments would be made in the mainland were it not for Taiwan's restrictive policies. This leads to an interesting question: Why does the government's assessment of risk differ from that of private firms? This then raises a second question: How does the state perceive its interests as differing from those of society's private firms? One area of difference regards goals. A government is interested primarily in security and autonomy, as well as respect. In Taiwan's case, this means the government wants to gain the maximum amount of leverage to pursue its goals in regard to relations with the mainland. Businesses are interested in profit. A second difference between the government and firm perspective is one of scale. While an individual company may decide that opportunities for profit outweigh political and economic risks in foreign investment, a government is interested in the totality of investments in a given location and the risk that this presents to the entire economy. Thus, what looks rational to individual firms may not appear rational from the broader perspective. Furthermore, Taiwan's government is subject to pressures from numerous competing interests, some of which oppose mainland investments based on the perception that interactions with China undermine Taiwanese autonomy and identity.

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[46] Wafo, "Political Risk," 37-40.

There are important political benefits and risks to Taiwan that result from investment in China. One risk is the loss of state autonomy due to the development of an influential business class that lobbies for policies favorable to the mainland. This is not a surprising outcome. Economic theory suggests that firms will do what they can to reduce political risk and maximize economic potential for their foreign investments. One way Taiwan firms do this is by lobbying their government for policies that will promote good relations with the mainland. Due to Taiwan's democratization, the government is much less autonomous from the demands of society than the mainland regime.[47] This representation is an essential part of democratization, although it does complicate the balancing of economic versus security goals in cross-Strait policymaking.

There are numerous examples of political pressure from Taiwan's business community, academics, and political leaders designed to loosen economic restrictions. Pressure is manifested most directly in the flaunting of government directives on investments. Lobbying for pro-business policies is also prominent. For instance, in 1996 the Association for Direct Links Promotion was formed to encourage direct transportation ties with the mainland. Notable Taiwanese business leaders who have criticized Taipei's restrictive policies include: Chang Yung-fa, chairman of the Evergreen Group; Wang Yung-ching, head of the Formosa Plastics Group; Stan Shih, chairman and CEO of the Acer Group; and Kao Chin-yen (高清愿), chairman of the Chinese National Federation of Industries and head of the food processing company President Group.[48]

This pressure was manifested in the 2000 presidential election. In March 2000 the Federation of Mainland China-Based Taiwan Trade Associations presented seven policy proposals to the five presidential candidates, calling for direct links with the mainland, loans for Taiwanese-owned com-

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[47]For instance, Leng argues that the strong state paradigm is no longer relevant for explaining Taiwan's economic policies, especially the island's policies toward the mainland. See Leng, *Taiwan-China Connection*, 1-3.

[48]See Frank Ching, "China Erodes KMT's Support," *Far Eastern Economic Review*, November 6, 1997, 46; "Taiwan Group Seeks Direct Mainland Links," *Straits Times*, November 8, 1999; and Luis Huang, "Government Urged to Ease Restrictions on Mainland China-Bound Investment," CNA, January 16, 2001.

panies in China, permission for Taiwan banks to set up mainland branches, and other favorable steps.[49] As a result of business influence, all three of the major contenders promised to improve the cross-Strait business environment. Kuomintang (KMT) candidate Lien Chan (連戰) called for the relaxation of restrictions on trade and investment and negotiations on direct postal, trade, and transportation links. James Soong (宋楚瑜) favored an end to restrictions on investments in the mainland and the ban on the "three links," while DPP candidate Chen Shui-bian also called for easing restrictions on direct links and large-scale investments.[50] Whether or not all three men were themselves philosophically committed to expanding economic ties with the mainland, the pledges illustrated the pressures exerted by Taiwan's business community during an election year.

A second risk in investing in China is the fact that doing so directly contributes to the growth of China's economy. This indirectly enhances the ability of the mainland to threaten Taiwan, as economic growth fuels the PRC's military buildup and further inflates the estimation of Beijing's power in the international community. Furthermore, Taiwan's mainland investments in the information industry may benefit the People's Liberation Army (PLA) by providing greater access to technology useful in warfare.

Another factor that Taiwan considers in assessing risk is the vulnerability of Taiwan companies to mainland economic sanctions. Because approximately half of Taiwan's foreign investments are in the mainland and close to 17 percent of its exports flow there as well, there seems to be a high degree of vulnerability. For instance, responding to President Lee's "state-to-state" theory in 1999, MOFTEC Minister Shi Guangsheng threatened "If the 'one China' principle is abandoned, cross-Strait trade and economic exchanges will be destroyed fundamentally and deprived of opportunities and conditions for further development."[51] Furthermore, the Taiwan In-

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[49]Sofia Wu, "Taiwan Investors in Mainland China Offer 7 Policy Proposals," CNA, March 8, 2000.

[50]For details, see Sofia Wu, "KMT Candidate Unveils Campaign Platform for Cross-Strait Ties," CNA, February 17, 2000; "Scrap Mainland Investment Cap: Soong," *South China Morning Post*, November 22, 1999; and Erik Eckholm, "Dire Warnings over China in Taiwan Race," *New York Times*, February 24, 2000.

[51]Mary Kwang, "China Warns Taiwan of Trade Loss," *Straits Times*, August 7, 1999.

stitute of Economic Research estimated that Taiwan would lose the equivalent of 7.6 percent of its total annual export trade if mainland China boycotted Taiwanese imports.[52]

However, political and economic realities reduce this risk.[53] More specifically, in Taiwan's case sanctions would be difficult for three reasons. First, Taiwan's trade and investments are indirect. Thus if the PRC targeted Taiwanese trade or investment, there would be some difficulty in separating Taiwanese assets from those of third countries or Hong Kong. Second, Taiwanese firms have established relations with various multinational corporations. Thus, targeting Taiwan firms would harm corporations from various countries and even entire industries. Third, the mainland itself would suffer from the closing or expropriation of Taiwanese firms and the damage to the investment environment that such sanctions would cause. Taiwan firms contribute a great deal to the mainland's exports and employ approximately three million Chinese workers.[54] Furthermore, in the year 2000 Taiwanese firms produced approximately 73 percent of the mainland's information hardware output.[55] In addition, economic sanctions against Taiwan would create a backlash from the international community and have a chilling effect on all foreign investment in China. Thus during times of tension, PRC officials go out of their way to reassure Taiwan investors that business is separate from politics. In other words, Taiwan's investments in the mainland are difficult to sanction because they are tied into the international division of labor and are important to the mainland's economic health. This then is a major political benefit of Taiwanese investment in China.

The economic importance of Taiwan to the international community is best seen in Taiwan's electronics and information technology sector

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52"Think-Tank Warns of Possible Mainland Boycott," CNA, June 20, 1999.

53In this regard see also Leng, "Political Analysis," 132-49.

54Alan Wachman, *Challenges and Opportunities in the Taiwan Strait: Defining America's Role* (National Committee on United States-China Relations, China Policy Series no. 17, January 2001), 25.

55Fang Wen-hung, "Mainland China to Surpass Taiwan in Information Hardware Production," CNA, November 6, 2000. See also Edward Chen, "70% of Mainland's [Information Technology] Products Said from Taiwan-Invested Firms," CNA, April 13, 2001.

which, as demonstrated earlier, is located on both sides of the Taiwan Strait. In 1999 reports held that Taiwan firms produce 40 percent of IBM's and 60 percent of Dell's desktop computers, while Dedrick and Kraemer noted that in computers "Taiwan has become an indispensable part of the global production system."[56] In 1999 Taiwan supplied 12 percent of the world's DRAM chips, if outsourcing from Japanese firms is included. After the 1999 earthquake in Taiwan, which disrupted production for approximately two weeks, DRAM prices on the world market increased 25 percent.[57] It is easy to see that PRC sanctions or violence in the Taiwan Strait would provoke a severer market response. Similarly, Chang Chun-yen (張俊彥), president of National Chiao Tung University (國立交通大學), has estimated that a regional war would result in the world's microchip supply being short by a third.[58] The disruption in the production of notebook computers, desktops, and related components would be even greater. This connection between Taiwan firms on both sides of the Strait with the international economy greatly raises the stakes for Taiwan, the mainland, and the international community in the bargaining over Taiwan's future.

Moreover, Taiwan's government faces real risks in not taking advantage of economic opportunities across the Taiwan Strait. By not allowing firms to trade fully and invest freely in the PRC, Taiwan limits the economic growth of the island's firms. This ultimately undermines economic competitiveness and reduces Taipei's leverage with Beijing.[59] This effect is seen particularly in the case of the information industry. The original waves of Taiwanese investment in China were made by sunset industries that were no longer competitive on Taiwan. The information industry differs in that this sector is Taiwan's hope for the future. Nevertheless, the

[56]Xiangming Chen, "Business over Politics," *China Business Review*, March/April 1999, EBSCO host; and Dedrick and Kraemer, *Asia's Computer Challenge*, 264. Leng suggests that Taiwan's government encourage firms to form international alliances to help protect against the threat of sanctions. See Tse-Kang Leng, "Dynamics of Taiwan-Mainland China Economic Relations," *Asian Survey* 38, no. 5 (May 1998): 508-9.

[57]"Quake Disrupts Taiwan Chip Mfg: Implications for China Relations," *ChinaOnline*, September 22, 1999, at <http://www.chinaonline.com>.

[58]"War Unlikely Given Investment: Aide," *South China Morning Post*, July 10, 2000.

[59]In this regard, see Boutin, "Cross-Strait Trade and Investment," 70-93.

same laws of economics that pushed the footwear industry to the mainland should apply to the computer industry as well. If Taiwan wishes to keep high-end processes (such as design) on the island, the government must accede to lower-end manufacturing processes occurring on the mainland in order to foster the health of the industry.

Conclusion

There is no consensus on how the mainland-Taiwan conflict will be resolved, although both sides are frustrated at the current political situation. Beijing claims that in the final analysis there is only one possible outcome —"one China," although the details are subject to negotiation. Opinion in Taiwan is divided. While the DPP calls for independence in its platform, KMT leaders have asserted that reunification with the mainland may occur after China democratizes. Others want more immediate reunification. Outside observers have put forth a variety of opinions as well. John Metzler claims that China will eventually reunify, although the manner in which this will occur is unclear. Yun-han Chu (朱雲漢) sees a possible military showdown sometime in the next ten to fifteen years, while Xiangming Chen more optimistically states, "So far, cross-Strait economic integration has unfolded as a gradual triumph of business over politics."[60]

Burgeoning economic links between mainland China and Taiwan clearly do play a role in the politics of reunification. Nevertheless, economic links cannot guarantee a peaceful resolution to the Taiwan issue. As Robert Gilpin concludes in a broader discussion of the links between economics and politics, "trade and other economic relations are not in themselves critical to the establishment of either cooperative or conflictual international relations. No generalizations on the relationship of economic interdependence and political behavior appear possible."[61] This is because,

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[60]John J. Metzler, *Divided Dynamism: The Diplomacy of Separated Nations* (Lanham, Md.: University Press of American, 1996), 201; Chen, "Business over Politics"; and Chu, "Political Economy," 190-91.

[61]Robert Gilpin, *The Political Economy of International Relations* (Princeton, N.J.: Princeton

in the mainland-Taiwan case, economic relations merely change the payoffs of various political moves. Thus, although broken economic ties greatly raise the potential cost of movement toward Taiwan independence, it does not rule out steps toward independence. Similarly, Beijing may still be moved to use force against Taiwan despite the high economic cost if it believes that other factors warrant the sacrifice.

Likewise, economic integration cannot drive a political solution due to the nature of the dispute (the issue of who holds sovereignty), the political power imbalance between the two sides, differences in form of government, and the fundamental questions of identity that are involved. Beijing's hopes that close economic ties would bring Taiwan back into the fold have failed to materialize because of the complexity of democratic politics on the island. While economics is a powerful force that fundamentally changes payoff structures, ultimately Taiwan's future requires a political solution, involving not only economics but also issues of identity, power, pride, security, political values, and international relations.

However, growing interdependence does discourage sharp deviations from the status quo. Trade and investment make any declaration of independence by Taiwan or any use of force by the PRC more and more costly for Taiwan, the mainland, and the world. Movements toward Taiwan independence would result in economic sanctions that would devastate Taiwan's most profitable firms, especially in the information industry. Similarly, Beijing's use of force or economic sanctions would bring severe economic consequences to China. As a result, domestic interests on both sides of the Taiwan Strait will advocate moderate policies and incremental change, as will the international community. Thus, economic interactions between mainland China and Taiwan, while not in and of themselves leading to a solution of the Taiwan issue, do help buy time to achieve the political compromises necessary for a peaceful settlement.

University Press, 1987), 58. See also Robert O. Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy* (Princeton, N.J.: Princeton University Press, 1984), 5-9.