

# **Dynamics of Taiwan-Mainland China Economic Relations: the Role of Private Firms**

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## Dynamics of Taiwan-Mainland China Economic Relations: the Role of Private Firms\*

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This article examines Taiwan's economic statecraft toward mainland China and the role of the business community in cross-Strait economic interactions. It argues that the realist perspective on economic statecraft cannot explain the current political economy between Taiwan and mainland China. The realist thought of international political economy argues that states are the only meaningful actors in the world economy. In an anarchic international society, relative gains in wealth and power are the goals of actors. The structure of bilateral power, either in political or economic terms, determines the "winners" and "losers" in the international arena. Foreign trade and investment policies can thus be utilized as an instrument to enhance national interests. Coercive and exchange-oriented "economic statecraft," such as economic sanctions and economic aid, should be implemented according to careful calculation of foreign policy goals.<sup>1</sup> From this perspective, economic interaction between Taiwan and mainland China could be used to serve political purposes. If the state can control the tempo and trends of economic interaction effectively, trade and investment can be greatly shrunk or expanded according to policymakers' political judgment.

However, research on economic statecraft shows that coercive economic statecraft and economic sanctions do not work well after the rise of new actors such as

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<sup>1</sup> David Baldwin, *Economic Statecraft*, New Jersey, Princeton University Press, 1985.

non-governmental organizations and multinational corporations (MNCs).<sup>2</sup> The home country government has difficulties extending its influence to corporations which acquire their capital, technology, and sales through the international market. As overseas affiliations become more important to firms, it is the host country's laws, rather than the home country policies, that really influence MNCs' daily operations. Hence, the net result of market internationalization is that there is greatly intensified competition among states for world market shares. That competition forces states to bargain with firms to locate their operations within the territory of the state, and with national firms not to leave home.<sup>3</sup> The realist assumption that states can control economic incentives to conduct political goals thus cannot fully stand. As internationally-oriented firms occupy strategic positions to bargain with home and host countries, states have to adjust their roles in promoting or constraining economic transactions.

Taiwan's economic policy toward mainland China provides a good example in examining this new type of interaction between the state and firms. The first section of this article will analyze why Taiwan's economic policies toward mainland China are "irrational"-- that is, the political controversies behind the economic interaction. Out of national security concerns, the Taiwan government has tried to impose restrictions on the business community's investment in mainland China. The second section of the article explains the governmental policies which regulate such economic activities. Taiwan business people have escaped governmental restrictions and launched new investment projects on mainland China based on their own calculations of economic profits. The real

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<sup>2</sup> Kenneth Rodman, "Public and Private Sanctions Against South Africa," *Political Science Quarterly*, Vol 109, number 2, 1994, pp. 313-334; Gary Hufbauer, Jeffrey Schott, and Kimberly Elliott, *Economic Sanctions Reconsidered*, Washington D.C, Institute of International Economics, 1990.

party which they must bargain with are the local authorities of host countries. Hence, these regulative policies have proven not to be so successful. Part three analyzes how the Taiwanese business community has dealt with its home country's restrictive policies, and the benefits and constraints they meet when they invest in mainland China. Finally, this article will re-examine the effectiveness of economic statecraft in the era of market internationalization and the changing role of the state.

### **Political Controversies in Cross-Strait Relations**

Cross-Strait relations have experienced various ups and downs in the past forty-nine years. Prior to Chiang Ching-kuo's decision to open up interactions with mainland China, confrontations between the two sides were an extension of Chinese civil war and a reflection of international bipolar confrontation during the Cold War era. Since 1987, cultural and economic ties between Taiwan and mainland China have been greatly enhanced. Mainland China resumed military pressure on Taiwan after Lee Teng-huei's visit to the United States in June 1995. The situation escalated into a crisis after mainland China launched missile tests near Taiwan's northern and southern ports before Taiwan's presidential election in March 1996. U.S. aircraft carrier groups were forced to intervene in the Taiwan Strait. As a result, cross-Strait relations reached a new low. Signals of resuming cross-Straits talks did not appear until February 1998.

The first major political obstacle impeding cross-Strait relations is the different interpretation of the "one China Principle" by the two sides. From the PRC's perspective, "one China" means first, there is only one China; second, Taiwan is a province of China;

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<sup>3</sup> Susan Strange, "States, Firms, and Diplomacy," *International Affairs*, 68: I, 1992, pp.10-12.

and third, PRC is the sole legitimate government representing the whole of China. China's sovereignty resides in the PRC, and Taiwan can enjoy some degree of autonomy in domestic affairs. Since Taiwan is a province of China, it can participate in the international arena only as a local government.<sup>4</sup> Under the "one country, two systems" formula, the degree of autonomy which Taiwan enjoys could even be larger than Hong Kong's. However, Beijing's bottom line is that the "one country" definitely refers to the PRC. Beijing's strategy has been to press Taipei to open up person-to-person interaction and initiate political dialogue with mainland China while at the same time vetoing Taiwan's participation as a full-fledged political entity in international organizations. "Peaceful means" have been adopted in the hope that they will narrow Taiwan's options and give it no choice but to negotiate for reunification. The PRC has reserved the right to use force if these peaceful means fail.

Taiwan's interpretation on the "one China" principle is quite different. From Taiwan's perspective, the political reality across the Straits is that two "equal Chinese entities" have governed Taiwan and mainland China separately for forty-eight years. Although both Taiwan and the mainland are Chinese territories, their political and economic systems are totally different. PRC has never effectively controlled the soil of Taiwan since 1949, and vice versa. Taiwan stresses that any proposals imposing conditions which are "suitable only after China's re-unification with Taiwan are not suitable at the current stage."<sup>5</sup> Thus, the mainland's "one country, two systems" formula is not suitable for a "sovereign state" like the Republic of China on Taiwan. Taiwan

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<sup>4</sup> "The Taiwan Question and the Reunification of China", *Beijing Review*, September 6-12, 1993, pp. i-viii.

argues that to reflect the current situation, the term of “a divided China governed by two separate political entities” is more realistic.<sup>6</sup>

Taiwan’s domestic situation renders cross-Strait relations even more complex. From the mainland’s perspective, democratization and Taiwan’s quest for autonomy are equal to Taiwan independence. Democratization has created new actors in policy-making, as social forces have also received the chance to participate in the decisionmaking process. Policy outcomes, like most democratic regimes, are always the result of compromise among competing groups, the latter of which include both pro-independence and pro-unification factions. According to various opinion polls, although the majority of the Taiwanese people support the “status quo”, ten to fifteen percent of the population are pro-independence. People who support immediate unification also occupy about fifteen percent. To win the largest number of votes, the Taiwanese government has to find the “gray area” between unification and independence. Otherwise, officials will be condemned as “following in the footsteps of the other side of the Straits.” Taiwan’s diplomatic initiatives can also be explained as the quest of being recognized as an dignified and autonomous entity.

Hence, Taiwan’s middle-road policy toward unification has been under severe attack from mainland China. Taiwan’s attempts to find an autonomous route of national development has thus been explained as “deviating” from the one China principle. Hence, even though cross-Strait economic and cultural relations have been greatly improved in the past ten years, Taiwan and mainland China still remain confrontational on political

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<sup>5</sup> This paragraph appears in Koo Chen-fu’s speech at UC-Berkeley, September 27, 1996. Koo is the Chair of the Straits Exchange Foundation (SEF), Taiwan’s semi-official institution responsible for talks with its Chinese counterpart. For the full text , see *Zhongguo Shibao*, September 28, 1996.

issues and in the international arena. Cooperation in “low politics” has not spilled over into “high politics”;<sup>7</sup> instead, political differences have cast a shadow over the prospect of forming an integrated economic circle based on equality and mutual benefits. Political conflicts have also influenced Taiwanese leaders in their economic policies toward mainland China.

### **“Jieji Yongren” : Taiwan’s Principles Regarding Cross-Strait Economic Interactions**

The preceding analysis has outlined the political conflicts between Taiwan and mainland China. Under these circumstances, national security has become a main concern for Taiwan’s mainland economic policy makers. Their basic perception is that mainland China is trying to “use economic interaction to force political concession” and “ push the business community to encroach on the Taiwanese government.”<sup>8</sup> According to statistics shown on Table 1 and Table 2, cross-Strait economic interactions are asymmetrical, as Taiwan’s export dependence on mainland China reached 18.39 percent in 1997. Furthermore, if not for its trade surplus with mainland China, Taiwan would actually have an overall international trade deficit. High economic dependence may lead to capital outflow to mainland China, decrease domestic investment, and expose Taiwan to the mainland’s political interventions. This high economic dependence and the escalation

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<sup>6</sup> Taiwan’s Government Information Office uses the concept of “one divided China” to replace “one China” in formal press releases. See *Zhongguo Shibao*, February 3, 1997.

<sup>7</sup> For a more detailed discussion on the relationship between economic interdependence and political cooperation, see Tse-Kang Leng, “ Economic Interdependence and Political Integration Between Taiwan and Mainland China: A Critical Review,” *Chinese Political Science Review*, V. 26, June, 1996.

of political confrontation since 1995 has led Lee Teng-hui to request the business community to be *jieji yongren* (cautious and self-restrained).<sup>9</sup>

(Table 1 and 2 about here)

Hence, Taiwan's economic policies toward mainland China cannot be fully understood through cost-benefit analysis. Due to political risk concerns, the state has tried to take part in this booming economic relationship and "apply the brakes" to protect national security. Three official principles have been declared in regards to governing cross-Strait economic interactions. The first principle is balance between national security and economic benefits; the Taiwan government will open up economic interactions step by step, depending on the political situation across the Taiwan Strait. The second principle is national interest. The main concern in promoting cross-Strait economic relations is Taiwan's economic autonomy and its competitiveness in the international market. Economic relations with mainland China should thus enhance, rather than reduce, Taiwan's economic superiority. The third principle is stability; the long-term goal of Taiwan's economic policy toward mainland China is to promote long-term political stability across the Taiwan Strait.<sup>10</sup> Under these basic guidelines, issues such as opening direct trade, postal, and transportation links are under consideration, but have not been realized. Some *ad hoc* treatments such as "off-shore transshipment centers" are being established. A "National Development Conference" convened in late 1996 also urged the

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<sup>8</sup> Lien Chan, *Government Report to the Legislative Yuan*, September 6, 1996

<sup>9</sup> Lee Teng-huei, *Opening Remarks at the 3<sup>rd</sup> Conference on Business Management*, Taipei, September 14, 1996

<sup>10</sup> *Cross-Strait Relations and Economic Policies Toward Mainland China*, Taipei, Mainland Affairs Council, 1997.



government to “prudently assess investment by large-scale Taiwanese and make reasonable standards for regulation”.<sup>11</sup>

In brief, Taiwan has tried to achieve multiple goals through its economic connections with mainland China. However, due to political confrontations, economic benefits have been sacrificed for the sake of protecting national security and autonomy. The speed of opening trade and investment to mainland China has also been influenced by the degree of political intensity across the Taiwan Strait. For example, the *jieji yongren* advisory was released in September 1996, a few months after the Taiwan Strait crisis. In January 1995, Taiwan also released an ambitious plan to build Taiwan as an “Asia-Pacific Regional Operation Center”. This plan features Taiwan as a base for multi-national corporation to exploit opportunities in booming Southeast Asia, mainland China, and other regions in the Asia-Pacific market.<sup>12</sup> However, in a report to the National Assembly in August 1996, President Lee indicated that the Asia-Pacific Regional Operation Center could not be “an instrument to promote economic relations with mainland China.” The main theme of cross-Strait relations is “stability”. Even though Taiwan is currently engaged in trade and investment liberalization, cross-Strait economic interactions are thus still subject to government regulations.<sup>13</sup> Before the Taiwan Straits crisis in 1996, the main theme of cross-Strait relations, as Taiwan’s then-Premier Lian Chen indicated, is economic interaction. Later on, the main theme

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<sup>11</sup> *National Development Conference Resolutions*, Taipei, National Development Conference Secretariat, January 1997, pp.19-20.

<sup>12</sup> *The Plan for Developing Taiwan as an Asia-Pacific Regional Operations Center*, Taipei, Council for Economic Planning and Development, January 5, 1995, p. 5.

<sup>13</sup> Lee Teng-hui, *Report to the National Assembly*, August 14, 1996.

was changed to “stability” instead of economic interaction. This sharp contrast explains the contraction policy due to the political rivalry between the two sides.

### **Taiwan’s Investment Policies Toward Mainland China**

The ban on Taiwanese investment in mainland China was lifted in 1991. However, only indirect investment is allowed by the Taiwanese government. Since 1991, indirect Taiwanese investments in mainland have been divided by the government into three categories: those on the permitted list, those on the prohibited list, and special cases. Although the prohibited list has shrunk since 1991, the “special case” categories, which list 4309 items, allow economic bureaucracies to determine which projects can be approved on a case-by-case basis.<sup>14</sup> As for the “prohibited list”, it includes investment on infrastructure, high-tech industries, and service sectors.<sup>15</sup>

In controlling cross-Strait investments, the Taiwanese government has attempted to minimize negative impacts on domestic development, and gradually release restrictions on investment. In May 1997, the Ministry of Economic Affairs (MOEA) released a set of new criteria for rating the “special cases” categories of investment projects. For example, if the industry is labor-intensive and less competitive in the international market, the chance of being approved to invest in mainland China is higher. By the same token, if firms have more investments in Taiwan’s domestic market and international market than mainland China, or accumulate investment capital from the international market rather

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<sup>14</sup> *Gongshang Shibao* ( Business Times), July 15, 1997

than Taiwan's domestic market, the rating for approval will also be higher.<sup>16</sup> According to these criteria, economic bureaucracies quantify each investment project and give scores. Moreover, the new criteria sets the ceiling of any single investment project at 50 million US dollars. This new set of regulations is based on the hope that Taiwanese investment in mainland China will be used as an instrument to transfer outdated technologies and labor-intensive industries. Under these new criteria, larger investment projects having "reverse" impacts on Taiwan international competitiveness and domestic investment would be greatly constrained.

### **Business Reactions to Governmental Regulations -- Bargaining with the Home Country**

Reactions toward the new governmental regulations have been mixed. In May 1997 year, two conflicting opinion poll results were released. The Ministry of Economic Affairs indicated that in an opinion poll that of the general public, 94 percent agreed that "national security should be the first priority in initiating economic policies toward mainland China"; 46 percent agreed that the government should "increase restrictions on investment in mainland China"; and 20 percent agreed that the "current restrictions should remain the same".<sup>17</sup> In contrast, the Chinese National Federation of Industries, Taiwan's peak business associations, released a different poll result. In a survey of Taiwan business people in mainland China, 50 percent of them did not agree with the *jieji*

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<sup>15</sup> *Gongshang Shibao*, May 29, 1997

<sup>16</sup> *Zhongyang Ribao*, May 29, 1997.

<sup>17</sup> *Lien He Bao*, May 15, 1997.

*yongren* policy. Furthermore, 30 percent of the them planned to expand, instead of withdraw, their investments in mainland China.<sup>18</sup>

Technical factors, such as the way questionnaires are asked, may influence poll results. However, this sharp difference in results emphasizes the ambition of the economic bureaucracies to promote their regulatory polices, and the reluctance of the business community to follow the government's lead. Generally speaking, official policies are lagging behind business incentives. According to the "Statute Governing Relations Between People of Taiwan and the Mainland Area," all the investment activities in China must be approved in advance by the Taiwanese government. However, the statistics show that most of the investment projects on mainland China from Taiwan are not screened by the Taiwan government. For example, in 1996, Taiwan statistics indicate that US\$1.2 billion and 383 investment projects were approved by the government. However, the mainland statistics shows that US\$7.1 billion and 3200 investment projects from Taiwan were negotiated. Table 3 displays this sharp contrast.

(Table 3 about here)

As Taiwanese enterprises have become internationalized, it is becoming harder for the government to control capital flows to mainland China. The most recent trend for the Taiwanese enterprises is to obtain capital in the international capital market to support their mainland projects. The favorite places for Taiwanese business communities are Singapore and Hong Kong. Wong-Wong Cookies Company, the biggest Taiwanese company of this kind in mainland China, has accumulated more than US\$63 million from the Singaporean stock market. Even though Hong Kong has been an integral part of

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<sup>18</sup> *Lien He Bao*, May 30, 1997.

China since July 1, 1997, many Taiwanese companies are optimistic about its highly liberalized capital market and are utilizing Hong Kong as a base of financial management .<sup>19</sup> Other multi-national corporations, such as Formosa Plastics, use their branch companies or subsidiaries in a third country to undertake their projects in mainland China. Moreover, Taiwanese investors can bring their capital out of Taiwan by transferring foreign exchange earned from exports. Exporters sometimes retain their foreign exchange to invest in mainland China. According to Citibank in Taipei, the amount of foreign exchange retained by Taiwanese exporters increased from US\$2.89 billion in 1987 to US\$24 billion in 1991. A large portion of this foreign exchange flows directly into China , and Taiwan has been unable to control this capital outflow. <sup>20</sup> In reality , if the investors own double nationality and do not have residence status in Taiwan, their investment activities are outside legal restrictions.<sup>21</sup>

Another factor which may contribute to the difficulties in controlling business activities is the increase of channels through which capital can be acquired. According to various surveys, small and medium Taiwanese businesses in mainland China acquire about 56-59 percent of their capital from Taiwan, 25 percent from mainland China, and 13 percent from a third country.<sup>22</sup> However, as China has gradually opened up its market in the service sector, this situation is gradually changing. More foreign banks have set up their branch offices in mainland China and provided necessary loans to the Taiwanese

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<sup>19</sup> *Jingji Ribao*, March 3, 1997.

<sup>20</sup> Tse-Kang Leng, *The Taiwan-China Connection: Democracy and Development Across the Taiwan Straits*, Boulder, Westview Press, 1996, p.114

<sup>21</sup> According to the current Nationality Law in Taiwan, it is legal to have a double nationality.

<sup>22</sup> Tehchang Lin, *Zhonghua Minguo Zhong Xiao qi ye zai Guangdong Sheng di Touzi yu Liangan Zheng Jing Hudong Guanxi* ( Taiwanese investment in Guangdong and the Politics of Economic Interaction Across the Taiwan Strait), Taipei, Ministry of Economic Affairs, 1997, p.71

business community. Local banks in mainland China have also eased their restrictions in lending to Taiwanese enterprises. Furthermore, the mainland government is considering allowing Taiwanese banks to set up branch offices in the mainland, opening the stock market for Taiwanese businesses, and further releasing other financial restrictions on the Taiwanese business community.<sup>23</sup> In reality, to better serve the business community, Taiwanese banks have been well-prepared to set up branch offices in mainland under official prohibitions. Although the mainland government has declared that some Taiwanese banks have been set up, Taiwan's Investment Screening Committee has not found any proof of such activities.<sup>24</sup>

Based on interviews carried out by the author in Guangzhou and Shengzhen in 1997, the *jieji yongren* policy has not had significant impacts on small and medium-size businesses from Taiwan; they are many steps ahead of government policies, and will continue to be so in the foreseeable future. Medium-sized enterprises have extended their reach in the anticipation that prohibitions will be lifted. For example, although the government still bans investment on cement industries in mainland China, major cement companies have begun to establish factories and other related industries, i.e., aggregate materials, in preparation.<sup>25</sup> Cement industries have also used the collective bargaining power of trade unions to press the Taiwanese government to lift the restrictions.<sup>26</sup>

The real target of regulatory policies is Taiwan's big enterprises. In June 1990, after several visits to China, Y.C. Wang, the president of the Formosa Group, Taiwan's "dragon head" in plastic and petro-chemical industries, announced a plan to build a US\$5

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<sup>23</sup> *Gongshang Shibao*, June 19, 1997

<sup>24</sup> *Lien He Bao*, March 12, 1997; *Gongshang Shibao*, July 3, 1997.

<sup>25</sup> *Liangang Jingmao Tongxun*, January, 1997, p.27

billion petrochemical complex on Haicang Island near Xiamen in Fujian province. The Haicang project came as a major shock to policymakers in Taiwan, as the US\$5 billion investment was about equal to Taiwan's total domestic investment between 1980 and 1989, and thus opened a new era of state-business bargaining. In late 1991, under pressure from high-ranking officials, Wang declared that the Haicang project was "postponed", but not canceled. At the same time, he urged the government to re-negotiate terms for a new petrochemical complex in Taiwan. In June 1992, the government finally approved Wang's project to build a US\$9.5 billion naphtha cracker in southern Taiwan, much bigger than the mainland project. Furthermore, The Formosa Group also struck a deal with the government under which the company agreed to fund much of the zone's infrastructure in return for long-term low-cost financing of US\$5.4 billion. Other concessions included a five-year tax break, low-cost water supplies, and a government agreement to fund port development and other costs.<sup>27</sup>

Y.C. Wang's second attempt to challenge Taiwan's mainland economic policy has been his power plant project in Zhangzhou, Fujian province. In May 1996, the US\$3 billion investment project was approved by the mainland's State Council. Many extraordinary preferential treatments, such as low-cost land and tax breaks, were granted. Preliminary construction was launched in May, 1996.<sup>28</sup> When the news was released in mid-1996, it caused a major shock to Taiwan's mainland economic policies.

Formosa's power plant project is a typical case in underlining how multinational corporations can evade a home country's control. In this US\$ 3 billion investment, the

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<sup>26</sup> *Liang'an Jingmao Tongxun*, July, 1997, p.35

<sup>27</sup> For a detailed discussion of Wang's case, see Leng, 1996.

<sup>28</sup> *Wen Wei Bao*, May 17, 1996.

mother company only contributes US\$ 400 million, or approximately 14 percent of the total. Formosa's overseas subsidiaries will play the major role of the investors. International banks, including Japan's Mitsubishi and Sumitomo and several German banks, have expressed their interest in loaning more than 2 billion US dollars.<sup>29</sup> In other words, major financial support has been from international, rather than domestic, sources. According to the reviewing rules of the Economic Screening Committee, Taiwanese companies' foreign subsidiaries can freely invest in mainland China without reporting to the government if the mother companies' stock share does not exceed 20 percent. In the Formosa case, the mother company holds only 10.6 percent of the stock.<sup>30</sup> In other words, in legal terms, the government would find it difficult to block Y.C. Wang's mainland project.

Although Wang finally submitted the investment project to the government for review, he himself withdrew the proposal afterwards under the pressure of the MOEA. However, as in the Haicang case, this project has not come to a stop; Wang has made it clear that the Zhangzhou project will not be used to "support the bandit", claiming that he intends to support more Taiwanese companies in mainland China, import more equipment from Taiwan, and enhance Taiwan's international competitiveness through economic division of labor with mainland China. He has stated that he will wait for "no more than one year" for a government response.<sup>31</sup>

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<sup>29</sup> *Zhongguo Shibao*, July 9, 1996.

<sup>30</sup> *Zili Zaobao*, May 29, 1996.

<sup>31</sup> *Zhongguo Shibao*, April 10, 1997.



## **The Taiwanese Business Community in Mainland China -- Interactions with Host Countries**

As indicated earlier, the main concern of Taiwan's policy regarding investment in mainland China is that the Taiwan business community may become a "political hostage" if cross-Strait relations grow more tense. However, Taiwan business people have gradually developed their own strategies of survival, forming a relationship of coexistence with local governments, and thus protecting their economic interests and maintaining their autonomy in doing business in the mainland.

Mainland China's basic policy has been to separate political differences from economic interactions, and to utilize economic benefits to promote more political openness. After the mainland's missile tests of 1995, the confidence of Taiwanese investors significantly decreased. According to an opinion poll of Taiwan business people conducted at the end of 1995, 72.36 percent of the respondents agreed that conflicts in the Taiwan Straits would influence their confidence in investment, and 84.1 percent agreed that such conflicts would increase the political risks of investment.<sup>32</sup> Some reports even indicated that mainland China tended to block Taiwanese investors' attempts to withdraw capital from mainland China; legal and commercial disputes were also on the rise.<sup>33</sup>

Under such a situation, the Chinese central government attempted to appease the Taiwan business community. Beijing has stressed that the missile tests were aimed at discouraging efforts to create "two Chinas" and not ordinary Taiwanese. Jiang Zemin also emphasized that political disputes should not interfere with economic cooperation. Regardless of the political situation, the Chinese government has pledged to do its best to

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<sup>32</sup> *Mingbao*, December 31, 1995.

protect the legal rights of Taiwanese businessmen.<sup>34</sup> Moreover, after the Taiwan Straits Crisis of 1996, the State Council's Taiwan Affairs Office decided to provide big Taiwanese enterprises with more preferential treatment and expedite the reviewing process. Attracting Taiwan's top 100 companies to invest on mainland China has been linked with "attacking the Taiwan independence attempts of the Taiwanese government".<sup>35</sup> The ultimate goal of the Chinese government is to continue to attract Taiwanese investment, and to use such relationship as leverage to influence Taiwan's policy-making toward mainland China. The Taiwanese business community in mainland China thus becomes the core of mainland China's united front strategy.

In reality, the Taiwan community has gradually become an integral part of the mainland's local development. In contrast to foreign direct investment from Japan, US, and other advanced countries, Taiwanese (as well as Hong Kong) business people share the same cultural, ethnic, and linguistic background with host areas. This cultural advantage makes it easier for them to merge with local interests. Since most Taiwanese investment in mainland China has been in labor-intensive industries, 30,000 Taiwanese companies have created millions of job opportunities for locals. Some Taiwanese factories have recruited thousands of employees from various provinces, and serve as centers of manufacturing, recreation, and even education. In other words, Taiwanese investments have not just brought capital and technology to the mainland. They have created a social network closely connected with the prosperity of China's coastal areas.

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<sup>33</sup> *Lien He Bao*, September 11, 1995.

<sup>34</sup> *Renmin Ribao*, August 30, 1996.

<sup>35</sup> *Lien He Bao*, June 11, 1996.

The Taiwan business community has also developed a relationship of coexistence with local mainland officials. As Taiwanese investment has contributed to local prosperity, and thus enhanced the power of local officials, the latter have offered necessary services to Taiwanese investors. Local Taiwan Affairs Offices have maintained close ties with individual enterprises, but their relationships are far from confrontational; these offices are well-organized, and report to parallel CCP units. Below the State Council and provincial governments, each county has its own Taiwan Affairs Office, and maintains close horizontal connections with other such offices. Taiwan business people have been reluctant to cooperate with Taiwan Affairs Office officials, but they have not been shy in bringing criticisms to their attention. Most of these criticisms concern the Chinese Customs Service and unreasonable local taxes. Nevertheless, the business community has spent much of its energy to develop good *guanxi* (relationships) with local officials in order to enable their business to run smoothly. Both local governments and Taiwan businessmen pay only lip service to certain executive orders from the Central Government. For instance, the “five-day work week” order has not been fully respected by local authorities, as factory workers have requested work on Saturday in order to earn more money. Factory owners have acceded to “public opinion”, and local governments have not objected to this arrangement.

The Taiwan business community has also organized collective power to protect its rights in mainland China. By the end of 1996, there were forty-three “Taiwan Business Associations” in mainland China. The Dongguan Taiwan Business Association is an example: in 1993 there were only 360 member companies, but by the end of 1996, it included 1403 members. The main goals of the Association are to “protect legal rights, take care of the living, improve the investment environment, and maintain the good

image” of Taiwan business people.<sup>36</sup> Leaders of local Taiwan Business Associations regularly return to Taiwan and attend seminars organized by the government. During the Taiwan Straits crisis in 1995, they suggested the Taiwan government to restrain itself and open up direct trade, postal, and communication links with mainland China.<sup>37</sup> In addition, during an annual trip to mainland China, Taiwan’s Chinese National Federation of Industries (CNFI) submitted a proposal to Jiang Zemin which suggested that the mainland should postpone political controversies and protect the legal rights of Taiwan business people.<sup>38</sup>

However, the collective bargaining power of the Taiwanese business community should not be exaggerated. The operation of the Taiwanese Business Associations are closely supervised by local Taiwan Affairs Offices, which always “recommend” deputy directors as their representatives. Furthermore, forming a nation-wide Association of Taiwanese Business has also been blocked by the Chinese central government, which intends to develop the Association as an intermediary to control the Taiwan business community. Horizontal linkage among these associations and any attempt to form a pressure group to challenge the central authorities are not allowed.

Another factor which may affect Taiwan business people’s bargaining power is competition from advanced countries’ multi-national corporations. The decrease of competitiveness of Taiwan firms as compared to MNCs has been associated with the adjustment of mainland China’s foreign trade policies. In mid-1996, mainland China decided to reduce tariffs from an average of 35.9 percent to 22 percent. At the same time,

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<sup>36</sup> An interview with Mr. Hong-teng Yeh , President of the Dongguan Taiwan Business Association, on December 5, 1996.

<sup>37</sup> *Lien He Bao*, February 28, 1996.

China also canceled some preferential treatment to foreign enterprises such as export tax deductions and tax-free import of equipment. Among the tariff reduction items, mineral, chemical and textile materials enjoyed a reduction of 45 percent, as well as some high-tech products such as integrated circuit and computer key parts. These are the items which American and Japanese multi-national corporations export to China; hence, they have enjoyed the largest benefit. In contrast, the major Taiwanese exports to China are mechanical instruments, plastic products, and other intermediate products. These items enjoy less benefits under China's tariff reductions.<sup>39</sup> Since the majority of Taiwan's exports to China support Taiwanese companies' investments, the operating costs of these companies are relatively higher compared to other advanced countries.

Mainland China's policy of attracting foreign direct investment is also in transition. Since 1994, China's policy of attracting foreign direct investment has gradually shifted from being "location oriented" to "industry oriented". Preferential treatments solely for coastal special economic zones (SEZs) are gradually being replaced by other policies which boost strategic industries such as infrastructure, bio-chemicals, and advanced electronics. Labor intensive industries are no longer mainland favorites. Service sectors such as banking, trading, and insurance which Euro-American and Japanese companies specialize in are especially welcomed.

These new policies have placed Taiwanese firms conducting labor-intensive manufacturing industries under great pressure from MNCs. In other words, Taiwanese enterprises have to compete with MNCs in areas which Taiwan does not have obvious comparative advantages. Take Shanghai, for example: after Deng Xiaoping's "southern

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<sup>38</sup> *Lien He Bao*, August 29, 1996.

tour” in 1992, Shanghai finally regained its position as the “locomotive” for the mainland’s economic development. Shanghai’s development strategy also reflects China’s ambition of attracting more high-tech industries and service sectors in preparing for the next century. MNCs invest in Shanghai in order to enter the huge domestic market and utilize high-quality human resources. However, in Shanghai, Taiwanese investments are relatively small. According to statistics, in June 1996, Taiwan was the sixth largest investor in Shanghai, next to Hong Kong, Japan, the US, Great Britain and Singapore. Taiwan’s investment amount consisted of only 4.85 percent of Shanghai’s total foreign direct investment. In the national sphere, Taiwan ranks number two, next only to Hong Kong in the investment value.<sup>40</sup> In Shanghai’s domestic market, Taiwanese firms find it difficult to compete with the large-scale marketing campaigns from MNCs such as Coca Cola and Sony.

Instead of competing with MNCs, some Taiwanese enterprises have begun to form “strategic alliances” with foreign firms to develop the mainland market. These joint ventures focus on the mainland’s domestic market, rather than utilizing mainland China as a base for processing export goods.<sup>41</sup> MNCs provide capital and technology to the joint venture, and the Taiwanese partners use their cultural and language advantages to establish manufacturing centers and market networks. A recent case is the alliance between Taiwan’s Mitac Group and IBM. After buying a unprofitable mainland computer company, Mitac sought an alliance with IBM to make and sell personal computers in

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<sup>39</sup> *Zili Zaobao*, April 22, 1996.

<sup>40</sup> *Gongshang Shibao*, August 19, 1996.

<sup>41</sup> Fongshuo Yang, “*Taishang qiye yun yong guoji tseluei lianmeng qianjin dalu shichang zhi fenxi*” (An Analysis of Taiwanese Strategic Alliances in the Mainland Market), *Jingji qingshi ji pinglun* (Economic Situation and Analysis), November, 1996, p. 62.

mainland China. IBM provides advanced technologies and key parts to Mitac, and its brand name is also a powerful vehicle to boost domestic sales. Through this strategic alliance, IBM products have entered the mainland market, and Mitac has gained more protection of its investment in mainland China. This trend of international strategic alliances is on the rise, as some MNCs have established the so-called “Greater China Center” in either Hong Kong or Taiwan, and sought partners to invest in mainland China.

### **Conclusion: State Versus Market in Cross-Strait Economic Relations**

International-oriented firms have been a major challenge to Taiwan’s constraining economic policies toward mainland China, as regulative policies do not have substantial binding effects on these firms. For Taiwanese enterprises in mainland China, what really counts is the attitude of local mainland officials, the local investment environment, and macro-economic policies. Taiwan’s regulative policies may influence the political risk assessment of large enterprises in the short term, but they may also open new rounds of state-business bargaining for more liberal policies in the medium and long run. National security is Taipei’s main concern, but Taiwan’s active business community has blurred the line between economic and political concerns.

In contrast to the success of state intervention in promoting export-oriented growth in the 60s and 70s, Taiwan’s cross-Strait economic policy is in fact a “market constraint” policy. This policy aims at reversing market mechanisms and the international trend of developing the emerging mainland China market. Compared to the “market augmentation” policy in the economic take-off period of 60s and 70s, this market policy needs even closer cooperation from the business community. However, as the preceding analysis shows, the internationalization of market and enterprise operations has made it

more difficult for the state to control capital flows and investment activities. It is the international market, not the incompetence of the state, that has created the gap between governmental policies and investment behavior.

Thus, the state must replace its negative policies with more positive ones in order to adjust to the trend of internationalization. The best way to fight the challenge is to become more international; if the state helps Taiwanese firms to enhance their competitiveness in the international capital market and operate their businesses through various strategic alliances with international firms, Taiwan will not have to worry about possible mainland economic sanctions. As internationalization deepens, sanctioning Taiwanese firms would mean sanctioning all related parties in the world. This internationalization strategy would therefore increase economic efficiency and national security at the same time.

Currently two major policies are being carried out by the Taiwan government to expedite the speed of internationalization. The first is to increase domestic investment on high-tech industries. This is based on the hope that Taiwan can create a “vertical division of labor” in internationalization, and thus keep capital-intensive industries and R & D sectors on domestic soil. If this is realized, Taiwan does not need to worry about the “hollowing out” effect of manufacturing industries. Moving out of labor-intensive industries to mainland China and Southeast Asian countries will be a natural trend under the framework of the vertical division of labor. The second attempt of internationalization would be to build Taiwan as an “Asia-Pacific Regional Operations Center (APROC)”; that is, to establish Taiwan as a specialized regional center for manufacturing, sea and air transportation, financial services, telecommunications, and media enterprises. To implement this plan, thousands of economic regulations need to be revised, the



infrastructure must be improved, and “three links” with mainland China must be realized. Hence, the APROC plan is playing the role of catalyst to promote internationalization. Both industrial upgrading and the APROC require strong governmental support and state intervention. This kind of intervention is a more positive way to introduce international factors to enhance Taiwan’s international economic competitiveness.

The ascendance of the business community in cross-Strait relations also poses a major challenge to the realist perspective of economic statecraft. Although the “spill-over effect” of economic interaction in solving political disputes should not be exaggerated, the Taiwan business community has utilized its economic resources to develop strategies of survival as cross-Strait relations has encountered difficulties. Equipped with skills in international marketing and financial management, Taiwanese firms have gained bargaining power with both sides of the Taiwan Straits. Solving economic issues, such as improving the investment environment and protecting business interests, may serve as a bridge to open new rounds of direct talks between Taiwan and mainland China. Compared to foreign MNCs, Taiwanese firms have a better chance to penetrate into the local socio-economic network, and then become an integral part of China’s economic development. If this scenario materializes, cutting Taiwanese investment would mean a halt to the mainland’s continuous domestic development. From a more positive perspective, since the state will be unable to reverse market forces, it should go along with them and improve efficiency and further develop the mainland market. After a careful calculation of the international economic situation and the importance of mainland projects in Taiwan’s global investment strategies, investing in mainland China could provide more, rather than less, of a guarantee for Taiwan’s national security.



**Table 1 Taiwan's Economic Dependence on Mainland China**♣ Units: Percentage  
U.S.

Year	Values of Taiwan's Exports to Mainland China	Shares of Exports to Mainland China in Taiwan's Total Exports
1987	\$1,226.50	2.28
1988	\$2,242.20	3.70
1989	\$3,331.90	5.03
1990	\$4,394.60	6.54
1991	\$7,493.50	9.84
1992	\$10,547.60	12.95
1993	\$13,993.10	16.47
1994	\$16,022.50	17.22
1995	\$19,433.80	17.40
1996	\$20,727.30	17.87
1997	\$22,460.30	18.39

◆ Sources: *Liangan Jingji Tongji Yuebao (Monthly Report of Cross-Straits Economic Statistics)*, Taipei, Mainland Affairs Council, February 1997, P.24 & 26; *Jin Chukou Tongji Yuebao (Monthly Statistics of Exports and Imports, Taiwan Area, R.O.C.)*, Taipei, Ministry of Finance, February 28, 1998, p. 10.

**Table 2 Taiwan's Trade Surplus with Mainland China in Its Total Trade Surplus**

♣ Units: US \$millions

Year	Taiwan's Trade Surplus with Mainland China	Taiwan's International Trade Surplus	Percentage
1990	\$3,629.20	\$12,495.20	29.04%
1991	\$6,367.60	\$13,299.10	47.88%
1992	\$9,428.60	\$9,479.30	99.47%
1993	\$12,889.50	\$7,869.80	\$163.78%
1994	\$14,163.80	\$7,697.20	\$184.01%
1995	\$16,342.40	\$8,116.30	\$201.35%
1996	\$17,667.50	\$14,704.40	\$120.35%
1997	\$18,540.00	\$7,672.30	\$241.65%

◆ Sources: *Liangan Jingji Tongji Yuebao (Monthly Report of Cross-Straits Economic Statistics)*, Taipei, Mainland Affairs Council, February, 1997, P.25; *Jin Chukou Tongji Yuebao (Monthly Statistics of Exports and Imports, Taiwan Area, R.O.C.)*, Taipei, Ministry of Finance, February 28, 1998, p. 10.

**Table 3 Investment Projects Approved by Taiwan and Mainland China**

\* Units: US \$millions

Year	Approved by Taiwan		Approved by Mainland China	
	No. of Projects	Amount	No. of Projects	Amount
1991	237	\$174.16	3,377	\$2,710.00
1992	264	\$246.99	6,430	\$5,543.00
1993	9,329	\$3,168.41	10,948	\$9,965.00
1994	934	\$962.21	6,247	\$5,395.00
1995	490	1,092.71	4,778	\$5,777.00
1996	383	\$1,229.24	3,200	\$7,100.00
1997	728	\$1,610.00	---	

◆Source: *Liang'an Jingji Tongji Yuebao (Monthly Report of Cross-Straits Economic Statistics)*, Taipei, Mainland Affairs Council, February, 1997, P.28; Mainland Affairs Council Data, February 28, 1998.