

# **Taiwan's Investment Policy in Mainland China**

## **A Domestic Perspective**

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### **INTRODUCTION**

In recent years, the political tensions between the ROC and the PRC have complicated economic communication across the Taiwan strait. Taiwan's over-dependence on trade and investment in mainland China has made it vulnerable to Beijing's economic sanctions and military threats. As a result, whenever cross-Strait relations deteriorate, Taipei always worries about Beijing's utilization of economic sanctions to endanger Taiwan's economic development. Moreover, it is worth noting that Taiwan's investment increase in mainland China will also likely result in great amounts of trade flow across the Strait, especially Taiwanese exports to mainland China. In this sense, trade and investment are becoming issues which cannot be separated by decision-makers in Taiwan. Thus, from Taipei's point of view, economic and political factors are indeed intermingled in the development of cross-Strait relations, while Beijing insists these two factors can be dealt with separately. Above all, among those political factors, the issue of national security is of the deepest concern to Taipei's decision-makers.

From the perspective of international political economy, politics and the economy are indeed interactive. With an analytical framework of political and economic interaction, or a competition between state and market, this paper assumes that the interaction of political and economic factors might have some impact on Taiwan's investment policy in mainland China. While Taiwan government has insisted on its role in guiding its investment policy in mainland China, it has gradually encountered opposition from society. Thus, the interaction of politics and economics has always been a hot issue in Taiwan's development of its investment policy towards mainland China since 1990. This paper attempts to analyze the four distinctive stages of Taiwan's investment in mainland China: liberal market policy, the Southward policy, the Asia-Pacific Regional Operations Center (APROC) and the "Jie Je Yong Ren" policy. The paper then examines how

politics interacts with economics in each stage. Some implications will be discussed in the conclusion.

### **POLITICAL AND ECONOMIC INTERACTION**

Theoretically, the interaction of politics and economics in international economy can be examined through two different perspectives: the liberal and the economic nationalist perspectives. Liberal economic theory is dedicated to free markets and minimal state intervention. It also argues that markets should be free from political interference. In essence, liberals believe that trade and economic communication are sources of peaceful relations among nations because the mutual benefits of trade and expanding interdependence among national economies tend to foster cooperative relations.<sup>1</sup>

Economic nationalism advocates the primacy of politics over economics. It asserts that economic activities should be subordinate to the interests of the state. Benjamin Cohen thus views foreign economic policy as part of a country's total foreign policy.<sup>2</sup> Economic nationalism also focuses on the state as the predominant actor in international relations and as an instrument of economic development. This perspective stresses the importance of security and national interests of a country in conducting a country's foreign economic relations. In this sense, states tend to influence markets for their own interests.<sup>3</sup>

This paper argues for the importance of the coexistence and mutual interaction of the state and the market. Neither the state nor the market can be used alone in explaining international political economy, and their relationship is interactive. Although the state as the embodiment of politics and the market as the embodiment of economics are distinctive features of the modern world, they obviously cannot be totally separated. Internationally, the tendency of a government is to restrict and make economic activities serve the perceived national interests of the state. As a result, although the logic of the market is to locate economic activities where they are most productive and profitable, the logic of the state is to control the process of economic growth and capital accumulation, or to regulate those economic activities that might endanger a country's national interests. The political economy thus represents a dynamic interaction in international economic relations.

The increasing role of the state in economic affairs is a key component in the study of domestic and international political economy. All the successful East

Asian countries, such as Japan, the four little dragons, and the PRC, have been marked by strong states committed to developmentalist policies. According to Alexander Gerschenkron's study, the state generally has to play a much stronger role in late-developing countries (e.g. the East Asian countries).<sup>4</sup> Additionally, in his analysis of statism, Edwin A. Winckler focuses on the autonomy and activism of state institutions and the extent to which they influence socioeconomic processes. He then concludes that national development requires state intervention in both market processes and mass mobilization.<sup>5</sup> The effectiveness of state action is rooted in its overall relationship to the rest of society. In this sense, no state allows the full and unregulated development of market forces.

Economic growth in Taiwan has been rapid and continuous over the past four decades. The role of the government of Taiwan has contributed to the economy's extraordinary growth rates and the emergence of its economic miracles. Taiwan is clearly a society in which state control of the economy is extensive and entrenched. Several structural transformations in Taiwan's society have been the direct result of government decisions and policies. During the liberalization of the late fifties and early sixties, Taiwan switched from a policy of import-substitution to one of export-led growth, based on labor-intensive industries, and then to more capital-intensive, heavy, and high-technology industry. In the 1960s and 1970s, government-owned firms dominated the major industrial sectors such as steel production, shipbuilding, engineering, chemical and petroleum processing, and the development of semiconductors.<sup>6</sup> Indeed, Taiwan is a case which demonstrates the reciprocal interaction between the structures of the state apparatus and the process of economic growth. The character of the state has certainly been changed by the form of economic development that has occurred.<sup>7</sup> For Taiwan, state policy has created a broad economic environment in which entrepreneurial activity can flourish. It has also transformed that environment periodically as Taiwan's comparative advantage in the global economy has changed.<sup>8</sup>

The policy reorientation undertaken by Taiwan in the second half of the 1980s and 1990s was largely driven by external forces. The past patterns of state intervention and macroeconomic management were no longer sustainable because of the profound changes taking place in Taiwan's external economic environment and their elevated economic position in the international division of labor. The changes in the global trade and finance regimes exerted the most direct pressures on Taiwan for liberalizing its economy. Nonetheless, in Taiwan, the movement

toward economic liberalism was checked by a legacy of state activism, yielding both continuity and discontinuity. However, the economic rationale for state intervention and the approach to macroeconomic management and sectorial guidance changed, but the initial objectives that state policies addressed and, more importantly, the centrality of the state in the process of economic restructuring, remained.<sup>9</sup> This historical legacy has thus set up the environment for the development of cross-Strait economic relations since 1987.

### **LIBERAL MARKET POLICY**

Although Taiwan government has repeatedly reiterated its policy of “no contact, no negotiation, and no compromise,” the restrictions on cross-Strait civilian contacts, particularly cultural and economic ties, have been gradually relaxed to meet reality. In 1984, Taiwan lifted restrictions on exports to mainland China through Hong Kong and Macao, opening trans-shipment trade between the two sides. Three principles were issued in July 1985 regarding the mainland policy: no direct trade with the mainland, no contacts between Taiwan businessmen and Beijing officials, and no interference in trans-shipment trade. However, in 1987, a new policy marked a major breakthrough by opening an indirect import of twenty-nine agricultural and industrial raw materials from the mainland in August, while in November Taiwanese citizens were allowed to visit relatives on the mainland. The Taiwan government began to consider the economy as the major factor in opening cross-Strait relations.

In order to legalize cross-Strait relations, in May 1989 the Justice Ministry started to draft regulations governing the relations between people on the two sides. On November 1, 1990, the Executive Yuan approved the “Statute for People-to-People Relations Between the Mainland Area and Taiwan Area.” Based on the act, the Ministry of Economic Affairs promulgated two measures: one for regulating indirect exports to the mainland, the other governing investment and technological cooperation with the mainland. The three premises for these regulations and measures are 1) balancing national security and economic profit, 2) indirect trade, and 3) government approval. In 1991, the four-decade-long ban on Taiwanese investment in mainland China was eased. According to “Regulations Governing Investments and Technical Cooperation with Mainland China,” in 1993, investment in mainland China must be conducted indirectly through the following four channels: 1) through a branch of a Taiwan company

established in a third country; 2) through investment in another company located in a third country; 3) through a company in a territory outside mainland China; 4) through indirect remittance.<sup>10</sup>

From the liberal perspective, Taiwan's investment in mainland China is based primarily on comparative economic advantages. Taiwanese enterprises regard mainland China's cheap and abundant labor, vast land, huge domestic market, and strong engineering and technological capacity in selected industries as complementary to Taiwan's abundant capital, manufacturing experience, management skills, and some research and development capacity. This economic integration, based largely on a vertical division of labor, can encourage industries in mainland China to concentrate on low value-added manufacturing while allowing Taiwan to accelerate industrial upgrading. Also, Taiwan's small and medium-sized firms investing in mainland China can use their well-established production and marketing networks to help similar firms in mainland China enter the international market. These kinds of economic ventures have generally been viewed by the government and businesses in Taiwan as win-win or mutually beneficial situations.

Immediately after 1987, Taiwanese investment in mainland China arose in a completely unregulated way. Taipei has claimed that Beijing's promotion of economic ties with Taiwan is politically motivated, and that such ties are inseparable from political considerations. The ROC government eventually realized that it must acquire accurate information concerning Taiwan's investment projects on the mainland. In order to do so, it abandoned its principle of no direct investment but no interference with indirect investment, and the government began to impose some order on indirect investment in mainland China. The MOEA issued the "Methods of Control over Investment in and Technological Cooperation with the Mainland" in October 1990. According to these methods and the "Methods of Control over Cross-Strait Indirect Investment," the MOEA issued a list of products in whose production on the mainland Taiwanese manufacturers were permitted to invest indirectly.

The products on this list were first selected by the MOEA's Industrial Development Bureau because they are either 1) raw materials necessary for Taiwan's industrial development, in abundant supply on the mainland; 2) produced by labor-intensive methods; 3) commodities with a relatively low degree of inter-industry interdependence; 4) their production in Taiwan is relatively disadvantageous. As a result, 2,875 items, or 41 percent of the total, were selected

from the Customs Import Tariff and Classification of Imported and Exported Commodities.<sup>11</sup> The list was later revised by the MOEA's Industrial Consultation Committee. The revised list included a number of new items, though it excluded products which were likely to jeopardize national security, damage Taiwan's economic development, or belonged to the category of high-technology restricted products. Finally, the MOEA approved a list of 3,353 items (about 47 percent of all Taiwanese products), most of which are products of traditional, labor-intensive industries.<sup>12</sup> Taipei's decision to open the door to indirect investment on the mainland for manufacturers of nearly half of Taiwan's products may indeed have had the effect of speeding up the movement of these industries to the mainland.

The ROC government has repeatedly emphasized that, in formulating its investment and trade policy toward the mainland, it must give due attention to political implications. However, the new regulations governing indirect investment seem to separate economics from politics. Consequently, trade and investment across the Strait thus increased tremendously. According to the ROC Ministry of Economic Affairs, by 1991 237 Taiwan businesses had a total of US \$174 million in direct mainland investment. This amount increased in 1992 to US\$246.99 million. Taiwan's investment in mainland China amazingly rose to 9,329 cases in 1993 totaling US \$3,168 million, an historic high in Taiwan's investment in mainland China. These official figures, however, were probably significantly lower than what existed in reality. The difference in numbers is primarily due to the sensitive political relationship between Taiwan and mainland China. Most Taiwanese firms are still wary of publicizing their investment activities on the mainland. As a result, according to Beijing's statistics, the amount of Taiwan's contracted investment in mainland China already was US\$5,543 million in 1992 and US\$9,965 million in 1993.<sup>13</sup> The vast difference can thus be identified.

### **THE SOUTHWARD POLICY**

The rapid increase of Taiwan's trade and investment in mainland China gave Taipei a warning signal. The primary argument against investing in mainland China was that too much trade with, and investment on mainland China was risky due to the latter's potentially unstable domestic policy and tough political position on Taiwan's international status. Related to this argument were the lack of legal protection for investments in mainland China and isolated instances in which Taiwanese businessmen and their factories on the mainland were robbed by local

bandits. Another disadvantage is that heavy manufacturing investment in the mainland may lead to deindustrialization in Taiwan, the so-called "hollowing out". Moreover, investment in mainland China may make Taiwan's economy too dependent on mainland China's market, which might endanger Taiwan's economic development if Beijing takes military threats or implements economic sanction against Taiwan. The most commonly used evidence in support of this market dependency is that Taiwan's trade with mainland China, as a share of its total trade had grown too fast, from 1.5% in 1986 to 9.3% in 1993, and to 11% in 1996.<sup>14</sup> The ROC government has expressed concern about this trend not so much for political reasons but for the enormous financial risk. There are too many unknowns in the future development of the mainland, where two-digit economic growth has been accompanied by hyperinflation. And there are still insufficient infrastructures and services to support further development.

With both political and economic speculation in mind in 1993, the ROC government implemented a Southward policy to divert part of the mainland-bound investment to some Southeast Asian countries where investment conditions are just as favorable for Taiwan investors as in mainland China. The Southeast Asian countries, owing to their geographical proximity to Taiwan, abundance of natural resources, plentiful labor supply, relatively cheap land, and great potential for economic development in the future, have become the most suitable places for attracting Taiwanese investment. Accompanying this trend is the introduction in some Southeast Asian countries of policies to promote foreign investment and economic liberalization. All of these factors have gradually made this region a potential market for Taiwan's foreign trade and investment.

In addition to the complementarity between Taiwanese and Southeast Asian economies, Taipei sees less political risk in developing close economic ties with these countries as they have more compatible ideologies and political systems. Furthermore, countries such as Indonesia, the Philippines, and Vietnam are potentially large markets because of their sizable populations and growth momentum although Southeast Asia is a much smaller market than mainland China. Taiwanese enterprises are also attracted to Southeast Asia because they have a much longer history of investing in the region and greater familiarity with its business environment.<sup>15</sup>

From the liberal perspective, two factors have contributed to the rapid increase in investment and bilateral trade between Taiwan and Southeast Asian countries. First, Southeast Asian countries are traditional suppliers of raw

materials to Taiwan's industries, including minerals and forestry products. Secondly, Southeast Asia has become an important region for Taiwanese investments since 1985, resulting in the demand for capital and semi-manufactured goods from Taiwan. Thus, despite the absence of diplomatic relations between Taiwan and ASEAN countries, the Taiwanese government has secured a number of bilateral agreements with them to protect Taiwanese investments.<sup>16</sup>

As Taiwan has no diplomatic relations with any country in Southeast Asia, it is wise politically to improve all forms of links with countries in the region. From past experience, Taiwan knows this can only be done through gradual steps, starting with less contentious issues (such as economic and cultural ones) and then moving on to political contacts. The signing of many trade and investment agreements with Southeast Asian countries, which are based upon a formal bilateral understanding, is a move in that direction. In the absence of diplomatic relations with countries in Southeast Asia, the Taiwan government has established a network of commercial and semi-governmental organizations, such as economic representative offices, to promote its political and economic interests. Two trips, one by President Lee Teng-hui and another by Premier Lien Chan to Southeast Asian countries in 1994, were clear evidence of Taiwan's intention to facilitate bilateral economic cooperation with Indonesia, Malaysia, the Philippines, Thailand, and Vietnam.

Prior to 1993, the trade volume between Taiwan and the ASEAN members had generally increased. From Table 1, it is clear that the growth rate of Taiwan's trade with ASEAN members was quite extraordinary in 1990. In that year, Taiwan maintained a double-digit trade growth rate with those countries, except with the Philippines, which only had a 3 % trade growth rate with Taiwan. It is also worth noting that the trade volume with Vietnam also had a 186 percent growth rate. From 1991 to 1993, Taiwan's trade growth rate with those ASEAN countries generally decreased somewhat. One reason in explaining this situation may be located in Taiwan's increasing trade flow with mainland China in the beginning of the 1990s. However, Taiwan's trade relations with Vietnam were still quite good, which can be observed from the growth rate of 63 percent in 1993.

However, at the start of 1994, the first year of Taiwan's initiation of the Southward policy, it can be seen that Taiwan's trade growth rate with Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam rose greatly. Table 1 again illustrates how each country's trade growth rate with Taiwan remained in



double-digits. In 1994, the growth rate of trade between Taiwan and Indonesia increased from the previous year's 11 percent to 22 percent. Taiwan's trade growth rate with Malaysia also increased from a previous 5 percent to 45 percent in 1994. This increased pattern can also be found in the cases of the Philippines, Singapore and Thailand. In other words, with the exception of Thailand, which merely accounted for less than twenty percent of Taiwan's trade with the other five ASEAN countries, that is, Indonesia, Malaysia, Singapore, Vietnam and the Philippines, all maintained a more than twenty percent growth rate. Thus, immediately after the initiation of the Southward Policy in 1994 and 1995, the volume of Taiwan's trade to ASEAN members increased dramatically. However, in 1996, Taiwan's trade with Indonesia, Singapore and Thailand had a negative growth rate, as illustrated by Table 1.

Prior to 1993, Taiwan's direct foreign investment in Southeast Asia was concentrated in Indonesia, Malaysia and Thailand. Taiwan's investment in Vietnam has increased greatly in recent years, although it only began in 1991. In that year, Taiwan only invested US \$17 million in Vietnam. Then, this amount increased to US \$158 million in 1993, larger than that of Thailand, Singapore, the Philippines, Malaysia and Indonesia. Compared to the trade flow between Taiwan and those Southeast Asian countries, Taiwan's investment in those countries did not have the same rise from 1993 to 1994 and 1995. In other words, an increased trend of Taiwan's trade flow to those countries appeared immediately after the initiation of the Southward policy, especially in 1994 and 1995. However, this increased pattern cannot be found in Taiwan's investment in those countries. From Table 2, almost all the countries, including Indonesia, Thailand and Vietnam, received less investment from Taiwan in 1994 compared to the previous year. Only Malaysia, the Philippines, and Singapore received much more investment from Taiwan in 1994 than in 1993. In 1995, Taiwan's investment amount in Malaysia, Singapore, Thailand and Vietnam was also less than that of 1994. Only in Indonesia and the Philippines was there a slight increase in Taiwan's investment. All these findings indicate that the Southward policy had had different impacts on Taiwan's trade and investment in individual Southeast Asian countries.

From the above analysis, in pursuit of both political and economic objectives in the region, Taiwan has successfully increased its trade relations with countries in the region. However, Taiwan's investment in the region does not actually reflect the influence of the Southward policy. One of the reasons which might explain this phenomenon is that Taiwan's businessmen have been much

more interested in investing in mainland China. Different investing environments, including language issues, customs, and geographical locations, might also contribute to the failure of attracting Taiwan's investment in the region. As a result, by May 1997, mainland China had received 35.38 percent of Taiwan's total foreign direct investment, while Malaysia and Thailand received only 6.41 percent and 3.39 percent respectively, and Vietnam, Indonesia and Singapore received less than 3 percent.<sup>17</sup>

**Table 1: The growth rate of Taiwan's trade flow in the region (%)**

	Indonesia	Malaysia	Philippines	Singapore	Thailand	Vietnam
1990	32	33	3	26	25	186
1991	13	36	3	7	9	96
1992	7	19	2	9	3	73
1993	11	5	5	13	14	63
1994	22	45	21	21	19	47
1995	13	12	35	27	28	34
1996	-4	11	22	-1	-2	16

Source: *Monthly Statistics of Exports and Imports: Taiwan Area, The Republic of China* (Taipei: The Department of Statistics, Ministry of Finance, June 1997), pp.15-21. Calculated by author.

Another reason for Taiwanese businessmen's reluctance to invest in some Southeast Asian countries may be due to political risk. A recent example is in the case of Cambodia. The political instability in Cambodia has endangered Taiwanese businessmen's safety in the country. Some businessmen were killed during the chaos in Cambodia in July 1997. Furthermore, the Taipei Economic and Cultural Representative Office in Cambodia, opened in September 1994, was also forced to shut down. This event has forced the Taiwanese government to consider the potential political risk of Taiwan's investing in the area, which obviously had not been taken into account by Taiwanese authorities before. This has again resulted in Taiwanese businessmen's hesitation to invest in Southeast Asian countries.

**Table 2: Taiwan's approved foreign investment by country  
(US\$ thousand)**

Year	Hong Kong	Indonesia	Mainland China	Malaysia	Philippines	Singapore	Thailand	Vietnam
1986	255	1,780	--	--	71	434	5,810	--
1987	1,283	950	--	5,831	2,640	1,301	5,366	--
1988	8,060	1,923	--	2,708	36,212	6,433	11,886	--
1989	10,372	311	--	158,646	66,312	5,209	51,604	--
1990	33,092	61,871	--	184,885	123,607	47,622	149,397	--
1991	199,630	160,341	174,158	442,011	1,315	12,540	86,430	17,139
1992	54,447	39,930	246,992	155,727	1,219	8,790	83,293	20,167
1993	161,918	25,531	3,168,411	64,542	6,536	69,473	109,165	158,396
1994	127,284	20,571	962,209	101,127	9,600	100,732	57,323	108,378
1995	99,555	32,067	1,092,713	67,302	35,724	31,649	51,210	108,146
1996	59,927	82,612	1,229,241	93,534	34,117	164,978	71,413	100,479

Source: Mainland Affairs Council, *Cross-Strait Economic Statistical Monthly*, Vol. 48-56 (August 1996 to April 1997).

Another weakness of the Southward policy is in the formulation of the policy itself. Originally, the primary purpose of the Southward policy was to prevent Taiwan's investors from being over-dependent on mainland China. In a comparison between Taiwan's investment in mainland China and Southeast Asian countries, it emerges that the average investment amount by Taiwan investors in mainland China is around US\$ 1 million. Most investments are in the manufacturing industry, which is labor-intensive. However, for those Taiwanese investors investing in Southeast Asian countries in recent years, the average amount is US \$6 million per case, which belongs to a more capital-intensive industry. In comparison, it can be seen that it is almost impossible to persuade Taiwan's investors in mainland China to transfer their investment to some Southeast Asian countries instead. In that respect the Southward policy has been a failure.<sup>18</sup>

### THE ASIA-PACIFIC REGIONAL OPERATIONS CENTER

With the intent of regional economic integration, the initial idea of the Asia-Pacific Regional Operations Center (APROC) began to be discussed in 1993. On January 5, 1995, the Taiwan government officially announced the formation of the APROC. This plan attempts to use Taiwan as a base to develop its economic relations with Asian-pacific countries. Within this regional economic integration, Taiwan intends to develop into a center for economic activities among these countries. One of the main reasons for developing the APROC was that Taiwan already had close trade relations with the region, proving that Taiwan was capable of becoming a regional operations center. Taiwan's growing investments, intensified trading relationships and economic partnerships within the region will also make Taiwan a key trading center.

According to the Council for Economic Planning and Development (OEPD), under the APROC Taiwan plans to set up six specialized operation centers in such areas as manufacturing, air transportation, telecommunication, sea shipment, media and banking.

- 1) Manufacturing: Taiwan should develop its manufacturing sector in the areas of technology, design, purchasing and processing.
- 2) Air transportation: In the short term, Chiang kai-shek International Airport would be used as a cargo transfer center to attract multinational corporations to set up regional transportation centers in Taiwan. Long term plans include developing Taiwan into a major transfer point for all commercial flights.
- 3) Telecommunications: By June 1995, telecommunications fees would be significantly lowered: by the end of 1995, regulations would be eased on the use of beepers, cellular phones and data communications. An additional 38,500 international telephone exchange circuits would be added and all cables would be converted to fiber optic by 1999.
- 4) Sea shipment: Harbor development will be simultaneous with urban development. Kaohsiung Harbor will become a shipping center and technological manufacturing once plans for direct shipping with mainland China are finalized.
- 5) Media: By the end of 1995, the Government Information Office planned to finalize plans for a media center to be located in Linkou, Kuando or Pali. The media center planned to focus on television, film and video

production, though print media has also been suggested.

- 6) Banking: According to the plan, citizens could look forward to better and more diverse financial services, especially in stocks and insurance. Taiwan may also provide loans internationally to make use of its financial resources.

According to the Taiwanese government, all of these six plans are intended to transform Taiwan into an Asia-Pacific regional operations center by the year 2000. Taiwan will carry out this plan in three stages; the first two being completed by 1997 and 2000. The main purpose of this three-stage plan is to develop Taiwan into a business operations hub in the Asia-Pacific region. The first stage is from 1995 to 1997, which emphasizes improving the domestic economic situation and developing the potential conditions for the plan. The second stage is planned from 1997 to 2000. The main mission in this stage is to achieve a comprehensively economic structural adjustment. The last stage is from 2000 onward. The primary goal in this phase is to stabilize Taiwan's role as the APROC based on economic liberalization.

Although these three different stages seek their individual distinctive goals, the underlying principle among them is indeed the same. In other words, to construct Taiwan as the Regional Center can also be illustrated as a process toward internationalization and liberalization. Hsu Li-teh, the vice prime minister, made a speech to the Executive Yuan in June 1996; he asked his fellows to respect market forces and to encourage the principles of fair and free market competition.<sup>19</sup> As a result, open international competition and liberalization have thus become the spirit behind the APROC, which truly reflect the principle of classical economic theory.

Many scholars and entrepreneurs in Taiwan argue that based on classical economic theory, the APROC must incorporate mainland China if its development is to be successful. In other words, if mainland China, which is one of the most important markets in the region, is excluded from this plan, this regional center will not materialize. However, some political factors still exist between Taipei and Beijing which make the three direct links impossible. From the critics' point of view, this would not only hinder economic communication across the Strait, but would also handicap the construction of APROC. As a result, they sought to enhance trade and investment across the Strait and eliminate any political obstacles encountered by Taipei and Beijing. This kind of thinking might not be

new, but it is somewhat different from the main thrust of the Southward policy, which was basically trying to avoid over-dependence on mainland China economically.

For APROC itself, it basically intends to break Taiwan's decades-old ban on direct links with the mainland by turning a section of the Kaohsiung port into an off-shore shipping center for cargo to and from the mainland. For Taipei, this is a flexible policy to break down the barriers caused by the ban on direct air and sea links between Taiwan and mainland China. Then, the Kaohsiung offshore shipping center would help develop the international shipping of containers and processed commodities in Taiwan. In order to facilitate a long-term business link with mainland China, the OEPD proposed that Taiwan should increase its cross-Strait trade and investment activities and ease its restrictions in the following ways: 1) Make public a list of items whose imports from the mainland are banned in indirect trading. 2) Expand the scope of cross-Strait investments, allowing investments on a registration basis if the invested values are within a regulated sum. 3) Ease restrictions on cross-Strait investments in the monetary market. 4) Ease exchange restrictions in trade and cultural representatives across the Strait.<sup>20</sup> The APROC's intention to enhance economic communication across the Strait is thus quite obvious.

However, while entrepreneurs are expecting to develop closer economic relations with mainland China at this moment, President Lee Teng-hui for the first time criticized the idea of the APROC in August 1996. He pointed out that the plan with its six sub-centers was too broad, almost designing a blue-print of Taiwan's economic development in the future. A small island like Taiwan cannot afford this huge project. According to President Lee, there should be some priorities in the development of such centers in Taiwan. In his opinion, the priority of Taiwan's future economic development must be focused on upgrading technology.

Furthermore, President Lee also criticized the construction of APROC's attempt to legitimize the "Westward policy", that is, to incorporate mainland China as an innerland of Taiwan's market and to enhance the economic relations between Taiwan and mainland China. He argued that the expectation to facilitate economic communication with mainland China had resulted in Taiwan's exerting a lot of effort in the study of problems concerning three direct links and trans-shipment: this would indirectly reduce Taiwan's international competitiveness. He thus in turn asked the government to pay more attention on how to improve the

domestic investment environment instead. Under this political instruction by President Lee, the concept of using mainland China as a potential market to construct APROC was forcibly withdrawn. In 1997, due to some political factors existing across the Strait and domestic political and economic reasons, the APROC is still only a utopia for the people in Taiwan.

### **THE JIE JE YONG REN POLICY**

After President Lee Teng-hui's visit to the United States in June 1995, Beijing started to conduct a series of military exercises near Taiwan. From July 21-26, Beijing launched missile tests near the East China Sea area; it then conducted a second wave of military exercises in the same region. In March 1996, Beijing again attempted to exert some influence on Taiwan's presidential election results. Towards this end, the PRC conducted another four waves of military exercises and missile tests towards Taiwan in the following months. These military actions not only deteriorated cross-Strait relations, but also had some impacts on Taiwan's domestic economy.

This political and economic interaction has not only complicated cross-Strait political relations, but has also had a negative impact on the development of both trade and investment across the Strait. With the experience of the role of the state in directing economic development, domestically and internationally, the "Jie Je Yong Ren" policy, announced by president Lee in September 1996, was another effort by the Taiwanese government to slow Taiwan's investment in mainland China. Accordingly, President Lee urged that the island avoid over-dependence on the mainland China as an investment outlet.<sup>21</sup> However, the result of the conflict between the state and the market is quite different from previous experiences. The KMT government is clearly unable to constrain Taiwan businessmen's investment in mainland China, especially for those small and medium-sized enterprises, mainly based upon the liberal market perspective. Although some larger enterprises are temporarily subjected to government regulation, no one can say how long these enterprises are going to wait patiently while direct foreign investment of other countries increases tremendously in mainland China. The confrontation of market and state now obviously becomes a tough task for the Taiwan government in conducting its cross-Strait economic relations.

The "Jie Je Yong Ren" is a policy intended to slow down Taiwan's over-dependence on mainland China in trade and investment. It asserts that Taiwan's

investors must be patient in determining their investments in mainland China because of some political and economic risks existing across the Strait. The legitimate goal of the “Jie Je Yong Ren” policy for Taipei is primarily based on national security considerations. The over-dependence of Taiwan’s trade and investment on mainland China, from the decision-makers’ point of view, has potentially endangered Taiwan’s economic development, particularly if Beijing nationalizes Taiwanese investors’ properties whenever cross-Strait relations deteriorate. As a result, Taipei attempts to use the “Jie Je Yong Ren” policy as a bargaining chip to negotiate with Beijing. Obviously, this policy violates the liberal perspective in dealing with cross-Strait economic relations. Although the role of the government has earned credit in guiding Taiwan’s economic development in the past, this trend is currently under a serious challenge by society. The investments of Taiwan’s small and medium-sized enterprises in mainland China, and those larger enterprises’ intention to follow, have all reflected the principle of a liberal market economy. This also reveals that traditional political authority and its intervention in market operations in Taiwan are all under the challenge of a pluralized society. The protests of entrepreneurs, such as Wang Yon-ching, Shi Chi-yu, Kao Ching-yun, and recently Chang Ron-fa, who are those key members in the KMT, all represent a serious protest to the government.

However, if the government intends to use politics to intervene in market operations and wishes it to be successful, then the government must first have enough reasons to convince people and then to legitimize its interference. Otherwise, the effectiveness of this intervention will not only be unattainable, but people will also lose their confidence in political authority. In short, the success or failure of the “Jie Je Yong Ren” policy is based on two concerns. The first is whether Taiwan’s businessmen and government have acted consistently towards political and economic issues in cross Strait relations. Second, since Taiwan government asks businessmen to slow down their investments in mainland China, are there any alternatives which can diversify the direction of their investment?

In general, economic development in mainland China cannot be undone, which can also be illustrated by the results of the China Communist Party’s 15<sup>th</sup> Congress in September 1997. In the eyes of most of Taiwan’s investors in mainland China, they do not believe that mainland China is willing to take any possible actions to nationalize or freeze their properties even under the possible deterioration of cross-Strait relations. For instance, during the PRC’s military



exercises near Taiwan in March and April, 1996, most Taiwan businessmen in Fujian and Guangdong were not worried about the security of their investments in mainland China.<sup>22</sup> Moreover, compared to other foreign investors in mainland China (including investors from Hong Kong and Macao), Taiwanese businessmen actually bear in mind long-term investment. This can be illustrated by their signing fifty-year' contracts regarding the rights to utilize the land, whereas other foreign investors rent only factories. Different perceptions of Taiwan's businessmen and government have thus resulted in businessmen's downplaying the "Jie Je Yong Ren" policy, while trying to avoid the regulations of the Ministry of Economic Affairs.

In order to persuade businessmen to follow the government's policy in slowing down investments in mainland China, Taipei also has kept encouraging investors to diversify their investments geographically. Two initiatives have been taken by the Taiwanese government. The first one is to improve the island's domestic investing environment, hoping to attract those businessmen staying in Taiwan. However, this initiative has not been fruitful. Although the Taiwan government has issued some policies attempting to improve the domestic investment environment, no concrete proposals or results have been completed. Political antagonism and the rejection of "three direct links" by the Taiwan government also discourage foreign investors from investing in Taiwan. Another important issue is the deterioration of social security in recent years. All of these factors thus seriously hamper the willingness of both Taiwan and foreign businessmen to invest in Taiwan.

The second initiative taken by Taipei is to diversify Taiwan's investment geographically, not to over-concentrate on mainland China, but spread to some other countries. The formation of the Southward policy is a good example. However, the ineffectiveness of the Southward policy reflects Taiwan businessmen's reluctance to invest in some Southeast Asian countries. For instance, Taipei has offered some foreign economic assistance (such as loans to Indonesia, Vietnam and the Philippines), to help them build industrial parks. The unwillingness of Taiwanese businessmen to move into these industrial parks marks the failure of the Southward policy. In addition to different cultural, linguistic and social customs, political risks may also appear as obstacles to Taiwan businessmen's investment in Southeast Asian countries.

In recent years, Taipei has enforced its economic diplomacy, endeavoring to return to the international community and to establish or facilitate diplomatic

relations with foreign countries. In addition to foreign economic assistance, Taipei and Beijing have added trade and investment to the recipient countries in order to supplement the inadequacy of foreign aid: South Africa and Panama are two examples. However, Taipei is unable to compete with Beijing, since Beijing has successfully mobilized its state-owned enterprises to support its economic diplomacy. It is still very difficult for Taipei to encourage local enterprises to go over to African or Latin American countries for investment. A lack of market incentives may be the main consideration. However, cultural and linguistic differences, political risks and geographical considerations are also factors contributing to Taiwan businessmen's reluctance to support the government's policy of pragmatic diplomacy. An inability to improve the domestic investing environment and the ineffectiveness of the Southward policy illustrates the dilemma for the Taiwanese government in diversifying its investment geographically.

The "Jie Je Yong Ren" policy represents another political and economic interaction in Taiwan's investment in mainland China. Although the government also intends to influence market development, it has encountered challenges from local enterprises. The confrontation between the state and the market has led to a series of debates. The situation has deteriorated recently, especially after Chang Ron-Fa, the chief of the Evergreen Group, asked the government to negotiate with Beijing on the issue of three direct links and easing the "Jie Je Yong Ren" policy. With the Taiwanese government's insistence on considering national security, the debate between the state and the market is expected to continue in the near future unless a political resolution across the Strait emerges.

## CONCLUSION

The interaction of politics and economics has complicated Taiwan's investment in mainland China. Do we need to put some pressure on Taiwan's investors and ask them to follow the "Jie Je Yong Ren" policy? Or can we just let them go, according to the principle of market liberalization? It is indeed very difficult to find an absolute solution. Again, it is also not easy to identify which perspective, state or market, is right or wrong. Although the conflictual situation between the government and the entrepreneurs will continue in the future, at least some of the myths relevant to this political and economic interaction across the

Strait must be cleared up. Hopefully, this might provide some implications for both political decision-makers and entrepreneurs in Taiwan.

Most people in Taiwan usually exaggerate the importance and the influence of Taiwan's investment on the economic development of mainland China. The government also endeavors to use this economic consideration as a bargaining chip for future negotiations with Beijing. However, can Taiwan's investments actually have a crucial impact on the overall economic development of mainland China? Since 1990, the total contracted amount of Taiwan's investment in mainland China, for the first time, ranked second place, next only to Hong Kong and Macao. But it only constituted 6 percent of all foreign investment in mainland China, in contrast to Hong Kong and Macao's 75 to 80 percent. An inference to this point is that, even if Taiwan's investment is totally withdrawn from mainland China, there are some doubts whether it will have a negative impact on mainland China's economic development. Moreover, it might be the case that some other foreign investments would immediately fill the gap after Taiwan's investments are withdrawn from mainland China. Thus, only from a political consideration is Taiwan's investment quite important to Beijing, under its emphasis of nationalism, anti-Taiwan independence and national unification. Consequently, for Taiwan investors, the "Jie Je Yong Ren" policy has only made them gradually lose market-share in mainland China and competitiveness in the international market.

From the above analysis, it can be realized that the "Jie Je Yong Ren" policy is important for the Taiwanese government in dealing with current cross-Strait political and economic relations. However, the Taiwan government needs to speculate on this policy from broader, more pragmatic perspectives. After Beijing and Taipei join the WTO, it can be expected that, under the open market and the principle of liberalization, not only will the "Jie Je Yong Ren" policy lose its momentum, but the three direct links will also never again be an issue in cross-Strait relations. At that moment, Taipei would totally lose its bargaining chip. In order to avoid this dilemma, Taipei may need to connect the "Jie Je Yong Ren" policy and three direct links issues with future cross-Strait negotiations. If Beijing makes some concessions to Taipei, such as ending antagonism and abandoning the willingness to use force against Taiwan, Taipei can then accordingly make an announcement to give up the "Jie Je Yong Ren" policy. Only in this situation can Taipei and Beijing develop truly supplementary and reciprocal relations in cross-Strait economic relations.

## Notes

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<sup>1</sup> Robert Gilpin, *The Political Economy of International Relations* (Princeton: Princeton University Press), pp.26-31.

<sup>2</sup> Benjamin J., Cohen, ed., *American Foreign Economic Policy: Essays and Comments* (New York: Harper and Row, 1968), p.32.

<sup>3</sup> Robert Gilpin, pp.46-47.

<sup>4</sup> Alexander Gerschenkron, *Economic Backwardness in Historical Perspective: A Book of Essays* (Cambridge: Harvard University Press, 1962), chapter 1.

<sup>5</sup> Edwin A. Winckler, "Globalist, Statist, and Network paradigms in East Asia," edited by Edwin A. Winckler and Susan Greenhalgh, *Contending Approaches to the Political Economy of Taiwan* (New York: An East Gate Book, 1988), p.275-276.

<sup>6</sup> Martin Staniland, *What Is Political Economy? A Study of Social Theory and Underdevelopment* (New Haven: Yale University Press, 1985), p.95.

<sup>7</sup> Chalmers Johnson, "Political Institutions and Economic Performance: The Government-Business Relationship in Japan, South Korea, and Taiwan," in *The Political Economy of the New Asian Industrialism*, edited by Frederic C. Deyo (Ithaca: Cornell University Press, 1987), pp.144-145.

<sup>8</sup> Cal Clark, *Taiwan's Development: Implications for Contending Political Economy Paradigms* (New York: Greenwood Press, 1989), p.209.

<sup>9</sup> Yun-Han Chu, "The East Asian NICs: A State-led Path to the developed World," in *Global Change, Regional Response: The New International Context of Development*, ed., Barbara Stallings (New York: Cambridge University Press, 1995), p.206.

<sup>10</sup> Tse-Kang Leng, *The Taiwan-China Connection: Democracy and Development Across the Taiwan Strait* (Boulder: Westview Press, 1996), p.107.

<sup>11</sup> Ching-chi jih-pao (*Economic Daily*), Taipei, July 27, 1990.

<sup>12</sup> Ching-chi jih-pao (*Economic Daily*), Taipei, September 2, 1990.

<sup>13</sup> Mainland Affairs Council, *Cross-Strait Economic Statistical Monthly*, no.58, June 1997, p.28.

<sup>14</sup> Mainland Affairs Council, p.26.

<sup>15</sup> Other conditions favoring going South include recent new incentives introduced by some Southeast Asian countries: both Indonesia and the Philippines in 1994 began to allow foreign companies to have 100% equity ownership, and to attract specific industries, the Philippine government offered Taiwan some of its textile and garment quotas for exports to the United States.

<sup>16</sup> Taiwan has signed such pacts with Singapore (1990), Indonesia (1995), the Philippines (1992), Malaysia (1993), and Vietnam (1993). A similar draft agreement of protecting investment was signed with Thailand in April 1996.<sup>16</sup> In addition, to ensure that the interests of Taiwanese investors are protected, Taiwan's Ministry of Finance is also working hard to secure double-taxation agreements with these countries.

<sup>17</sup> Mainland Affairs Council, p.31.

<sup>18</sup> Xingming Chen, "Taiwan Investments in China and Southeast Asia," Strategic Digest, Vol. XXVI, no. 12, December 1996, p.1743; Mainland Affairs Council, p.28.

<sup>19</sup> Hsu, Li-teh, "Respecting Market Function and Promoting Administrative Efficiency: Toward the Asia-Pacific Regional Operations Center," the OEPD, June 1996.

<sup>20</sup> China News, January 6, 1995, p.1.

<sup>21</sup> International Herald Tribune, August 19, 1996, p.11.

<sup>22</sup> The-chang Lin, Investment of the ROC's Small and Medium-sized Enterprises in Goungdong and Political and Economic Interaction across the Strait, Ministry of Economic Affairs, April 1997