

Preserving Taiwan's Political Status

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Abstract

Cross-strait relations between the People's Republic of China (PRC) and the Republic of China (Taiwan) have historically been tenuous. At present the PRC claims sovereignty over both mainland China and Taiwan; Taiwan pays lip service to a similar claim of a unified China, though the nature of Taiwanese claims to mainland China is likely in response to political pressures exerted by the Beijing government than any internal desire for assimilation. At home, Taiwanese politics are dominated by the Pan-Blue and Pan-Green coalitions, with the former in favour of stronger political and cultural links with the mainland government and the latter in favour of independence. Until a consensus can be reached among the Taiwanese people, it is the responsibility of the Taiwanese government to ensure their political identity is one of their own making. The increasing economic integration between the mainland and Taiwan has left the Taiwanese government increasingly susceptible to manipulation of its political institutions. Unless policies to strengthen Taiwan's economy and reduce this economic dependence are implemented, Taiwan will effectively surrender control over its political future to the PRC government. This paper examines the current economic relationship and then offers options to maintain and enhance Taiwan's political status.

The political status of the Republic of China (ROC) is complicated. Claims and counter-claims abide on whether ROC and People's Republic of China (PRC) relations are governed by the *Two States Theory* (i.e. "one country on each side" of the Taiwan Straits), the *One China Policy* (i.e. "the [PRC] is the sole legitimate government of both Taiwan and China") or the *One China Principle* (i.e. both sides "recognise there is only one sovereign China which includes both mainland China and Taiwan". (One-China policy n.d.). The PRC's position is that it is the sole legitimate representative of that sovereignty. The ROC's claims the same title for itself. In between, there are various evolving positions. In the midst of this ambiguity, the Republic of China must continue to find ways to survive both politically and economically under its de facto independent status. The purpose of this essay is to discuss the various options to maintain and enhance Taiwan's political status. For the sake of brevity, the Republic of China and the People's Republic of China will be referred to as Taiwan and China, respectively.

Background

Taiwan's Political Status: An Evolving Stance

In early 1991, facing the new realities of PRC economic dominance in world affairs, the ROC "President Lee Teng-hui [stated that] the ROC would no longer challenge the rule of the Communists in mainland China" (Political status of Taiwan n.d.). The PRC read President Lee's statements as a dangerous departure from the *One China Principle* since an abrogation by the ROC to claims over the mainland could eventually be developed into claims of independent sovereignty over Taiwan¹ (Political status of Taiwan n.d.). Unwilling to confront China's wrath, the ROC therefore continued until the mid-90s, to maintain its position that it was a de jure sovereign state with claims over both Taiwan and the mainland. The PRC for its part continued to signal its displeasure, so much so that in 1996, in the midst of Taiwanese presidential elections, it fired a few ballistic missiles over Taiwan hoping to tilt the elections against President Lee. The "event had little impact on the outcome of the election ... but it is widely believed that the PRC's aggressive acts, far from intimidating the Taiwanese population, gave Lee a boost that pushed his share of votes over 50 percent" (Political status of Taiwan n.d.), (Langfitt 2009).

By 1999, President Lee Teng-hui was ready to advance Taiwan's political stance to the next stage. In his *Two State Theory*, "both the Republic of China and the People's Republic of China would acknowledge that they are two separate countries with a special diplomatic, cultural and historic relationship" (Political status of Taiwan n.d.). The PRC responded swiftly, angrily denouncing Lee's statements and promised retributions should Taiwan pursue a path towards independence, as Lee's statements seemed to imply (Bunnag 1999). Diplomatic relations were not healed when the Lee's policy planner stated that the "Cross-Straits relations should not be a 'father-so' relationship as Beijing claims. We hope cross-strait ties will move toward a 'brotherly' or 'neighbour-like' relationship." (Wu 1999)

¹ "A political crisis was avoided since the Courts in Taiwan did not accept President Lee's statement, primarily due to the reason that the (now defunct) National Assembly never officially changed the national borders".

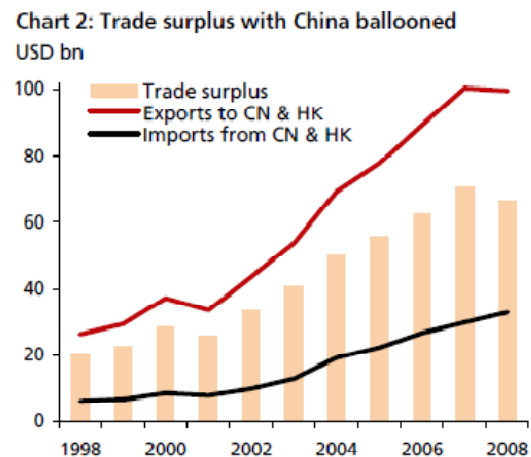
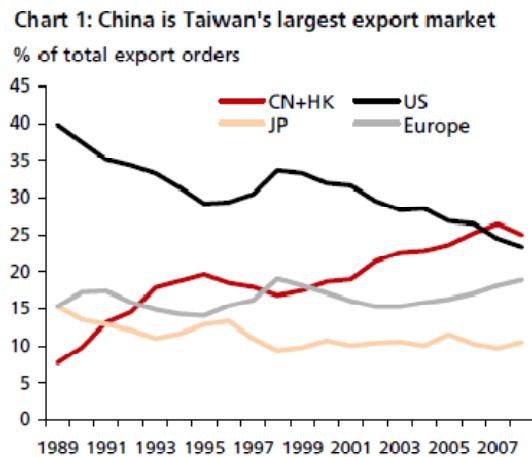
President Chen Shui-bian further extended the concept of Taiwan as an independent entity. His *Four-stage Theory* of the Republic of China essentially states that Taiwan is an already independent state “separate[d] from mainland China and is called the ‘Republic of China’” (Republic of China n.d.). Fear that moving too radically, too quickly may precipitate a Chinese military response may have caused his party, the DPP and its allies to lose the parliamentary elections in 2008. The DPPs call for a referendum to join the United Nations was particularly ill-advised as the average Taiwanese is only too well aware of the 1500 or so missiles aimed at its borders from across the Straits. The election of the Pan Blue coalition (KMT) in 2008, which supports eventual reunifying Taiwan with mainland China as part of a single Chinese nation has slowed the momentum (Chinese reunification n.d.). However, President Ma Ying-jeou statements that he would not negotiate with the PRC on the subject of reunification during his term imply more a holding pattern than a regression to the policies prior to the 1990`s. “While striving for stabilization and normalization of relations with China, Taiwan has taken a cautious step in advocating the “3 Nos” – no unification, no independence and no use of force”² (A New Era for Taiwan-PRC Relations, a panel discussion 2009). The reality is that Ma is facing a shrinking GDP, declining trade as a result of global slowdown, and pressures from the business classes within Taiwan to act. Since China represents Taiwan's largest trade source, he has little freedom but to act while planning for the world economy to improve. Hence the need to reduce any source of economic friction while defending the current status quo in other areas.

Taiwan's Economic Reality: The China Influence

Exports account for more than two-thirds of Taiwan`s economy. (Ong 2009). In 2006, the PRC accounted for 21.6% and 11% of Taiwan's exports and imports respectively (excluding Hong Kong) (Central Intelligence Agency 2006). In 2008 with slowdown in exports to western markets, “Taiwan's exports to China from January to April surpassed 30 percent of the country's total exports, recording US\$26.09 billion and representing a rise of 20.3 percent year-on-year” (Taiwan's exports to China top 30% of total 2008). Today, China is Taiwan`s largest trading partner. This figure is growing rapidly as both economies become ever more interdependent. Chart 1.0 gives the long term trends (DBS Group Research 2009).

² President Ma Ying-jeou's Inaugural Address of May 20, 2008: “I sincerely hope that the two sides of the Taiwan Strait can seize this historic opportunity to achieve peace and co-prosperity. Under the principle of ‘no unification, no independence, and no use of force,’ as Taiwan's mainstream public opinion holds it, and under the framework of the ROC Constitution, we will maintain the status quo in the Taiwan Strait...”

Chart 1.0: Taiwan's Export Market and Trade Surplus



Taiwanese investment in China has shown similar impressive gains as Taiwan shifts many of its labour-intensive, export oriented, industries to the Mainland (Hou 2002). Private Taiwanese investment in mainland China is estimated to total in excess of US\$150 billion, which equals official tallies of Taiwan's total investments for all of Southeast Asia combined (Winkler Partners 2007). This estimate is based on the Taiwanese investments in China that have been officially approved by the Taiwanese government. It grossly underestimates Taiwan's true foreign direct investments (FDI) in China (Cooke 2006). Many Taiwanese have made investments in Taiwan without government approval and often through overseas tax shelters. An interesting study by the Jamestown Foundation concludes that "while most official sources place Taiwan's "reported share" of FDI into China in the 7-8% range, the "estimated true share" of Taiwan's FDI contribution has emerged closer to the 20-22.5% range (Cooke 2006). No country, with the exception of Hong Kong approaches even marginally this level of FDI participation. "Most of the electronics and information products that mainland China now ships to the U.S. and Europe are manufactured by Taiwan-invested firms ... [these] investment[s] in the mainland by Taiwanese firms has created between five and ten million jobs in China" (Siew 2002). To an outside observer, it appears Taiwan is betting heavily that it can put all its eggs in one basket and manage the risk, should that basket fall.

The impact of this increasing dependence on trade with the mainland and integration into its economy could have significant repercussions in so far as the dependence is relatively asymmetric. With exports to China accounting for almost 30% of Taiwan's total exports, the island becomes increasingly vulnerable to economic pressures. As Taiwan represents less than 3% of China's export markets, its economy remains relatively immune to any trade dislocations with Taiwan (Cooke 2006). The Chinese policy currently appears to be one of coercing Taiwan to fall more securely under its umbrella rather than outright intimidation. Using the carrot and stick approach, it offers to relax its policies if Taiwan enters an

economic free trade agreement and threatens more restrictive trade policies if Taiwan does not acquiesce. The recent push to sign the Economic free trade agreement between China and Taiwan is a push in that direction. Most tariffs and other trade barriers will be eliminated. The Taiwan business community, having invested heavily in China is desperate to enter such a deal. Taiwan now sells about half its petrochemical products to the mainland on which China imposes a tariff of about 6.5 percent (Cha 2009). Tariffs on similar products from Korea are lower and will soon be eliminated; putting Taiwanese's companies at a further disadvantage. Hsieh Jun-hsiung, executive manager of the Petrochemical Industry Association of Taiwan, emphasized the urgency of the agreement. "The sooner, the better. We just sent an urgent letter to the government to push them to do it quicker... Our requirement is quite simple: Right now our treatment is unequal compared with other countries. We need equal treatment. If Taiwan keeps the status quo on this, about half of our products will be unsellable soon." (Cha 2009)

Stronger punitive measures by mainland China, or the mere threat could derail the Taiwan economy, causing investors and capital to flee into safer havens and forcing the government to submit to Beijing's demands. It seems unlikely the PRC will choose this option in the short term and invite worldwide condemnation, with negative consequences on its own trading relationships. President Hu Jintao's "eight points" speech at the end of 2008 as much as accepted that the unification of Taiwan will be peaceful and in the long term (Jintao 2004). In the interim, the hope is to create economic ties so strong that ultimately they become effective political binds as well. However, the political relationship between Taiwan and the mainland is best characterized by ambiguity. A change in the "eight-points policy" clearly cannot be discounted in the longer term, perhaps following a further strengthening of China's economic influence in the world. Nationalist and jingoist feeling could precipitate a similar response. Such feelings are never far off when a people feel claims to a territory, though that territory has existed as a separate entity longer than most living Chinese (Chinese Premier Warns Against "Taiwan Independence" 2004).³

In Taiwan on the other hand, 75 to 80 percent of the people prefer to maintain the status quo (Saunders and Kastner 2009). Less articulated, but perhaps equally important is the emergence of a strong lobby that advocates stronger cross-strait relations and derives support from the approximately 750,000 other Taiwan business people stationed in China (Reuters 2009). This "transnational capitalist class" welcomes strengthening of trade relations and economic agreements as means of securing their investments and relaxing taxation policies for increasing profitability (Langfitt 2009). If the pro mainland China stance of much of the Hong Kong business community is any precedent, this transnational capitalist class will forward interests in future elections that are likely at odds with those who seek a more cautionary approach to the cross-strait dialogue. The influence of this class will be considerable because of the economic resources they can bring to bear on any issue. However, this conflict between fear of

³ "Chinese Premier Zhu on March 15, 2004 ... at a press conference held shortly after the conclusion of the 3rd Session of the Ninth National People's Congress (NPC) stated that [China] will not tolerate 'Taiwan independence' and that the Chinese people are ready to shed blood and sacrifice their lives to defend the unity of their motherland and the dignity of the Chinese nation".

dominance by China and economic opportunism is yet to play out and its outcome will depend on how well Taiwan manages its economic policies and pursues globalization of its economy.

The Taiwan Option

Taiwan still retains some options to maintain the current status quo and its independence. The serious economic strait Taiwan finds itself in these days is a combination of world economic events and self-inflicted wounds. Recovery is possible from both and is discussed below:

World Economic Events and Self-inflicted Wounds

By the 1990's, the out-sourcing of low tech manufacturing to countries with cheap labour had become a phenomena. Multinationals were in the front of this movement to expand their profitability and competitiveness. Faced by a forced revaluation of its currency and the resulting pressures on its export sector, Taiwan responded by aggressively sourcing out its low tech manufacturing. It was a choice between following suit had or perishing. China seemed the logical choice. It offered incentives for new investments and one of the fastest growing economies in the world. Both sides of the straits spoke a common language, shared many common values and the 150 miles or so to the mainland made commute to the manufacturing sites attractive. By 2003, China had become Taiwan's largest trading partner. HSBC Securities economist Arthur Woo summarized it best; "Taiwan's investment in China should be viewed as a mutual division of labour,...China acts as a cheap manufacturing base, freeing up valuable resources for research and development and management of operations in Taiwan." (Meer and Keliher 2003)

Given the globalization of markets, the structural changes to the Taiwan economy were perhaps inevitable; their direction was less sanguine. China's trade with other world economies is mercenary. It needs the capital for its industrialization and the markets for its manufactured goods. The economic relationship with Taiwan is also emotionally charged. There is always the possibility that China is operating under a set of strategic policy dictates wherein economic considerations are secondary. Nor can an "irrational" response from China be precluded under a different set of circumstances such as an economic crisis which requires the Chinese leadership to provide a military distraction to an unhappy public. Hence, Taiwan must diversify before its options become severely limited. The recommendations are presented below and include my analysis of discussions held with government officials and representatives at nongovernmental organizations:

Recommendations

- 1. Diversification:** The ECFA agreement with China must be the first step in opening similar agreements with ASEAN countries. Exactly how far China goes in allowing Taiwan to enter FTAs with other nations will provide an important insight to the PRC agenda. Exactly how far President Ma

succeeds in making access to FTAs with other nations a condition of the ECFA agreement with China will determine his political clout and his ability to shape Taiwan's future agenda. However there are other options available to Taiwan that are even more promising than trade with the ASEAN countries. India offers such an opportunity. It is now entering a period of economic growth and expansion "similar in magnitude and importance to the one the PRC is now leaving" (Scissors 2009). There are projections that India's growth rate in the next 20 years will exceed China's and a partnership with India could carry Taiwan into a "more balanced" and secure growth with mutual gain for both countries. This option should be pursued as a priority; with capital transfer coming from Taiwan's investments in China (Park 2008)⁴. Similar FTA initiatives should be pursued with the United States, Japan, Mexico and South America to achieve diversification.

During a visit to the Nankang Software Park there were some comments that Taiwan had considered trade with India but Indian tax structure was too fragmented and not conducive to foreign investment. Furthermore, earnings taxed in India would be taxed again when repatriated in Taiwan. This double taxation has made investments less profitable. These arguments appear to be supported (Kelka 2008). However, there was recognition that tax issues need to be resolved because of significant investment and earning opportunities. At the visit to the Ministry of Economic Affairs, government officials indicated that no India policy was in the pipeline to resolve these difficulties. It is unclear why this is the case given the tremendous opportunity for cooperation. In my limited understanding, I felt that the private sector was more aggressive in searching for opportunities while the government sector was still fairly cautious in its approach. Ultimately, nothing much is likely to develop in India-Taiwan trade relationships until the government takes an initiative to address taxation and trade impasses.

Generally there is recognition within the Taiwanese community that it prefers dealing in a familiar cultural environment. Given the society's very homogenous nature, it appears to limit Taiwan's ability to adapt to an increasingly limited multicultural relationship with South Asia. It is not clear whether there is any trend to attempt to modify this response and become more flexible in accommodating different cultures. From my personal observations, Taiwan has adapted to Western influences very well but the challenge remains to face the additional realities of powerful economic forces that are developing to the southwest as a countervailing force to the influence from across the straight.

- 2. US Support:** The U.S. congress has always been a strong supporter of Taiwan interests. Washington should be lobbied to support behind the scene efforts to encourage countries to negotiate economic agreements that are consistent with best practices and do not discriminate vis-a-

⁴ "Taiwanese companies tend to reinvest and retain their earnings in their subsidiaries in China. The figure stood at 39.2% and 24.8%, respectively, in 2005."

vis China. To that end, Taiwan must provide sufficient incentives, economic and political, to be perceived as important ally.

There is a strong belief that in spite of the US acquiescence to Beijing's demands (i.e. a slowdown and perhaps scrapping of plans to transfer military equipment, namely defensive missiles and attack helicopters by the Bush and Obama administration), the United States will come to the aid of Taiwan should a military incident with China take place. Almost missing is any recognition that with developing Chinese capabilities, a military intervention by the United States would be too slow and ineffective, according to a RAND study (Trimble 2009). Furthermore, economic interests with China may force the United States to make no more than strongly worded statements and condemn these actions in the United Nations. Additionally, the United States recognizes that it does not have any treaty obligations with Taiwan and this is well understood. It is therefore in the best interests of Taiwan to develop stronger economic ties with the United States.

- 3. Productivity:** China's low cost producer advantage is slowly eroding. For example, in the supply of low end hand tools, the average unit price of products from China's products increased from US\$1.83 in to US\$4.7 kilogram in 2006. Unit prices of Taiwan's exports increased from US\$4.86 per kilogram in 2003 to US\$6 over the same time period (Liu 2007). While China still enjoys a significant cost advantage, these hurdles are not insurmountable. Further investments in technology and tax incentives to industries should help close the gap. Furthermore, China will in the near future be required to revalue the Yuan much like Taiwan did in the late 1990's. It is conceivable, that with careful planning and strategic investments, Taiwan may regain its lost market share. Time may be on Taiwan's side.
- 4. APEC Membership:** Taiwan's role in APEC is limited to economic matters to accommodate China's demands. It is unlikely this role will change. However, within these limitations, Taiwan still has sufficient flexibility if it can channel its energies to increase productivity, to become a significant player. It also means making the riskier investments in high end technology without a clear expectation of return on the investments. The government should continue to support investments in biotechnology.
- 5. Attract Talent:** It is unlikely that Taiwan with a small population base can fully provide the immense technical talent necessary to fully participate in cutting edge technology. It is therefore essential that it open its borders with lucrative incentives to the academia and high calibre professionals and scientists whose contribution is essential for it to succeed and make the cultural changes to absorb the newcomers.

- 6. Business Community Endorsement:** The interests of the business community and the ordinary public should be reconciled. The former sees the business opportunities in China and the latter fears the change in government institutions.

- 7. Restrict Foreign Takeovers:** Strategic sectors of the economy, necessary for future growth, must remain under Taiwanese control. This may require legislation.

Additional Notes: On Cultural Diplomacy

Among the students we met at the universities and public officials, there is a belief that a shared cultural heritage will preclude a Chinese military response and help Taiwan preserve its economic and political institutions should an eventual unification occur. Generally the experiences in the relationship with Hong Kong and China have largely been ignored in this set of beliefs. From an outsider's perspective, it is not obvious why a nation would allow special status for a 'province' that would make up less than 3% of the country's population, except perhaps as interim measure. The Taiwanese people need to reassess the merits of cultural diplomacy as a means of securing their political independence

Conclusions

Taiwan has acted with great courage and strength to survive against all odds when confronted by a neighbour who thwarts it at every turn and an international community that is largely silent to its ordeal. These conditions are not likely to change in the near future. Taiwan has survived against great odds and there is every reason to believe that with planning and foresight it will survive until such time that new political realities take hold. At that time, mainland China may acknowledge that the relationship between the giant and its neighbour is more "brotherly" than "father and son". At that time, the international community may also awake to a different conscience and acknowledge that Taiwan deserves the status it seeks.

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