

**TAIWAN STRAIT III:
THE CHANCE OF PEACE**

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TAIWAN STRAIT III: THE CHANCE OF PEACE

EXECUTIVE SUMMARY AND RECOMMENDATIONS

Apparently irreconcilable positions on the 'one China' principle have emerged between China and Taiwan over the last decade, with Taiwan for some time now asserting not only that it is a separate political entity but an independent sovereign country. China for its part remains absolutely unwilling to compromise its position that Taiwan and the mainland are part of one country, and has not renounced the use of force as a means of making that principle a reality. The risk of war between them must, accordingly, continue to be taken seriously.

But there is a real chance of continuing peace across the Taiwan Strait for the foreseeable future, provided that:

- ❑ conscientious efforts are made at the military level to create transparency and build confidence to lower the risk of miscalculation and misunderstanding;
- ❑ the present tendency toward growing cooperation between the two entities on economic and social matters continues; and
- ❑ the broader international community, while making some greater accommodation with 'status sentiment' in Taiwan, continues to hold the line against formal recognition of Taiwanese sovereign independence.

This report focuses on the non-military measures necessary to ensure continuing peace. There are many positive dimensions to the relationship between China and Taiwan that can compensate to some degree for the increasing political and military tension between them as a result of their conflict about Taiwan's status. China is now Taiwan's principal export market, and Taiwan is a

major source of foreign investment in China. The two governments are also edging closer to a formal relationship in other areas of policy, such as joint offshore energy development, fisheries and customs activities. And the two are now meeting formally for the first time ever at officials' level in the context of the World Trade Organisation (WTO), a process initiated in December 2002.

Prospects for a resumption of high-level political contacts are now the best they have been for several years, since there is now considerable overlap in the short to medium terms goals of China and Taiwan. Both sides want dialogue, further opening up of the economic relationship, and progress toward economic integration. The resumption of comprehensive direct shipping and air links, severed since 1949, now looks more likely than ever, but may still take one or two years to be implemented.

The political point scoring that both sides have used in responding to the many tactical issues involved in re-establishing such links is a reminder that the big issue of principle – Taiwan's status – is never far from the surface. But the depth of contacts in various areas of practical work-a-day civil policy (transport, customs, fisheries, energy development, investment, trade and tourism) provides a very rich canvas for increasing contact between the two sides.

All that said, the two sides' long-term objectives on the question of Taiwan's status are far apart. And China is demanding that Taiwan make sustained, visible progress toward a peaceful settlement or risk a resort to armed hostilities. These considerations will continue to play themselves out in the domestic politics of Taiwan as it tries to

move forward on reopening of comprehensive direct transport links, on further opening up of economic ties, or, at a higher level, on the reopening of political talks with China. Taiwan is insisting that it be treated as an equal to China, and that China begin to deal with Taiwan government officials in that capacity.

For the moment, China is prepared to appear more flexible on whether Taiwan should openly support the 'one China' principle as a precondition for reopening of political dialogue. Some meeting of minds is possible, and we cannot rule out a major symbolic rapprochement between the leaders of China and Taiwan within two to three years – perhaps in the context of Taiwan hosting one or more of the 2008 Olympic Games events. But Taiwan's government does not have much room for manoeuvre, and its hand will be shaped by the prospects for re-election of President Chen Shui-bian in the 2004 presidential elections.

If Taiwan wants to stop China increasing military pressure on it, it does not need to entirely abandon its pursuit of a new national identity. Not that it could do so anyway: the strength of sentiment in Taiwan about a new national identity makes it essential for Taiwan's leaders to continue to give some public prominence to this issue. But Taiwan's leaders do need to continue, as President Chen has shown he can, to ensure the appropriate balance between public handling of the identity issue and the momentum of practical measures for better cross-Strait relations. Scores on the board in these practical areas of cooperation are absolutely essential in China's leadership councils for constraining impulses toward use of force.

The international community has a role to play in this. There is considerable scope for giving greater play to 'status sentiment' in Taiwan by progressively but gradually extending its participation in international organisations. But one proviso must still hold. Taiwan cannot expect to be admitted to membership of international organisations where statehood is a requirement of such membership. The major powers must not give China any room to think that movement on Taiwan's participation at a technical level in certain international organisations is a prelude to formal recognition of Taiwan as a state.

Growing cooperation between China and Taiwan in concrete, day to day policy areas and a greater,

though still constrained, international accommodation to 'status sentiment' in Taiwan, do appear to provide a fairly certain path to peace. This will be threatened only by the extent to which China or Taiwan, or any of the major powers, moves to resolve the ambiguity surrounding Taiwan's international status. Taiwan will need to remain an anomaly in the international system for some years yet.

RECOMMENDATIONS

To China and Taiwan:

1. Intensify the breadth and depth of cross-Strait links and joint activities, especially those that can take place in or near the Taiwan Strait.
2. Place greater political emphasis on concrete cross-Strait cooperation and interchanges than on high-profile arguments about recognition of the 'one China' relationship.
3. Work toward Taiwan hosting at least one event (e.g. baseball) in the 2008 Beijing Olympic Games.
4. Resume high level political contacts.
5. Adopt a more consistent policy of promoting business-like and courteous exchanges with and about each other, avoiding inflammatory, provocative and unnecessarily personal statements.
6. In this spirit, end the battle of the 'diplomatic lists', and agree informally on a 'cease-spend' in the dollar diplomacy that seeks to buy impoverished third world countries or micro-states away from each other's list.
7. Work toward a formal customs agreement through bilateral contacts at officials' level within the WTO.

To China:

8. Accept that there is no significant support within Taiwan for the 'one country, two systems' formula first adopted two decades ago.
9. Accept that gradual economic integration provides the mechanisms of building mutual trust on which political integration can proceed, and that continued threats of military pressure on Taiwan will undermine the trust and sense of security that are essential prerequisites for political integration.

10. Support Taiwan's membership of international organisations where statehood is not a requirement for membership.
11. Show more flexibility in accepting Taiwan's participation, where and when the subject area makes it appropriate, in organisations where statehood is a requirement.

To Taiwan:

12. Finalise legislation on comprehensive direct air and shipping links as soon as possible.
13. End controls on investment, tourism and other exchanges that discriminate against China.
14. Sustain and reiterate from time to time the commitments in President Chen's inauguration speech to avoid formal political moves that could provoke a military response by China.

To UN Member States

15. Recognising the sensitivity of the sovereignty issue, and the continuing utility of the 'one China' principle in maintaining peace across the Taiwan Strait, do not undermine that principle by acting in any way to recognise *de jure* Taiwan as a state.
16. Do not support Taiwan's membership of international organisations where statehood is a requirement for membership, but where and when appropriate do support its participation in such organisations in other ways.
17. Actively oppose, both in public and in diplomatic contacts with China, the threat or use of force in addressing difficulties in cross-Strait relations.

**Beijing/Taipei/Washington/Brussels,
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TAIWAN STRAIT III: THE CHANCE OF PEACE

I. INTRODUCTION

ICG's first report in this series, *What's Left of 'One China'*,¹ documented the evolution of the positions of Taiwan, China, the U.S. and other international actors on the issue of Taiwan's international status. It concluded that the old 'one China' idea which had for so long provided a framework for peace is now at the point of final fragmentation. Taiwan continues to challenge it, and domestic political imperatives suggest this challenge will continue. There is no consensus in Taiwan on how far to push, and new U.S. military support for Taiwan is encouraging those who would test China's limits. China has made plain that this challenge could lead to war, but is hoping that its strategy of carrots and sticks, supported by occasional demonstrations of its military power, can persuade Taiwan to sign up once again to the 'one China' idea without the need for use of force.

The first report also concluded that the three key actors are unlikely to abandon their current positions. But each wants peace. This means, as the report also concluded, that the only way to keep the peace would be for China and Taiwan, with U.S. support, to find creative ways of going forward on concrete, lower level issues that might at least give China some room to believe that reunification had not been written off entirely. The report suggested that the three main players need to operate much more visibly and vigorously in the positive domains of cross-Strait relations and continue to subdue any tendency to provocation.

ICG's second companion report, *The Military Balance and the Risk of War*,² indicated that

military tension, albeit muted, continues ; that while military capacity on both sides is limited, the danger of political warfare escalating into military confrontation cannot be ignored; and that concern about national security still underpins the attitudes of many in Taiwan to any cross-Strait links in the civil sector. It argued for conscientious efforts to be made to create transparency and build confidence, in order to lower the risk of miscalculation and misunderstanding that could otherwise lead to serious military consequences.

The present report, picking up where the first concluded, focuses on the main areas of present non-military interaction between China and Taiwan: political contacts; economic relations; transport and communication links; other maritime affairs (such as energy and fishing); and social contacts. It examines their extent and depth, how they can be accommodated alongside apparently irreconcilable positions on Taiwan's status, and how, appropriately enhanced, those contact areas might contribute to reducing the continuing military tension and maintaining cross-Strait peace for the foreseeable future.

It also describes the way in which the wider international community can make a positive contribution to maintaining stability. A crucial task is to keep open the sense of possibility that some longer term constitutional relationship between China and Taiwan might ultimately be achievable: what form such an ultimate settlement might take will be the subject of a subsequent ICG report.

¹ ICG Asia Report N° 53, *Taiwan Strait I: What's Left of 'One China'?*, 6 June 2003.

² ICG Asia Report N° 54, *Taiwan Strait II: The Risk of War*, 6 June 2003.

II. ENHANCED CROSS-STRAIT COOPERATION AS A PATH TO PEACE?

A. POLITICAL CONTACTS

There are two faces to China-Taiwan political contacts:³ a public one and a private one. The public face is well known, and is characterised by a mix of much acrimony and some cooperation. The private face of China-Taiwan political contacts is not well known at all, but appears at times to have been conducted on a level of cooperation that belies the acrimony in the public domain. China-Taiwan political contacts also occur at many levels: from senior leadership figures to local government officials, from ruling party officials to opposition figures.

Political contacts across the Taiwan Strait are charged with high politics, and therefore involve all of the normal posturing and staking out of positions – and potential for compromise – that any political contest involves. But cross-Strait political contacts are for many participants deeply emotional events. In China, these emotions run from a cool business-like approach, through pride and optimism about the prospect of national reunification and warmth toward their Taiwan compatriots, to suspicion, contempt and even hatred for those in Taiwan who have so vigorously pursued independence and a separate international status. For Taiwanese participants, the range of emotions is similar. But for many of them, the passion which they feel for asserting independence is tinged with a bitterness and steely determination that is not quite matched so consistently on the China side. One important difference is that for a country as large and as troubled as China, reunification with Taiwan is one of many issues of fundamental national significance; in Taiwan by contrast, the relationship with China is an overwhelming day to day issue. It is all too easy to overlook this emotional asymmetry which marks many aspects of political contact between the two sides.

³ The term ‘political contact’ here has several connotations. It can refer to meetings between representatives of the governments or political parties of the two sides. But it can also refer to meetings involving others, such as business people or academics, where the subject of discussion or purpose of the meeting is essentially political.

Emotional volatility has been aggravated by China’s growing sense of impatience with Taiwan, by Taiwan’s growing resentment toward China’s intimidation, and by the fundamental lack of consensus within Taiwan about what China represents to it. China-Taiwan political contacts are not a disciplined political negotiation, but a shot-gun blast of pellets impacting a very big target, often a long way from the bull’s eye. Taiwan’s government has identified this problem as a serious one,⁴ but has not been able to do much about it. There is patchy evidence that both governments have used private contacts, involving emissaries from the highest levels, to bring more discipline to the contact process. But China’s political strategy toward the Taiwan government has continued to be based on undermining its credibility by promoting contact with unificationists and by publicly berating the more ardent advocates of independence. In January 2003, the Taiwan government accused China of trying to turn talks between private groups into a form of official cross-Strait negotiation that would put the Taiwan government at risk of losing its sovereignty and dignity.⁵

1. High Level Intergovernmental Contacts

As ICG’s first Taiwan Strait report noted, when both sides were still committed to the ‘one China’ idea in 1991, the mechanisms they established to conduct high level exchanges were the so-called ‘unofficial’ or ‘private’ organisations, the Straits Exchange Foundation (SEF) and the Association for Relations Across the Taiwan Strait (ARATS).⁶ China is still pressing for a resumption of the talks between these two organisations that last occurred in 1998. Taiwan has shown some signs of responsiveness to this idea, and China has recognised this. President Chen has said on occasion that the SEF is the organisation ‘best placed’ to conduct a dialogue with China. And a senior official of the Mainland Affairs Council (MAC) in January 2003 welcomed a proposal from China to resume the SEF-ARATS dialogue as a ‘starting point for establishing a stable and peaceful

⁴ According to the Chair of the MAC, Tsai Ing-wen: ‘The authority of the government might be threatened by business interests or interference from political parties and this is the most difficult part when dealing with cross-Strait affairs’. See Lin Miao-Jung, ‘MAC Chairwoman Questions Loyalty of Private Groups’, *Taipei Times*, 12 January 2003.

⁵ Ibid.

⁶ See *Taiwan Strait I: What’s Left of ‘One China’?*, op.cit.

cross-Strait framework'.⁷ A week later, on 15 January, Qian Qichen of the Politburo Standing Committee said he believed that China-Taiwan could resume consultations immediately, though he did add the standard formula that this was as long as Taiwan recognised that both sides of the Taiwan Strait are part of China.⁸

But as far as Taiwan is concerned, its organisation, the SEF, is now largely irrelevant to what it regards as high-level political contact. Taiwan is trying to force China into accepting direct negotiations with it on an 'intergovernmental' basis.⁹ President Chen has sidelined the National Unification Council, set up in 1990, and the associated Guidelines on National Unification, laid down in 1991. He appears to be pushing the leading non-governmental bodies, such as the SEF, from centre stage. The Chairman of the SEF, Koo Chen-fu, was reappointed to the post in 2002 after his 85th birthday, a sign that his Foundation may not be taken that seriously any longer. By contrast, the Cabinet level Mainland Affairs Council, led by Tsai Ing-wen, one of the architects of President Lee's 'special state to state' formulation, is now the absolute powerhouse when it comes to cross-Strait policy, sometimes even contradicting or reinterpreting remarks made by the President.

China continues steadfastly to reject any direct contact with the highest levels of the Taiwan government until it stops expressing outright hostility to the 'one China' principle. For example, at the APEC Heads of Government meeting in Mexico in October 2002, President Jiang Zemin rejected an invitation to visit Taiwan that had been extended to him during informal contacts with Taiwan's delegate, Lee Yuan-tseh,¹⁰ on the grounds

that 'this is a political problem: the one-China principle'.

China's approach to direct contacts with the highest political levels of the Taiwan government can be seen in its handling of visits to China by members of the DPP (the present governing party) under a new policy laid down in January 2002. Qian Qichen made a direct appeal for the first time for members of the DPP to come to China: 'We welcome them to come for sightseeing and visit in appropriate status and increase their understanding'. China had previously held DPP members at arm's length because of their open support for independence. This invitation by Qian was consummated on 17 March 2002 with the first arrival under this invitation of a DPP member of parliament.¹¹ But in the sentence before making this invitation, Qian made a sharp distinction between the 'broad masses of DPP members' and the 'small number of stubborn Taiwan independence elements'. This was subsequently interpreted by Chinese sources to mean that Taiwan's President and Vice President would not be welcome in China. An official of the Taiwan Affairs Office of the State Council said that Chen and Lu 'are not included among the broad ranks of DPP members', 'but rather fall into a different category'.¹² Newspaper commentaries throughout 2002 and 2003 continued to attack the 'independence elements', sometimes naming President Chen, sometimes naming Vice President Annette Lu. China has made plain its view, contrary to that of Taiwan, that discussions on direct transportation links 'do not constitute political negotiation'.¹³ In this way, China is trying to repudiate Taiwan's position that talks on direct links must involve the Taiwan government.

But an informal meeting of high-level representatives of the Presidents of the two countries, and even of the two Presidents themselves, should not be ruled out. In March 2000, Jiang Zemin expressly identified the possibility,¹⁴ as did Chen Shui-bian in May 2002. By

⁷ In a meeting with reporters from Taiwan's media, Chen Yunlin, Director of the Taiwan Affairs Office in China, said: 'Cross-strait ties will improve substantially if the Taiwan authorities are sincere about opening direct transport links and resume dialogue and consultation on the basis of the 1992 consensus'. See Lin Miao-jung, 'Taiwan Welcomes Offer from China', *Taipei Times*, 9 January 2003.

⁸ Xinhua, 15 January 2003 (FBIS-CHI-2003-0115).

⁹ This position has been put consistently by the Chen Administration. For a recent reiteration, see 'Government Must Negotiate Direct Links: Official', *China Post*, 13 January 2003.

¹⁰ The sending of Lee as Taiwan's delegate was a master stroke of diplomacy by Chen. Lee, the President of Taiwan's Academia Sinica, and a Nobel laureate, has high credibility and respect in China because from the earliest days of its open door policy, Lee – then based in the U.S. – has been visiting China and advising it on education and

science policy. ICG interview, September 2002. Lee is also head of President Chen's Cross-Party group on relations with China, and a close adviser of the President in this area.

¹¹ Agence France-Presse, 17 March 2002.

¹² Zhongguo Xinwen She, 30 January 2002, FBIS-CHI-2002-0130.

¹³ See account of a meeting of the Taiwan Affairs Office in *Wen wei po* (Hong Kong), 15 January 2003 (FBIS-CHI-2003-0115).

¹⁴ Jiang said Chen could visit China for talks and that 'we may also go to Taiwan', according to Xinhua. See <http://asia.cnn.com/2000/ASIANOW/east/03/20/taiwan.electon.02/>.

early 2003, there were some early signs that China was muting its attacks on independence advocates and beginning to contemplate dealing more directly with the Chen Shui-bian Administration. For example, in October 2002, ministers from the two governments met in a formal side meeting at the APEC summit in Mexico.¹⁵ In January 2003, China gave permission somewhat surprisingly to the head of the DPP's China Affairs Department, Chen Chung-hsin, to visit China, albeit as part of a cross-party delegation of some twenty members.¹⁶ Once Taiwan agrees to re-establish comprehensive direct transport links,¹⁷ China may be more willing to receive the highest level political leaders like Chen, but for political and personal reasons, most Chinese leaders are reluctant to give Chen any rewards at all.

There is likely to be increasing pressure and momentum for a meeting of the leaders of the two countries, or their closest personal advisers. Much will depend on the attitude that Taiwan is adopting on the 'one China' principle, on identity politics, and on security relations with the U.S. If Taiwan is being too strident or too robust in these areas for China's liking, a top-level meeting would be almost impossible.

So-called secret channels (perhaps more appropriately called 'confidential' or simply 'non-public') remain a vexing issue in Taiwan politics. Though a normal tool of any intergovernmental diplomacy in circumstances where direct open contacts are nonexistent or in some other way inappropriate, their use across the Taiwan Strait has been subject to criticism in Taiwan. Former President Lee Teng-hui consistently used such contacts with China for most of the decade from

1991 to 1999.¹⁸ There is some sign that President Chen is also using private or confidential channels,¹⁹ but many in Taiwan regard private diplomacy on an issue as important as Taiwan's status as unacceptable in a democracy. President Chen acknowledged this in his 2003 New Year speech when he called, somewhat disingenuously, on China to recognise the demand in Taiwan for transparency.²⁰ It is certain that many of the breakthroughs in cross-Strait contact would not have occurred without the use of confidential channels, and this will remain the case.

2. Lower Level Intergovernmental Contacts

There is a wide variety of more promising political contacts at lower levels. The most promising new contacts are those between the WTO missions of China and Taiwan in Geneva, the first of which occurred in December 2002. From China's point of view, this meeting can be represented as nothing more than normal in a WTO context, especially since Chinese officials in the meeting consistently used the name under which Taiwan had entered the WTO: 'separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu'. But the fact that this meeting happened at all has considerable political significance. It establishes the first ever intergovernmental working meeting charged with concrete areas of policy between China and Taiwan,²¹ and, since many of the restrictions that Taiwan currently maintains on economic and transport links with China are prohibited under WTO rules, an opportunity has arisen for steady progress at the intergovernmental level on issues of cross-Strait exchanges.

In January 2003, Taiwan indicated a much firmer willingness to move forward on talks with China in the 'unofficial' forums that have been set up, such as between the aviation associations of both countries to address direct flights. On 1 January 2003, the Chair of the MAC, Tsai Ing-wen, declared that it was time for the DPP government officials to overcome their lack of familiarity with Chinese authorities, and for the government to make progress in three areas: direct transport links,

¹⁵ Agence France-Presse, 25 October 2002 (FBIS-CHI-2002-1025).

¹⁶ Lin Mei-Chun, 'DPP Official Visits Beijing', *Taipei Times*, 21 January 2003. China's January 2002 policy of allowing DPP members to visit China was said by Chinese officials at the time to exclude senior DPP officials visiting in their party capacity. An Associated Press report cited a government official as saying that Chen would likely meet with Vice Premier Qian Qichen and officials of China's Taiwan Affairs Office. Chen Chung-hsin, a moderate who favors stronger economic ties with China, was personally selected by President Chen for the post of head of the DPP's China Affairs Department as part of a bigger party reorganisation that occurred at the time of President Chen's assumption of the chairmanship of the DPP.

¹⁷ This is discussed at length later in this report.

¹⁸ ICG interviews, May 2002.

¹⁹ Ibid.

²⁰ *Taipei Times*, 2 January 2003 (FBIS-CHI-2003-0102).

²¹ An earlier event that might be characterised in this way was the side meeting between APEC delegations of China and Taiwan in Mexico in October 2002.

the rights of Taiwanese business people in China, and allowing Chinese to visit Taiwan.²² Tsai pointedly noted that progress in these areas was possible in the first half of 2003 since neither China nor Taiwan had major political events to tackle, a reference in China's case to the 16th Party Congress and leadership transition in November 2002, and in Taiwan's case to the mayoral elections in December 2002 and the presidential elections scheduled for March 2004.

At times when big political issues or milestone events have not been prominent, there has been a steady stream of visits to Taiwan by Chinese officials (including serving members of the PLA) in one capacity or another for the purposes of consultations on matters of mutual interest.²³ Just who these Chinese officials have met has not been publicly well-documented. This practice of exchanging lower level officials is likely to continue. Taiwan's national security laws have prohibited its government officials from visiting China, but the Chair of the MAC has called for revision of the appropriate laws to lift this ban. And China has indicated its responsiveness to visits by Taiwan officials in an 'appropriate capacity'.

3. China's Contacts with the Taiwan Opposition

As long as the KMT was the governing party in Taiwan, in a one party political system, contacts between it and the Chinese Communist Party (CCP) had an important conflict resolution potential. The KMT and the CCP were the original adversaries in China's civil war, and it was these two political parties who could most easily end it. After the election of the DPP pro-independence president in March 2000, and the expulsion of former President Lee from the KMT, China put some store in its ability to deal with the KMT as the 'natural' party of government in Taiwan and as a potential partner in keeping alive in Taiwan some semblance of the 'one China' idea. In the three years since the election of the DPP president, the KMT has suffered a serious decline, involving further losses in national parliamentary elections, and internal cleavages. These have made it a less than reliable interlocutor for China in any effort to shore up its position in Taiwan on the issue of

reunification, even were a KMT candidate to win the next Presidential election in 2004.

But the even bigger difficulty remains the KMT position on 'one China' and democratisation in China. Writing on 13 January 2003, the KMT Chairman, Lien Chan, saw democratisation in China, not unification, as the ultimate goal of cross-strait relations.²⁴ He pledged to work toward a much longer-term goal of the 'Chinese nation's integration', but his party's rhetoric is paying less attention to reunification and more attention to the new Taiwan identity. In the same article, Lien said that exalting Taiwan's ancient sages and rebuilding native consciousness are the essence of Taiwan's identity. Lien noted that the KMT is the party that most upholds 'Taiwan consciousness', while not restricting the future development of that consciousness. And other KMT leaders feel obliged to consistently criticise China for its lack of liberal democracy. KMT mayor, Ma Ying-jeou, has slammed China for its suppression of Falun Gong.

So recent political advances by the KMT – the landslide victory of the KMT incumbent, Ma Ying-jeou, in the December 2002 election for Taipei city mayor, and its initial agreement from the PFP to field a joint ticket for the 2004 presidential election – do not necessarily translate into its being a more natural partner for China on the issue of reunification. But as ICG's first Taiwan Strait report concluded, the room for manoeuvre in domestic politics of any Taiwan government to press a unificationist platform acceptable to China is almost non-existent.

The KMT is not simply out of step with China on the 'one China' issue. It is marching on a different road in a different direction. In 1992, the KMT-led government was able to agree with China in the SEF-ARATS talks that the two sides would agree to disagree on their different interpretations of 'one China'. Eleven years later, after tumultuous political changes in Taiwan, of which democratisation and the emergence of the new Taiwan identity have been two of the most profound, the KMT has nowhere to go with its support of 'one China' that is in any significant way different from where the DPP wants to go. China rebuffed the current KMT Chairman and presidential candidate Lien very seriously in 2001

²² *Taipei Times*, 2 January 2003 (FBIS-CHI-2003-0102).

²³ ICG analyst interviews over many years beginning in 1994.

²⁴ Central News Agency, 13 January 2003 (FBIS-CHI-2003-0113).

when it rejected his idea for a confederation between China and Taiwan. Lien had tried to get the idea inserted into the KMT party platform but, given China's response, senior KMT leaders had it quietly shelved.

That sort of internal bickering within the KMT about national identity and Taiwan's international status, and the political miscalculation of its presidential candidate on this key issue, does not augur well for his prospects in the 2004 presidential election, even if recent opinion polls have shown a joint KMT-PFP ticket leading a Chen ticket. Given the high levels of opposition in Taiwan to China's 'one country, two systems' proposal, any sign by the KMT and PFP that they sit too close to China's view could be electorally damaging in the presidential race.²⁵

For this reason, China will almost certainly have to continue moving away from a policy favouring contacts with the KMT and other opposition parties in Taiwan over contacts with the DPP. It cannot afford to be seen to be favouring the KMT because of the inevitable charge that will be levied against that party for being tools of China.

4. Taiwan's Contacts with the China 'Opposition'

Just as China has played up to the opposition in Taiwan in an effort to put pressure on the DPP, so, too, has the Taiwan government in recent years developed stronger contacts with political opposition forces in China. For Taiwan's government, this has the advantage of demonstrating to domestic Taiwan audiences just how undesirable is any form of political unification with the mainland. It also serves to further enhance Taiwan's democratic credentials in the eyes of the international community. As far as the Chinese leaders are concerned, however, this activity by Taiwan is evidence that it remains a political enemy of CCP rule on the mainland. There are several focal points of the relationship between Taiwan and political opposition forces or repressed

groups in China – Tibet, democratic activists, and Falun Gong – and Taiwan's activities in these areas are intensifying.

For example, on 20 January 2003, Taiwan established a new Taiwan-Tibet Exchange Foundation which will eventually replace the moribund Cabinet-level Mongolian and Tibetan Affairs Commission (MTAC), a hang-over from the residual claim of Taiwan as the ROC to the territory of both Tibet and Mongolia (Outer and Inner).²⁶ On the one hand, this is yet another small step by Taiwan away from its past constitutional relationship with the mainland that is based in large part on pragmatic considerations.²⁷ But it is also a sign of Taiwan's determination to keep in close contact with certain political forces in China hostile to its government.²⁸ The Taiwan-Tibet Foundation will consist of government think-tank members, DPP members and private entrepreneurs familiar with Tibetan affairs. It is organising a third visit to Taiwan by the Dalai Lama and a visit by a cross-party delegation from Taiwan to the Tibetan government in exile in Dharamsala, India. The foundation's work is being advertised as focusing primarily on religious and cultural exchanges and humanitarian aid, and it is being represented as non-political. In particular, sources close to the Foundation asserted that it 'will not be involved in politics and

²⁵ See, e.g., 'President Chen Behind in Pre-Election Polls', *Central News Agency*, 14 April 2003 <http://taiwansecurity.org/CNA/2003/CNA-041403.htm>; 'Polls Indicate Strong Support for Lien-Soong', *China Post*, 20 April 2003. The joint KMT-PFP ticket and its likely prospects in the 2004 presidential election are discussed in the companion ICG report, *Taiwan Strait I: What's Left of 'One China'?*, op.cit., section V.B.

²⁶ Lin Chieh-Yu, 'New Tibetan organisation to be opened', *Taipei Times*, 20 January 2003. The Legislative Yuan has already cut NT\$12 million from the Commission's budget this fiscal year to go toward the new foundation's expenses, but a formal decision on axing the Commission is the prerogative of the executive arm of government.

²⁷ ICG's first Taiwan Strait report reviews the residual references in Taiwan's constitution to any constitutional link with the mainland, including several references to Tibet and Mongolia. Taiwan and Mongolia have already set up mutual representation offices (unofficial embassies). The MTAC's view of Tibet as part of the Republic of China under its constitution has generated some dissatisfaction within the Tibetan government-in-exile. It also created obstacles in the run-up to the Dalai Lama's two visits to Taiwan, in 1997 and 2001. Since it used to regard Tibet as part of China, Taiwan used to handle visits by officials of the Tibetan government-in-exile in the same way as visits by China's officials. The problem was resolved in part after Taiwan's Ministry of Foreign Affairs took over the responsibility from the MTAC for issuing visas to Tibetan officials.

²⁸ The chairman of the National Association of Small and Medium-Size Enterprises, Day Sheng-tong, will serve as the Foundation's first chairman. DPP member of parliament, Hsiao Bi-khim will serve as vice chair, and Presidential Office Secretary-General Joseph Wu will be its deputy secretary-general.

will not become embroiled in the unification-independence issue'. The foundation's operations will include medical aid, agricultural techniques for Tibetan exiles in India, language training, academic exchanges, volunteer work and publishing.

The founding ceremony of the Foundation was attended by President Chen Shui-bian and the representative of the Tibetan government-in-exile, Tashi Wangdi.²⁹ At the ceremony, Chen said that Mongolians and Tibetans should not be classified as 'people from China'.³⁰ He also noted that the Dalai Lama's two visits to Taiwan were symbols of improving relations between the exiled Tibetan government and Taiwan. Chen noted certain similarities between the Dalai Lama and himself: 'Having been involved for a long time in Taiwan's democratic movement, I can totally understand the Dalai Lama's ideas on human rights and non-violent endeavours'. Chen said that the foundation could harness governmental resources, as well as private sector resources, to provide all kinds of help to the exiled government of Tibet.

As for political dissidents, the DPP invited two prominent democracy activists now in exile, Wang Dan and Wei Jingsheng, to attend the inauguration ceremony of Chen Shui-bian in May 2000.³¹ At that event, Chen promised to undertake an international offensive on human rights, and Taiwanese human rights groups pressed him to include the situation in China as part of this, specifically calling on him to raise human rights issues in contacts with China.³² Chinese dissidents in exile visit Taiwan from time to time and regularly publish in the Taiwan press. In a speech on 17 January 2003, Chen described China as a threat to its own people, and announced the planned establishment in June 2003 of a new Taiwan Foundation for Democracy, which will promote Taiwan's cooperation with other democracies to promote what he termed 'global

democratisation' and regional security.³³ China certainly sees a strong link between the Taiwan government and some dissident activities inside China. It has put on trial numerous dissidents for spying for Taiwan. In January 2003, China started the trial of Dr Wang Bingzhan, an American citizen who was kidnapped in Vietnam and taken to China.³⁴ He was charged with spying for Taiwan and organising and leading a terrorist organisation.

China suspects that Taiwan has close links with the Falun Gong group, in large part because of private connections between some Falun Gong members and citizens of Taiwan. It also became suspicious of Taiwan when Falun Gong managed to transmit its own radio and TV broadcasts from Taiwan that were able to override normal Chinese transmissions on state controlled media. Some Chinese media commentaries on Falun Gong in January 2003 drew a close link between its activities and those of the 'Taiwan splittists'.³⁵ Other commentaries specifically denounced Ma Ying-jeou, though without naming him, for his defence of Falun Gong on religious grounds.³⁶ One noted that 'what some of the politicians in Taiwan are doing is obviously not conducive to the healthy development of relations across the strait'.³⁷

The degree to which individual Taiwan politicians play up human rights abuses in China and maintain contacts with opponents of the CCP will become an increasingly useful barometer of their likely interest in dealing directly with the CCP on reunification in a way that China will find acceptable.

B. ECONOMIC RELATIONS: POLITICAL IMPACT

For the government of Taiwan, the scale, depth and intensity of economic relations with China present a dilemma. Can trade with and investment in China promote peace in the Taiwan Strait? Or 'does Taiwan's growing dependence on China enable

²⁹ *Taiwan News*, 21 January 2003.

<http://www.taiwanheadlines.gov.tw/20030121/20030121p2.html>.

³⁰ This is a reference to Taiwan's own pre-existing arrangements for dealing with Tibetans rather than an unambiguous attack on China's position that Tibet is part of China, but there is little doubt that Chen sees it as useful in his political contest with China to say such things.

³¹ *South China Morning Post*, 21 May 2000 <http://special.scmp.com/taiwaninauguration/Article/FullText.asp?ArticleID=20000521213347021.html>.

³² BBC News 3 June 2000 <http://news.bbc.co.uk/1/hi/world/asia-pacific/775916.stm>.

³³ *Taipei Times*, 18 January 2003 <http://www.taipeitimes.com/News/front/archives/2003/01/18/191416>.

³⁴ China Support Network, 23 January 2003 <http://www.kusumi.com/chinasupport.net/topnews41.htm>

³⁵ See, for example, Xinhua Domestic Service, 9 January 2003 (FBIS-CHI-2003-0111).

³⁶ See, for example, Xinhua Hong Kong Service, 10 January 2003 (FBIS-CHI-2003-1010).

³⁷ Ibid.

Beijing to gain greater economic, social and even political leverage over Taiwan, affecting Taiwan's national security? In other words, are those economic and trade relations a harbinger of peace for Taiwan or a Trojan horse of China's that will allow it to subordinate Taiwan to it?'³⁸ In the absence of a consensus in Taiwan on what the political relationship with China should be, and in the face of China's continued intimidation of Taiwan, both points of view receive considerable coverage. Pro-independence forces emphasise the need for a balance between Taiwan's security and the economic gains from deeper economic integration with China; while pro-unification forces emphasise the virtue of economic integration for promoting peace with China and enhancing the prospects for an eventual political reconciliation. Most leading members of Taiwan's business community are strong advocates of unfettered commercial relations with China.

The other side of this coin is less visible, but no less important. In China, the leadership has consistently made great efforts to entice Taiwan investment into China and promote cross-Strait trade. But this has brought with it a degree of vulnerability as well. The sheer size of Taiwan investment in China relative to other sources, discussed below, and its concentration in labour-intensive industries in sensitive locations (countryside townships and coastal cities in Fujian and Guangdong) give Taiwan a potential leverage over China's policy that cannot be dismissed. Half of all China's exports (and therefore its rapidly increasing hard currency earnings) come from foreign invested enterprises.³⁹ While Taiwan itself may only account for about 10 to 15 per cent of those export earnings, any serious military action by China against Taiwan would seriously threaten continued investment from the U.S., Japan, and the EU, as well as from Taiwan. A reduction in this investment would in turn create a massive unemployment problem in some of China's key cities and rural townships, and its leaders already

regard current unemployment levels in these as dangerously high.

The strategic significance of the cross-Strait economic relationship is not limited to bilateral interactions. Where once either side had the potential to restrict or open particular trade or investment avenues, as members of the World Trade Organization (WTO) both are now obliged to apply a non-discriminatory regime toward the other – what Taiwan does for the U.S. or the EU, Taiwan is also obliged to offer to China (and vice versa). Moreover, Taiwan itself needs increasing investment from foreign sources, including the U.S., Japan and Europe. In order to ensure this, Taiwan cannot just follow its own instincts in cross-Strait relations, but must ensure a relatively harmonious environment both domestically on the Taiwan identity issue and internationally to promote investor confidence.⁴⁰

Therefore, the issue of economic dependence and vulnerability cannot be seen too starkly. As the following discussion of trade and investment shows, it is not a question of one side or the other being able to exercise strong leverage without significant penalties. There is also no clear cut lining up of sentiment in either entity between perspectives of economic dependence and the desirability of striking confrontational poses. As Vincent Siew, a KMT proponent of political unification or integration with China, has put it:

For the sake of our national and regional security, we cannot afford to ignore any of these concerns. We cannot afford to truly allow a Trojan horse to enter Taiwan. However, cross-Straits trade and economic ties cannot simply be cut off. Even a slowdown in the development of such ties will surely bring harm to ourselves. Furthermore, if they were to be cut off, it would leave only political and military confrontation to stoke up the level of conflict.⁴¹

All sides recognise the inevitability of a mutually dependent economic relationship across the strait,

³⁸ Vincent C. Siew, 'Trade and Investment and the Taiwan Straits – building bridges', Conference Paper, Exploring Federalism and Integration – the EU, Taiwan, China and Korea', Berlin 26-27 October 2002. Siew is Chairman of the Cross-Straits Common Market Foundation and a former prime minister of Taiwan.

³⁹ See Lai Pingyao, 'Foreign Direct Investment in China: Recent Trends and Patterns', *China and World Economy*, No. 2, 2002, p. 31.

⁴⁰ See Heather Smith and Stuart Harris, 'Economic Relations across the Taiwan Strait: Interdependence or Dependence', in Greg Austin (ed.), *Missile Diplomacy and Taiwan's Future: Innovations in Politics and Military Power*, Strategic and Defence Studies Centre (Canberra, 1997), p. 211.

⁴¹ Siew, 'Trade and Investment', op. cit.

simply by dint of proximity and cultural affinity, not to mention China's position as the most populous developing country and Taiwan's position as a very small but wealthy⁴² and technologically developed entity. The real significance of cross-Strait economic relations to the political contest about Taiwan's status is, therefore, not so much in global, long term or absolute terms, but in how each side chooses to manipulate various aspects of change in the relationship for political advantage in the occasional political skirmishes. Current and prospective trends in this regard are discussed below in respect of trade, investment and the formalisation of economic relations through such things as a free trade agreement.

1. Trade

According to WTO statistics,⁴³ China is Taiwan's biggest export market, having displaced the U.S. in November 2001.⁴⁴ The U.S. market for Taiwan's exports had only a decade earlier been three times the size of the China market for Taiwan. In 2002, China accounted for one quarter (24.9 per cent) of Taiwan's exports and the rate of growth was rapid

(36 per cent over the previous year).⁴⁵ Taiwan has a much lower level of dependency on China for its imports, around 7 per cent: see Table 1. China has only low levels of trade dependence on Taiwan, and there has been no appreciable change in the decade, although Taiwan has been consistently second or third in rank as China's source of imports by value.⁴⁶

The most important trend in Taiwan's trade dependence overall is the rapid rise of China's dominance and the slow decline in relative terms of the position of the U.S., Japan and the EU as markets for Taiwan. The three fell by 3.2 per cent, 6 per cent and 6.2 per cent respectively in 2002.⁴⁷ The total volume of cross-Strait trade in 2002 was close to U.S.\$40 billion. Cross-Strait trade has yielded a massive trade surplus for Taiwan. In the first half of 2002, the surplus in Taiwan's favour reached U.S.\$11.29 billion, up by 30.7 per cent from the same period last year.

This pattern of trade between China and Taiwan is hardly abnormal for neighbours. Very large proportions of U.S. and Canadian trade are with each other (about 20 per cent for the U.S. and about 70 per cent for Canada); and a similarly large proportion of the trade of EU members is with each other (about 60 per cent of total EU trade).⁴⁸

Coming from a total ban on trade with China in 1987, Taiwan now has very few politically-based restrictions on trade with China. The principal ones that remain in place relate to Taiwan industries wanting to relocate to China, as discussed in the following section on investment. According to Taiwan's Board of Foreign Trade, the regulations governing the export of Taiwanese goods to mainland China are identical to those governing exports to other countries and regions (except that they must be by indirect transport routes). As for imports, beginning in August 1988 Taiwan gradually opened up its market to the 'indirect' import of raw materials and semi-finished products from China.

⁴² Taiwan's foreign currency reserves at the end of 2002 were third highest in the world, at U.S.\$162 billion, after China at second highest (U.S.\$275 billion) and Japan at highest (U.S.\$460 billion). The dollar amount for Taiwan is a December estimate, while the amounts for China and Japan are November estimates. See Central News Agency, 3 January 2003 (FBIS-CHI-2003-0103).

⁴³ It is common for trade statistics from different sources to show quite marked variations. For example, there is such a difference in the trade statistics of Japan and China that the two have long argued over which one has a trade surplus with the other.

⁴⁴ See Report of the U.S. International Trade Commission, October 2002 <http://www.usconsulate.org.hk/ushk/economic/2002/102402.htm>. 'The drop in U.S.-Taiwan trade volume from 2000 to 2001 in part reflects a longer, downward trend in agricultural trade between the two economies. The total value of U.S. agricultural exports to Taiwan fell by 31 per cent between 1995 and 2001, decreasing from U.S.\$3.3 billion in 1995 to U.S.\$2.3 billion in 2001. The value of U.S. agricultural imports from Taiwan also fell during that period, from U.S.\$600 million in 1995 to U.S.\$542 million in 2001. U.S. agricultural exports to Taiwan consist primarily of bulk commodities like wheat, coarse grains, soybeans, and cotton. The United States imports a number of consumer-oriented agricultural products from Taiwan, such as snack foods, processed fruits and vegetables. The United States also imports fish and other seafood from Taiwan.'

⁴⁵ Central News Agency, 27 December 2002, citing Ministry of Economic Affairs Statistics (FBIS-CHI-2002-1227).

⁴⁶ Source: Compiled from China Customs Statistics. Siew, 'Trade and Investment', op. cit.

⁴⁷ Central News Agency, 7 January 2003, citing data from Taiwan's Ministry of Finance (FBIS-CHI-2003-0107).

⁴⁸ See Australia Department of Foreign Affairs and Trade, 'The APEC Region Trade and Investment 2001', Canberra, October 2001.

Unit: percentage share

Table 1: Cross-Strait trade Dependency since 1991⁴⁹

Year	Taiwan to Mainland China			Mainland China to Taiwan		
	Export Dependency	Import Dependency	Trade Dependency	Export Dependency	Import Dependency	Trade Dependency
1991	9.09	1.79	5.79	1.57	10.86	5.94
1992	11.90	1.55	7.05	1.32	12.03	6.53
1993	14.96	1.32	8.48	1.11	12.24	7.02
1994	15.75	2.18	9.26	1.54	12.67	6.97
1995	16.03	2.99	9.75	2.08	13.55	7.47
1996	16.52	2.99	10.17	2.03	13.79	7.66
1997	16.81	3.42	10.33	2.14	14.41	7.52
1998	16.62	3.93	10.45	2.24	13.11	6.94
1999	17.45	4.09	11.08	2.32	12.81	7.14
2000	17.63	4.44	11.23	2.50	11.61	6.82
2001	19.58	5.50	13.02	2.22	9.88	5.88
2002 Jan/June	23.82	6.72	15.98	2.50	11.54	6.80

The main overarching legislation⁵⁰ contains a blanket ban on all goods from China, except for thirteen categories which are fairly general and which have allowed a wide range of imports.⁵¹ As of April 2000, Taiwan businesses could import about 55 per cent of all items covered by ten-digit international trade reporting (HS) codes. But two overriding conditions must be met: the importation must not be ‘counter to national security interests’ and must not have ‘any adverse effects on related industries’ in Taiwan. There is an often expressed

fear in Taiwan of trade dependence on China. In a speech on Tatan Island on 9 May 2002, President Chen foreshadowed maintaining the system of controls on the total volume of trade, presumably out of concern over possible dependence.

According to Taiwan’s Board of Foreign Trade, ‘Cross-strait economic and trade exchanges are built on the premise of the preservation of Taiwan’s security and economic competitiveness, and they serve to promote mutual trust and benefit, develop positive bilateral relations and create win-win situations’.⁵² The board also asserts that ‘[trade] relations are currently still based on the principle of unification through mutually beneficial exchange’.

As part of a broader trade liberalisation effort, many of Taiwan’s tariff and non-tariff barriers to trade have been reduced or dismantled in recent years. Substantial barriers remain in a number of sectors, including agriculture and automobiles. On the whole, however, Taiwan’s trade regime is more liberal than that of its neighbours and on a par with

⁴⁹ Sources: Extrapolated from BOFT, MOEA, *Statistics on Cross-Straits Economic Situation*, various issues, and *China Customs Statistics*, various issues. Siew, ‘Trade and Investment’, op. cit.

⁵⁰ Regulations Governing Permission of Trade between Taiwan and the Mainland Area promulgated in 1993 and amended some eight times up to 2002. http://www.trade.gov.tw/english/law_import1.htm.

⁵¹ The relevant article expresses exceptions to the ban in the following language: ‘Items ... designated and announced by the competent authority may be imported on a general basis’; and ‘Items listed as permissible for import pursuant to the Regulations Governing Permission for Importation of Industrial Technology from Mainland Area’; and ‘Raw materials, parts and components imported by the Duty-Bonded Factories for processing to export, and goods/articles for reconditioning to export’.

⁵² Board of Foreign Trade, http://www.trade.gov.tw/eng2002/content_show.asp?NO=1010&html_code=N&Rnd=0.8931848.

that of most developed countries.⁵³ Taiwan's average nominal tariff rate of 7.1 per cent is similar to that of other developed countries. (The average U.S. tariff rate is 2.8 percent).⁵⁴ There are higher tariff rates: up to 15 per cent on agricultural and food products; almost 20 per cent on automobile parts; and an average of nearly 30 per cent on passenger vehicles.

A number of products are also subject to various non-tariff barriers, such as trade licensing and import permit restrictions. These restrictions affect several hundred product classifications, and in cases ranging from pharmaceuticals to sport fishing boats they constitute significant barriers to imports. Restrictions are applied to a number of agricultural products, including sugar and rice. Foreign companies exporting to Taiwan have also raised issues regarding various arbitrarily enforced standards on products, such as air conditioners. Taiwan's import system for alcohol and tobacco products has been criticised as cumbersome and costly. Many of these non-tariff barriers are the subject of ongoing bilateral discussions with major trading partners and inconsistent with the WTO, and should be reduced or eliminated as a result of WTO accession.

As is the case with a number of countries, Taiwan also enforces substantial government procurement preferences and requirements that limit the importation of foreign goods and services. Taiwan's technology transfer requirements have also drawn some criticism, particularly in the aerospace sector. Taiwan has, however, agreed to adhere to the WTO Government Procurement Agreement upon accession to the WTO and has voluntarily undertaken some reform in this area.

WTO membership commits Taiwan to economically significant further liberalisation. In January 2002, the Chair of the MAC, Tsai Ing-wen, reaffirmed Taiwan's commitment to meeting this obligation both in general terms and in respect of opening up to new imports from China, 'to the extent that this does not seriously jeopardise our

national security'.⁵⁵ In the same speech, Tsai also called on China to use its membership in the WTO along with Taiwan as a 'forum for both sides to interact in a multilateral context and try to learn to live with each other under one roof, as competitors, business rivals, or even partners'. She said it would be a 'good exercise for both sides to build trust and confidence and develop rules of engagement for themselves',⁵⁶ adding earlier in the speech that this could be one way of re-establishing the dialogue mechanism of the 1990s.

China took its time responding positively to this suggestion., giving Taiwan's Geneva delegation the cold shoulder for almost ten months after it joined the WTO on 1 January 2002.⁵⁷ The first substantive encounter between the two delegations, which occurred in a multilateral meeting, was frosty, with the China delegate dismissing some enquiries from the Taiwan delegation as a 'bilateral issue' to be dealt with between China and Taiwan, and not appropriate for the multilateral forum. By November, the mood began to change, and in December, the two sides held direct talks for the first time.⁵⁸ These were on a technical matter (China's imposition of market safeguard action against a range of steel products, including some produced by Taiwan), and the talks were held in a hotel and not WTO headquarters. But the ice was broken.

2. Investment

China is by far the biggest recipient of Taiwan's outward foreign direct investment. In 2002, for the first time, China investment exceeded 50 per cent of Taiwan's overall outward investment – 53.3 per cent in 2002, up from only 38.8 per cent in 2001.⁵⁹ In December alone, the number of new applications filed by Taiwanese enterprises to make indirect investment in China came to 189, with a value amounting to some U.S.\$450 million. Taiwanese investment in the mainland concentrated on

⁵³ Taiwan Board of Foreign Trade, <http://www.trade.gov.tw/english/page31-4.htm>.

⁵⁴ Report of the U.S. International Trade Commission, October 2002.

⁵⁵ Tsai Ing-wen, 'A New Era in Cross-Strait Relations? Taiwan and China in the WTO', Heritage Lectures, No. 726, 14 January 2002, p. 4.

⁵⁶ Ibid., p. 7

⁵⁷ Central News Agency, 25 October 2002 (FBIS-CHI-2002-1025).

⁵⁸ *Financial Times*, 16 December 2002.

⁵⁹ *Taiwan Economic News*, 24 January 2003, citing data from the Ministry of Economic Affairs.

Unit: U.S.\$billion

Table 2: Annual Taiwan Investment in Mainland China since 1991⁶⁰

	Value Taiwan Investment in China (Taiwan Statistics) ⁶¹	% Share of Taiwan's Total Outward Investment	Contracted Value (China statistics) ⁶²	% share of China's total contracted DFI	Realised Value (China Statistics)	% share of China's total realised DFI
1991	.174	9.52	3.537	6.76	.869	3.72
1992	.247	21.78	5.543	9.54	1.050	9.54
1993	3.168	65.60	9.965	8.94	3.139	11.41
1994	.962	37.30	5.395	6.53	3.391	10.04
1995	1.093	44.61	5.777	6.33	3.162	8.43
1996	1.229	36.21	5.141	7.02	3.475	8.33
1997	4.334	59.96	2.814	5.44	3.289	7.26
1998	2.035	38.17	2.982	5.72	2.915	6.41
1999	1.253	27.71	3.374	8.18	2.599	6.45
2000	2.607	33.93	4.042	6.48	2.296	5.64
2001	2.784	39.14	6.914	9.99	2.980	6.36
2002 Jan/June	1.536	50.08	4.363	9.92	1.924	7.83

Jiangsu, Guangdong, and Fujian provinces, with electronics manufacturing, base metal, chemicals, precision machinery and plastic manufacturing the top five sectors. Total approved China investments for 2002 reached U.S.\$3.85 billion, up 38.6 per cent from 2001 and a new high in recent years.

Up to and including the first half of 2002, Taiwan's cumulative investment in the mainland amounted to U.S.\$21.43 billion. China's estimate of total Taiwan investment is much higher, at U.S.\$31.06 billion as of June 2003: see Table 2. The actual amount probably far exceeds the official statistics of either side, since Taiwan investors often used Hong Kong-based companies as surrogates to get around earlier restrictions on investments in the mainland imposed by Taiwan law.

Among foreign investors in the mainland, Taiwan ranks in third place, with only Hong Kong and the U.S. having invested more. For China, Taiwan investment has certainly made a huge contribution to its economic development, particularly through the inflow of a great amount of foreign technology and generation of substantial foreign exchange earnings. Most of the electronics and information products that China now ships to the U.S. and Europe are manufactured by Taiwan-invested firms. Investment in the mainland by Taiwan firms has created between five and ten million jobs there.⁶³

The downside for Taiwan has been the hollowing out of its domestic industries, and their relocation to China. Some have warned that if Taiwan's technology and capital continue to flow across the Taiwan Strait, it will eventually cost Taiwan its economic 'superiority' over China.⁶⁴ As a result, the prospect of Taiwan manufacturers shifting their production of large integrated circuits to China has become a hot subject of debate over the past year. Senior officials of the Ministry of Economic

⁶⁰ See Siew, 'Trade and Investment', op. cit. Sources: Mainland Affairs Council, *Cross-Straits Economic Statistics Monthly*, various issues; Chunghua Institute for Economic Research, *Mainland China Industrial Development Quarterly*, various issues; DRI Asia Database.

⁶¹ Figure for 1993 in Taiwan's statistics includes investment from previous years that was registered in 1993 for the first time.

⁶² The 1991 figure indicates cumulative investment to that year, not just the annual amount for 1991.

⁶³ Siew, 'Trade and Investment', op. cit.

⁶⁴ Ibid.

Affairs have warned businesses not to put all their eggs in the China basket.⁶⁵

But this consideration is not preventing a continuation of the steady liberalisation of Taiwan's investment into China. For example, in December 2002, the Legislative Yuan's finance committee reached agreement with the Ministry of Finance to allow Taiwan insurance companies to increase from 20 to 35 per cent the share of their total investments going to projects outside Taiwan, including those bound for China.⁶⁶ The positions taken reflected the concerns mentioned earlier, such as dependence and vulnerability, but support and opposition did not follow party lines closely. A DPP member, Yu Jane-daw, pressed for an increase in the outbound investment ceiling to 40 per cent because of a 'saturated market and low investment returns in Taiwan' and the hope for expanding economies of scale by making greater overseas investments. The Finance Ministry said precautions should be taken before allowing more Taiwanese capital to flow into China and to prevent rapid capital outflow from Taiwan. But it was prepared to back an increase of the ceiling to 30 per cent. It was supported by several committee members, including the DPP's Alice Wang and the PFP's Chen Chih-pin. In the end, a DPP member and chair of that committee session recommended a compromise position of 35 per cent. If the investment ceiling is raised to 35 per cent through subsequent legislative amendments, an estimated U.S.\$150 billion would then be allowed to move out of Taiwan, much of it to China.

The Taiwan government and the private sector are trying to respond to the challenges presented by the flood of Taiwan investment to China and the consequent hollowing out of Taiwan's own manufacturing industries. They have clearly faced the same sort of structural adjustment problems experienced by a number of newly industrialising countries, and even larger developed countries, such as Japan. And given the large scale of the investment flow to date, it is difficult to read too much geopolitical significance into continuing, quite limited restrictions on new investment in

China. It is more a question of how quickly the existing restrictions will be eased or lifted and what particular domestic political bargains will be struck along the way. In a recent survey of new Taiwan investors in China, only 13 per cent of firms had closed their domestic operations entirely.⁶⁷ The main 'losses' occurred in small to medium enterprises, while large firms actually increased their production in Taiwan at the same time as they expanded into China. As many as 49 per cent of smaller firms surveyed said their production in Taiwan was falling.

The issues raised by this process of hollowing out are seen as very important in Taiwan by a variety of constituencies, but even the DPP government recognises a certain inevitability about it from an economic point of view, and does not attempt to paint China as the villain as a result. The Taiwan government's recognition of this inevitability was reflected in its switch from President Lee's old policy framework of 'no haste, with patience', to one of 'active opening, effective management'.⁶⁸ The important policy goal for Taiwan is not to prevent the migration of its production to China but to ensure that Taiwan producers 'will conduct their core operation and retain the key value in the supply chain'⁶⁹ through services and management in Taiwan. The policy responses will not be easy to shape nor the outcomes guaranteed, but this is by and large a world-wide phenomenon, not one unique to cross-Strait relations. This does not prevent of course, occasional recourse by political leaders to very broad arguments alleging that the hollowing out in China's favour creates a security risk of some sort to Taiwan.

The more interesting trend from a geopolitical perspective, and one that is being encouraged by the government of Taiwan, is the effort to 'balance' Taiwan's investment in China with that of Chinese investment in Taiwan.⁷⁰ There have been promising developments, as Taiwan has progressively liberalised its regimes for China-origin investments.

⁶⁵ In 2002, non-China outward investment from Taiwan was down 23.26 per cent on 2001. As a result of Taiwan's economic downturn, local enterprises had invested less in electronics manufacturing, especially in the U.S.

⁶⁶ Joyce Huang, 'Investment Ceiling May Increase', *Taipei Times*, 27 December 2002.

⁶⁷ Central News Agency, 24 October 2002 (FBIS-CHI-2002-1024). The survey was conducted by the Ministry of Economic Affairs.

⁶⁸ Paul S. P. Hsu, 'Policy Brief on Taiwan in the WTO', Paper presented to the Evian Group Trade Policy Compendium, Montreux, 12-14 April 2002.

⁶⁹ Ibid.

⁷⁰ According to the Chair of the MAC, Taiwan is 'building up a system to facilitate two-way investment, trade and capital flows'. See Tsai, 'A New Era in Cross-Strait Relations?', op. cit., p. 4.

For example, as Taiwan banks have opened in China, beginning with eight in December 2001, banks from the mainland are now looking to open in Taiwan. Several already have agreements dating from September 2002 on clearing of transactions, even if they do not have a physical presence on the other side of the strait. Mainland entrepreneurs are also now likely to be allowed to invest in Taiwan real estate.

But the concept of seeking a balance in investment trends in a particular bilateral relationship, like seeking a balance in bilateral trade, is not one based in solid economics. While a country's overall situation relative to the rest of the world in terms of trade and capital flow is a primary indicator of economic well-being, a balance in trade or capital flow in a particular bilateral relationship is much less important. So the concept of 'balance' in cross-Strait financial flows is more a tool of political propaganda. The main aspect of the economic interchange, even if there is a large imbalance, is that it forces the two sides to establish mechanisms for solving disputes and developing mutually advantageous policies.

There are downsides to this process of normalisation from the point of view of maintaining a special relationship between China and Taiwan. On the one hand, as WTO rules force a progressive easing out of discriminatory policies, Taiwan investors will probably lose the special advantages they currently enjoy in China as a result of their status as 'Taiwan compatriots'. In surveys of Taiwan businesses in China, about 20 per cent have identified this as their primary concern.⁷¹

3. Formal Bilateral Economic Structures: A China-Taiwan Free Trade Agreement?

In January 2002, both Taiwan and China made important mentions of the prospect and virtue of the two sides agreeing to some sort of bilateral structure on which to conduct economic relations. China, as part of more flexible positioning in a speech by Qian Qichen, called for greater formalisation of existing cross-Strait economic activity through some sort of 'mechanism'.⁷² And,

as mentioned above, Taiwan, in a speech by MAC Chair, Tsai Ing-wen, called for the establishment of some rules of engagement and a return to some sort of bilateral mechanism which would provide for interaction on economic matters in a 'more structured and systemic mechanism'.⁷³ The momentum for movement in that direction is building. Former KMT Prime Minister Vincent Siew has recommended the establishment of a free trade agreement (FTA) between Taiwan and China as a first step to creating a Chinese common market.⁷⁴ And, as mentioned above, the two sides had held a formal meeting on economic matters for the first time through the WTO framework in December 2002.

As far as the medium term perspective is concerned, the WTO contacts and an FTA probably represent the two poles of the achievable in terms of a formal bilateral economic coordinating structure. Many officials in China are likely to resist the idea of a China-Taiwan FTA. In October 2002, China's formal position was that Taiwan is not entitled to rely on Article 24 of the General Agreement on Tariffs and Trade (GATT) that provides for the signing of FTAs since that provision only applies to states.⁷⁵ Taiwan disputes this view on the grounds that it has equal status with all other members of the WTO in spite of the various names under which any member might have joined. But the poles are not that far apart. One Chinese source confirmed that an FTA was one possibility considered when Qian's 2002 proposal was floated.⁷⁶

There are a number of other bilateral and international circumstances suggesting that an FTA is possible. Above all, Taiwan and China have already been talking about bilateral economic policy for many years, in many different forums and across a broad spectrum of specific technical aspects. The most notable has been legal protection in China of Taiwan investments. Taiwan investors had long feared that one day, for political reasons, the Chinese government might simply seize their assets. While hypothetically that remains a

⁷¹ Central News Agency, 26 December 2002 (FBIS-CHI-2002-1226).

⁷² Qian said: 'to bring about a new rise in the level of cross-Strait economic relations, we are willing to solicit views and suggestions from Taiwan's various circles on establishing a cross-Strait economic cooperation mechanism and on forging closer cross-Strait economic relations'. 'Qian Qichen Speech

on Taiwan', Xinhua Domestic Service, 24 January 2002, FBIS-CHI-2002-0124.

⁷³ Tsai, 'A New Era in Cross-Strait Relations?', *op. cit.*, p. 2.

⁷⁴ Siew, 'Trade and Investment', *op. cit.*

⁷⁵ Central News Agency, 25 October 2002 (FBIS-CHI-2002-1025).

⁷⁶ ICG interview, November 2002.

possibility in an extreme case, the Chinese government responded to Taiwanese concerns some eight years ago by passing appropriate legislation in 1994 'on the protection of investments of Taiwan compatriots'. (The law also provided for preferential treatment for Taiwan investors.) The contacts between the two sides on the establishment of direct transport links (discussed further below) are now several years old, quite technical and quite elaborate.

Secondly, China is actively pursuing separate free trade arrangements with Hong Kong and Macau. And in November 2002, Chinese officials even floated the possibility of a four-party FTA involving those two, along with China and Taiwan. This idea was rejected at first glance by some in Taiwan's MAC as impossible as long as China was not prepared to deal with Taiwan government economic officials.

A third set of reasons is the evolving regional and global rush to conclude FTAs. There is a long list of countries signing, negotiating or investigating bilateral and multilateral FTAs. In East Asia, for example, this includes U.S.-Singapore, U.S.-Australia, U.S.-Taiwan, Singapore-Taiwan, China-ASEAN, Japan-Korea, and Japan-Mexico. At the regional level, a number of governments see the APEC process for promoting free trade and further liberalisation as chronically stalled as a result of the 1997 Asian financial crisis, and FTAs as a means of keeping pressure on states to honour existing commitments, such as the agreement on free trade in APEC's 1994 Bogor Declaration, or to liberalise multilateral trade rules beyond those under the existing commitments of the WTO.⁷⁷ In this environment, it is not unreasonable to expect China and Taiwan to see considerable virtue in concluding an FTA, if the issue of international status of Taiwan and its naming can be handled to the satisfaction of both.

The issue of naming is not likely to be insurmountable. Under the WTO framework, China is now talking to Taiwan directly at official level on the basis of the name 'Customs Territory of Taiwan, Penghu, Kinmen and Matsu'. This is the name under which China agreed to let Taiwan join the WTO. The name does not challenge China's position on 'one China', and it even appears to

reinforce it. The bigger issue is the public presentation of the conduct of negotiations with Taiwan government officials, a precondition Taiwan is trying to set.⁷⁸

It will be the politics that will dominate further consideration of a Taiwan-China FTA. On the positive side, as Japan's published FTA strategy notes, any FTA can 'give rise to a sense of political trust' among the parties.⁷⁹ This is exactly what China and Taiwan would want most out of an FTA, though there would be important economic gains for Taiwan.

The 'trust' that would accrue to a Taiwan-China FTA – its symbolic value – would be particularly important to China in counterbalancing what appears to be a snowballing political momentum in the U.S. to sign an FTA with Taiwan. On 6 November 2001, Senator Max Baucus, a Democrat, introduced such legislation.⁸⁰ On 21 October 2002, a study by the U.S. International Trade Commission on the effects of a U.S. FTA with Taiwan concluded that trade flows for certain sectors would probably increase substantially, up to 100 per cent in motor vehicles and some foods (though with limited impact on the overall U.S. economy).⁸¹ If the U.S. and Taiwan sign an FTA, but China and Taiwan cannot, then this will be seen by some in China as one more element in U.S. and Taiwanese efforts to 'split' Taiwan from China. It is unlikely, therefore, that Chinese leaders will sit back and let the U.S. gain yet another formal agreement when it would be relatively easy for them in political terms (and strongly supportive of their main political goal) to counterbalance it with their own FTA with Taiwan.

C. TRANSPORT AND COMMUNICATION LINKS

After 1949, Taiwan and China had banned all direct links with each other. As part of China's move away from military approaches to the Taiwan issue

⁷⁷ See, for example, 'Japan's FTA Strategy', issued by the Ministry of Foreign Affairs in October 2002.

⁷⁸ 'Beijing's Free Trade Area Proposal gets Cool Response', *Taiwan Economic News*, 29 November 2001.

⁷⁹ 'Japan's FTA Strategy', *op. cit.*

⁸⁰ Congressional Record, 6 November 2001, excerpted on the Taiwan Studies Institute webpage: www.taiwanstudies.org/view_story.php3?501.

⁸¹ U.S. Consulate General, Hong Kong, 'ITC Says US-Taiwan Free Trade Agreement Would Have Limited Impact', www.usconsulate.org.hk/ushk/economic/2002/102402.htm.

in 1979, it made an offer to Taiwan to open direct shipping links. In 1981, PLA Marshal Ye Jianying outlined a plan recommending that China and Taiwan establish 'three links' (postal⁸², air and sea) and 'four exchanges' (academic, cultural, economic and athletic) as the 'first step' to 'gradually eliminate antagonism and increase mutual understanding'. In 1982, China proposed simultaneous opening of duty-free trade between the two sides of the Strait. Taiwan's first positive response came in 1987, with a slight easing of a total ban on travel to the mainland. Most travel restrictions were progressively lifted, but it was not until 1997 that the first cross-Strait direct sea transport contacts were allowed on a very limited scale and under a somewhat tortuous formula that involved off-loading only cargos that had not come from mainland China. The arrangement was limited to the trans-shipment of goods through Taiwan's southern port city of Kaohsiung by foreign-registered vessels to and from just two southern Chinese ports (Xiamen and Fuzhou). Direct trade was still banned, and direct shipping involving ships registered in China or Taiwan was prohibited.

The return of Hong Kong to China's sovereignty in 1997 made a mockery of the continuing ban by Taiwan on direct transport links. Since Taiwan already had extensive transport links with Hong Kong and through Hong Kong to China, Taiwan was left in the situation of permitting such links to

one part of China (albeit a Special Administrative Region) while prohibiting them to the rest of China.

The total prohibition on direct links could not last. In March 2000, the Taiwan parliament passed the Offshore Island Development Act, which provided for the implementation of direct links between China and the islands of Kinmen, Matsu and Penghu 'before they are implemented for Taiwan as a whole'. (China had passed laws in 1994 allowing for such links.) These transport connections were called the 'mini links'. Such 'mini-links' had been proposed by China's Fujian Province as early as 1992. The mini links were designed primarily to facilitate people movement, not trade, and this has been borne out by usage since their establishment, with most ships carrying passengers only.⁸³ On 2 January 2001, the first direct transport links that were provided for under the new law occurred between Kinmen and Matsu and China. The March 2000 legislation conflicts with Taiwan's Statute Governing Relations between Peoples of the Taiwan Area and the Mainland Area, which still prohibits direct transport links between China and Taiwan, and with other Taiwan laws controlling movement of people out of Taiwan and into China.

Successive Taiwan governments have sought to retard and resist with all sorts of devices the rapid implementation of direct links with China because they feared an inevitably unequal power relationship between China's very large economy and Taiwan's relatively small one. President Chen Shui-bian has been no exception in seeking to retard the development of direct links. But in a speech on Tatan Island on 9 May 2002, President Chen committed himself to doing so, saying in a very warm speech:

A moment ago, when we were looking at mainland China off in the distance, I was aware of a feeling deep in my heart. The two sides are so close that we can see the opposite shore with the naked eye. The interaction among private citizens is quite frequent. This kind of feeling is really very special and intimate...our Kinmen serves as an even better place than the Berlin Wall and

⁸² Most discussions about the three links, including in this report, focus on air and sea transport, because postal links, insofar as they are distinct from the shipping and air links that carry them, have long now been established. Postal links were important as a form of social contact when the proposal was made in 1979, and their significance at the time cannot be understated given that the two sides had almost no contact at all. In May and June 1979, China's postal authorities unilaterally started telegraph, telephone, surface mail, and registered letter services to Taiwan, but these were by indirect routes. In June 1989, Taiwan permitted its postal authorities to formally take up ordinary mail for mainland addresses. Gradually, airmail services (by indirect routes) were inaugurated between the Taipei Airmail Centre and Beijing, Shanghai, Guangzhou, Fuzhou and Xiamen on the mainland. Meanwhile, a surface mail service went into operation between Beijing, Shanghai, and Guangzhou on the mainland and Taipei and Keelung. In June 1993, China and Taiwan signed a Compensation Agreement on Tracking Registered Letters across the Strait. Taiwan postal agencies began to dispatch registered mail to the mainland, and to accept requests to track registered letters.

⁸³ See Mainland Affairs Council, 'Implementation Results of the Provisional "Mini Three Links"', 30 May 2001.

Panmunjom for people to recall the lessons of history and contemplate the horrors of war.⁸⁴

Chen ended his remarks with the following statement:

In short, I am willing to open the door with love and sincerity, confidence and action. I have full confidence in Taiwan and in the future of relations between the two sides of the Taiwan Strait.

The implementation of the direct links cannot occur overnight. There will be a number of complex commercial and technical (legal) considerations to be addressed, and some of these carry important political ramifications for the 'one China' question and issues of Taiwan's international status. This has been particularly evident in the efforts since May 2002 to open up direct air links. Having declared in May that the government would submit legislation to parliament before the end of the year to provide for direct links, Taiwan then became embroiled with China in a pattern of tit-for-tat megaphone diplomacy on the issue, with apparent breakthroughs being followed by apparent setbacks. The following chronology of this process, up to the first landing in China (Hong Kong and Macao excluded) of a Taiwan-flagged aircraft on an 'indirect' charter flight on 26 January 2003, shows its stop-start aspect and the way in which Taiwan politicians in particular used the process for political advantage:

- 10 May 2002: President Chen says he might allow private groups to hold direct negotiations with China about opening direct transport links;⁸⁵
- 21 May: leading Taiwan Affairs official in China express the hope that Taiwan will live up to the Chen commitment to allow talks between non-governmental groups so that direct links can be established at an early date;⁸⁶
- 26 May: news report that Chinese authorities would not reject a visit to China by MAC

Chair, Tsai Ing-wen, if she visited under an appropriate capacity;⁸⁷

- 28 May: China says that the crash of an airliner in the Taiwan Strait and the need for disaster cooperation shows the importance of establishing cross-Strait aviation links;⁸⁸
- 3 June: MAC says that the government will present an amendment to legislation to the parliament before the end of the year to allow for direct links, and promises that within three months Penghu would be included in the 'mini links'; MAC foreshadowed the earliest possible date for direct links would be mid-2003 but simultaneously pressed legislators not to eliminate the 'negotiation factor' by allowing for unfettered direct transport links;⁸⁹
- 19 June: Taiwan Cabinet extends travel provision of the 'mini links' to allow transit of Taiwan business people not normally living in Kinmen or Matsu;⁹⁰
- 6 July: Chinese leader, Qian Qichen, tells Taiwan not to let politics interfere with talks on opening of direct links; that discussion could proceed without discussing the 'one China' issue, but as long as the links were regarded as 'domestic' routes;⁹¹
- 31 July: Taiwan announces new regulations implementing the decision of 19 June on transit of Taiwan business people and their relatives through Kinmen and Matsu; regulations also provided for the export of goods from anywhere in Taiwan through Kinmen and Matsu, but the Ministry of Economic Affairs would still need to 'formulate the details';⁹²
- 23 September: Director of the American Institute in Taiwan, Douglas Paal, is reported to express U.S. interest in the opening of direct links;⁹³
- 28 September: *Asahi Shimbun* publishes an interview with President Chen in which he

⁸⁴ Remarks by President Chen Shui-bian, Tatan Island, 9 May 2002. See <http://www.taipei.org/chen/chen0509.html>.

⁸⁵ BBC, 11 May 2002 (www.taiwan.security.org/News/2002/BBC-051102.htm).

⁸⁶ *China Daily*, 22 May 2002.

⁸⁷ *Taipei Times*, 26 May 2002.

⁸⁸ Reuters, 28 May 2002.

⁸⁹ *Taiwan News*, 4 June 2002; Associated Press, 4 June 2002.

⁹⁰ *China Post*, 20 June 2002.

⁹¹ Reuters, 6 July 2002.

⁹² *Taiwan News*, 1 August 2002.

⁹³ *China Post*, 24 September 2002.

- rejects China's requirement that direct links be treated as 'domestic' routes;⁹⁴
- 17 October: to get over the dispute about whether direct links should be called 'international' or 'domestic', China's Qian Qichen suggests that they be termed 'cross-Strait' routes, with the amplifying remark that direct links are purely an economic affair; and that talks could proceed without discussion of the 'one China' principle;⁹⁵
 - 18 October, Taiwan's Prime Minister, Yu Shyi-kun, promised to investigate and verify the remarks made by Qian, but asserted that direct links were no panacea for Taiwan's economic policy; Yu complicated the issue by saying that the cross-Strait routes should also be open to other international carriers; MAC Vice Chairman Chen Mintong says that any talks have to be conducted in accordance with Taiwan law, implying the need for the involvement of Taiwan officials;⁹⁶
 - 19 October: Taiwan's Chen Shui-bian welcomes China's show of good will, but says he is not certain that Qian's view represents China's view; calls for negotiations on the principle of democracy, equality and peace – implying that Taiwan wanted to constrain the possibilities;⁹⁷
 - 27 October: more than half of Taiwan's members of parliament sign a petition organised by a KMT member calling on the government to allow Taiwan airlines to conduct direct charter flights into China for the Lunar New Year, in part to test the feasibility of direct links;⁹⁸
 - 28 October: MAC Chair, Tsai Ing-wen, says that the petition's proposal for direct charter flights seems simple but is 'entangled' with negotiations over direct links, and repeats the position that Taiwan government will have to be involved;⁹⁹
 - 30 October: China repeats position that talks on direct links can be held without reference to political talks as long as the links are not described as being between two countries;¹⁰⁰
 - 31 October: Taiwan's Chen Shui-bian insists that his government officials will need to be involved;¹⁰¹
 - 5 November: KMT think tanks accuse the DPP government of going slow on direct links and having no vision for the future;¹⁰²
 - 7 November: Taiwan's defence ministry proposes severe limits on direct flight because of security concerns: that flight routes involving China's coastal cities should be avoided; that night flights should be banned; and that Taipei airports not be used;¹⁰³
 - 18 November: Leak from a report in preparation by the MAC suggests that it will propose limiting entry point for direct flights into Taiwan to Kaohsiung, that China might reject use of Taipei's Chang Kai Shek international airport because its use might imply that the routes were international, and that Taiwan had ruled out using Taipei's Sungshan airport since it only serviced domestic routes;¹⁰⁴
 - 18 November: Chen Shui-bian says that Taiwan will agree to 'conditional direct links' only when national security can be assured;¹⁰⁵
 - 20 November: MAC says that China's air carriers will not be allowed to operate indirect charter flights for the coming Lunar New Year;¹⁰⁶
 - 21 November: Taiwan Deputy Prime Minister, Lin Hsin-I, says that direct links have both favorable and unfavorable impacts on Taiwan industry;¹⁰⁷
 - 27 November: China charges (quite correctly), that Taiwan's continuing restrictions on

⁹⁴ *Taiwan News*, 29 September 2002.

⁹⁵ Associated Press, 17 October 2002.

⁹⁶ *Taiwan News*, 19 October 2002.

⁹⁷ *Taiwan News*, 20 October 2002.

⁹⁸ Associated Press, 28 October 2002.

⁹⁹ *Taiwan News*, 29 October 2002.

¹⁰⁰ Associated Press, 30 October 2002.

¹⁰¹ *Taipei Times*, 1 November 2002.

¹⁰² *Taipei Times*, 6 November 2002.

¹⁰³ Agence France-Presse, 7 November 2002 (FBIS-CHI-2002-1107).

¹⁰⁴ *Taipei Times*, 19 November 2002.

¹⁰⁵ Central News Agency, 18 November 2002 (FBIS-CHI-2002-1118).

¹⁰⁶ *China Post*, 21 November 2002.

¹⁰⁷ Central News Agency, 21 November 2002.

comprehensive direct links is a violation of WTO principle;¹⁰⁸

- 29 November: report that China gave a Taiwan civil aviation industry group an application form for charter flights ('periodic' as opposed to regularly scheduled flights) into China;¹⁰⁹
- 8 January 2003: China announces that six Taiwan airlines could operate charter flights to and from Shanghai, and that 40 flights had been booked for the upcoming New Year;¹¹⁰
- 16 January: Taiwan announces that goods bound for China would henceforth be allowed transshipment through Xiamen under the 'mini-links' process until there could be a relaxation of the ban on other direct shipping; (this move was part of a wider government review of how to make the 'mini links' work better, a possible sign that for the moment at least the government has no intention of relaxing the ban on direct shipping apart from the mini links);¹¹¹
- 24 January: Taiwan says that talks on direct links can be discussed through 'semi-official' channels, mentioning the SEF-ARATS process as one possible way;¹¹²
- 25 January: MAC officials reported to be on passenger manifest for the historic first indirect flight into Shanghai (via Hong Kong) of a Taiwan flag aircraft the following day;¹¹³ and
- 26 January: a leading MAC official, Chen Mintong, says that the flights will help the development of cross-Strait relations; he expresses the hope that the two sides will learn how to deal with each other from this

experience, but the fear that direct links might promote rapid capital flight and hollowing out of Taiwan industry.¹¹⁴

In coming years, many of the technical issues involved in opening direct air and shipping links will provide fuel for a continuation of the intense political struggle and strident propaganda that has characterised cross-Strait relations. In fact, there will be no let up in this political struggle as the two sides contest the shape and form of moves toward closer political relations. Each of the two links (air and shipping) will in fact be established in full at different times, thereby providing both sides with an opportunity, possibly even an incentive, to drag out or otherwise manipulate the process. But the establishment of direct links, long demanded by China but linked firmly to its 'one China' principle, is now seen in Taiwan government circles as inevitable in the short to medium term, even if they intend to keep them somewhat limited and controlled.

Thus, China and Taiwan have now taken what China identified in 1981 as the 'first step' for reduction of tensions between the two. Once the formal legislative steps are completed, such a move would represent a major symbolic breakthrough in cross-Strait relations, even though some direct links of varying scale have been in place between Taiwan and China for a number of years. The projected move on direct links would soften substantially the political significance of still limited military preparations by both sides for the contingency of war.

D. OTHER MARITIME AFFAIRS

Apart from the issue of direct shipping links, there are three areas of maritime policy in which China and Taiwan have found some basis for cooperation: maritime claims, energy development and fisheries operations. In the case of the last two, the cooperation has developed steadily and with few competitive aspects. In the case of maritime claims, there are both cooperative and competitive political aspects. But all three areas of policy continue to hold important potential for further cooperation. China has shown a strong interest in development of off-shore oil and gas since the earliest days of its open door policy, and it has had a longstanding interest in off-shore fisheries. Its growing interest

¹⁰⁸ See Zhongguo Xinwen She, 27 November 2002: 'PRC's Zhang Mingqing: Taiwan Obstruction to Three Links Violates WTO Principles' (FBIS-CHI-2002-1127).

¹⁰⁹ Xinhua, 29 December 2002 (FBIS-CHI-2002-1229).

¹¹⁰ Xinhua, 8 January 2002 (FBIS-CHI-2003-0108).

¹¹¹ Central News Agency, 16 January 2003 (FBIS-CHI-2003-0116). One such new measure which shows how limiting and seemingly petty the current arrangements are was the government's agreement as part of this review of the mini links to allow Taiwan-published magazines and newspapers to be shipped to subscribers on the mainland via Kinmen or Matsu.

¹¹² *Taipei Times*, 25 January 2003.

¹¹³ *China Post*, 26 January 2003.

¹¹⁴ *The Washington Post*, 26 January 2003.

in sea-borne trade and acquiring a modern navy have also been closely linked to the issue of maritime jurisdiction. While naval development has offensive as well as defensive implications, all of the other areas of China's maritime interest have dictated that China adopt a cooperative attitude, not just to Taiwan but to the international community in general.

1. Maritime Claims

Against the flow of the political contest over sovereignty as it applies to international status, China and Taiwan have maintained a policy of tacit agreement on issues of maritime sovereignty for several decades, and a posture of quiet engagement on these issues for much of the 1990s. This latter trend has been seen both in a lining up of positions on some issues, and a process of regular consultation and exchanges among maritime law specialists from both sides. This has included regular visits to Taiwan of Chinese researchers (officials) from the State Oceanic Administration of China.

Since sovereignty over the sea derives *in toto* from sovereignty over land territory, the sovereignty dispute between China and Taiwan has had an inevitable impact on maritime claims, such as territorial sea, customs inspection zones,¹¹⁵ continental shelf resource jurisdiction and exclusive economic zone (EEZ) jurisdiction.¹¹⁶ From China's point of view, a necessary legal implication of its position on Taiwan's status is that China has the right to determine the baselines of its territorial sea around Taiwan-controlled territory and the extent of the jurisdictions that extend from the baselines. It is also a necessary implication of recognition by other states of China's sovereignty over Taiwan that they should, therefore, recognise China's right to declare and police these maritime jurisdictions in respect of Taiwan. But this is not the practice of most states, nor of China itself. Since Taiwan has enjoyed *de facto* independence, most states – including China – have not sought since 1967 to challenge Taiwan's exercise

of maritime jurisdiction broadly in line with the law of the sea applicable at the time. Taiwan has consistently declared and enforced a range of maritime jurisdictions that it should have no right to in the absence of status as a state.

The restraint by China on these maritime jurisdiction issues derives in part from its lack of desire to become embroiled in a maritime crisis with Taiwan that could lead to naval confrontation with the U.S. But it is also related to China's relatively conservative approach to enforcing its maritime claims where these are disputed with other states.¹¹⁷ The sustained competition for recognition by China and Taiwan has contributed in part to the lack of movement in the delimitation of overlapping continental shelf and EEZ jurisdiction with Japan in the East China Sea and with the Philippines in the South China Sea. More importantly, China's restraint in respect of Taiwan's maritime surrounds provides some room for manoeuvre for China to perhaps agree ultimately on a formula for Taiwan's status that leaves it in full control of maritime jurisdictions that are normally only the prerogative of states.

Since China and Taiwan competed, until 1991 at least, to be the exclusive sovereign of all of China, they both continued to compete as the legitimate defender of a 'Chinese' claim to offshore territories whose ownership was disputed. These include the Senkaku Islands (disputed with Japan), the Paracel Islands (disputed with Vietnam) and the Spratly Islands (disputed with Vietnam, the Philippines and Malaysia). The Spratly dispute further extends the range of China-Taiwan entanglements in claimed maritime resource jurisdictions that overlap with those of Vietnam, the Philippines, Malaysia, Brunei and Indonesia. China and Taiwan have had a common interest in advancing mutually supportive claims about the historical basis of their separate (but nearly identical) claims to the disputed territories.

As military tensions between China and Taiwan have increased in the past eight years, the policy of quiet

¹¹⁵ 'Contiguous Zone' in international legal parlance.

¹¹⁶ Under international law, a state is entitled to claim a twelve nm. territorial sea, a further twelve nm. contiguous zone, an EEZ up to 200 nm. from the baselines of its territorial sea, and a continental shelf jurisdiction whose extent is determined by a complex formula but which in certain particular circumstances can be up to 350 nm. from the baselines.

¹¹⁷ Even in respect of the South China Sea, where China's actions have been seen by many observers as aggressive, China has not attempted to enforce its claims by evicting other claimants. It has been prepared to use force to protect its physical presence. See Greg Austin, *China's Ocean Frontier: International Law, Military Force and National Development* (St Leonards, 1998), Chapter 3.

cooperation between China and Taiwan on maritime claims has come under some pressure. First came complaints from Taiwan specialists that China was undertaking unlawful military activities in Taiwan's EEZ, then by 2002 came claims that Chinese military intelligence ships were undertaking unlawful activities in Taiwan's territorial sea. These new competitive developments in respect of maritime jurisdiction remain of concern, but they are more than counter-balanced by signs of cooperative behaviour in this domain. One of the best examples is China's exclusion of Taiwan from the territories for which it published baselines in May 1996.¹¹⁸ China had been undertaking a thorough survey and policy study of its baselines ever since the conclusion of the UN Convention on the Law of the Sea in 1982.¹¹⁹ China enclosed Hong Kong within the new 1996 baselines, but did not publish baselines for other potentially sensitive areas, such as the Bohai Gulf, Taiwan, the Spratly Islands, and coastal areas adjacent to North Korea and Vietnam. Though China foreshadowed subsequent publication of baselines for these locations, its restraint in respect of Taiwan was the result of a deliberate decision that it did not want to create unnecessary difficulty in relations with Taipei.¹²⁰ In spite of a clarification that China would 're-announce' the straight baselines for Taiwan and associated islands in due course, as well as other baselines, for which preparations and study were still continuing,¹²¹ China has not yet done so.

2. Energy

An even more convincing example of China-Taiwan maritime cooperation has been in the development of offshore energy. In 1982, China invited Taiwan's oil enterprises to form partnerships with Chinese companies to explore offshore oil resources. In 1994, the Chairman of the China National Offshore Oil Company (CNOOC), Chen Bingqian, suggested to representatives of Taiwan's oil industry that the two sides cooperate in any ways that were mutually acceptable. Chen

specifically invited Taiwan's participation in joint oil exploration in the Taiwan Strait. The two sides entered negotiations but these were interrupted temporarily by China's missile tests and other military pressure on Taiwan in March 1996. But soon after, there was a resumption of exchanges between Taiwan and Chinese officials in marine development policy. By July 1996, CNOOC and OPIC, a wholly-owned subsidiary of Taiwan's China Petroleum Corporation (CPC), had signed an agreement for joint seismic survey work in the South China Sea near the mouth of the Pearl River. The agreement was implemented from 1998 to 2000 and led to the identification of seven potential oil and gas formations. Experts from both parties agreed on the potential of the area and decided to enter into the exploration stage. In 2002, state-run oil companies from China and Taiwan formed a joint venture for this purpose.¹²² The new joint venture company will drill and sample from three oil wells over the next four years in the Tainan-Chaoan basin,¹²³ an area between China's Guangdong province and southern Taiwan.

The joint venture is the first ever between state-owned corporations of the two sides of the Taiwan Strait. The company will run on a strict 50-50 basis, with three members from each side on the new board, and with offices in Taipei and Shenzhen, China. The joint venture will be registered in a third location, the Virgin Islands. The China partner, CNOOC, has for many years been one of the most internationalised and progressive of all China's state-owned companies. It has been vigorously involved in oil exploration in many parts of the world. The Taiwan partner is working nine oilfields in six countries.

The exploration area covers 15,400 sq. km. and lies closer to China's mainland coast than to Taiwan, but near a notional median line in the Taiwan Strait between Taiwan's Penghu Islands and the Guangdong coast.¹²⁴ The significance of this is that the area lies within 200 nm. of the land territory of China and Taiwan, and therefore within their potential EEZs (that is, if Taiwan were a state).

According to a press report, Taiwan's MAC asked its CPC to play down the agreement, ostensibly out

¹¹⁸ For text of the government statement, see Xinhua, 15 May 1996, carried in FBIS-CHI-96-096, 16 May 1996, pp. 35-36: 'Declaration on Sea Baselines for Paracel Islands'.

¹¹⁹ The convention obliges states to publish their baselines.

¹²⁰ Personal communication to ICG analyst.

¹²¹ Teng Yueh, 'Beijing to Publish Sea Baselines of Taiwan and its Outlying Islands after They Are Determined', *Wen wei po*, 17 May 1996, p. A2, translated in FBIS-CHI-96-097, 17 May 1996: 'PRC: China to Reannounce Sea Baselines of Taiwan'.

¹²² *Taiwan News*, 17 May 2002.

¹²³ Tainan is a location on Taiwan's southern coast. Chaoan is a location on China's southern coast.

¹²⁴ The area is centred on a spot between 21°-23°N and 118°E.

of concern over the joint venture's ability to make profit,¹²⁵ but more likely because such cooperation conflicts somewhat with the stance the DPP administration of President Chen wants to take toward China. In agreeing to the deal, some six years in the making, the Taiwan government bowed to heavy pressure from investors and executives to ease its restrictions on commercial links with China.¹²⁶ Taiwan does not want its state-controlled companies to join the rush across the Taiwan Strait, but they have a different view. CPC is hoping to forge an alliance with the China National Petroleum Corporation (CNPC) under which it would sell refined oil products to the mainland while buying Chinese crude. CPC officials have also discussed joint onshore oil exploration on the mainland, but no projects have yet been submitted to the Taiwan government for approval.

3. Fishing Operations and Disaster Relief

China and Taiwan now cooperate quite well in fisheries and related disaster relief. In 1979, China made an offer to Taiwanese fishermen to use mainland ports in emergencies, and by the 1990s there was in operation a system of offering mutual protection in typhoon conditions or other emergencies. By 1994, Chinese citizens had come to make up the bulk of crews working Taiwan-based fishing boats which operated in the Taiwan Strait, with their share of the total labour force perhaps as high as 80 per cent. This practice was recognised formally and allowed under Taiwan law in July 1994 since it had implications for the presence of Taiwan-registered or Taiwan-owned fishing vessels in China's ports and coastal villages to embark or disembark crews. Taiwan had refused to allow China's nationals on its fishing boats to land in Taiwan territory. In 2002, some 25,000 to 30,000 Chinese labourers were employed in the Taiwan fishing fleets and lived on boats off Taiwan.¹²⁷

However, on 1 February 2002, the eve of Chinese New Year, China banned its nationals from working on Taiwan vessels. This was seen in industry circles as an attempt to force Taiwan shipowners to improve working and living

conditions for the mainland fishermen.¹²⁸ Taiwan's Council of Labour Affairs and the Council of Agriculture (COA) agreed to offer financial subsidies to encourage local owners to hire Taiwan fishermen, but industry sources said few local people were now willing to do that sort of work. But specialists in China and Taiwan have indicated that it was part of an effort to signal to Taiwan that its continued delay in establishing effective cross-Strait political contacts would have an economic price.¹²⁹ (China simultaneously stopped recognising legal documents notarised in Taiwan – such as certificates of birth and marriage – and this had serious disruptive effects on Taiwan business people trying to set up households in China with their spouses and get their children into schools there.)

In response to the Chinese move on fishermen, representatives from around ten Taiwan fishery associations visited China on 15 March for talks with China's Cross Straits Cooperation and Coordination Committee. China said on 27 March that it was willing to set up a non-governmental mechanism with Taiwan to enable the fishermen to return to work.¹³⁰ Through the following twelve months, the Chinese workers were allowed to return¹³¹ following a number of remedial measures¹³² by Taiwan. These were capped by a reported decision in January 2003 to allow the Chinese fishermen to set foot on shore in Taiwan for the Lunar New Year as a trial measure for an extended regime.¹³³ At the time, Taiwan industry officials said the government hoped that the two sides of the Taiwan Strait could cooperate in forging a viable mechanism for negotiating China's fishery-labour exports on an equal footing. The Taiwan government also pressed China for a goodwill response to this move, offering to further improve facilities for Chinese fishermen if such a response was forthcoming.

¹²⁵ *Taiwan News*, 17 May 2002.

¹²⁶ Petromin, 22 April 2002 <http://www.petromin.safan.com/news/arc3-2002.html>.

¹²⁷ Agence France-Presse, 28 March 2002 <http://www.taiwansecurity.org/AFP/2002/AFP-032802.htm>.

¹²⁸ Central News Agency, 14 March 2002 <http://www.taippei.org/teco/cicc/news/english/e-03-14-02/e-03-14-02-12.htm>.

¹²⁹ ICG interviews, October 2002.

¹³⁰ Agence France-Presse, 28 March 2002 <http://www.taiwansecurity.org/AFP/2002/AFP-032802.htm>.

¹³¹ Through the second half of 2002, China also had to find jobs for 300,000 Chinese offshore fishermen displaced from fishing boats as a result of new bilateral fisheries agreements with its neighbours (Korea and Vietnam).

¹³² For example, Taiwan industry associations drew up a package of measures (still to be implemented) and Taiwan set up special reception centres for Chinese fishery workers and merchant seamen at a number of major ports.

¹³³ *Taipei Times*, 27 January 2003.

Another aspect of the bilateral relationship is the contact between fishing vessels of one side and the navy or coast guard vessels of the other side. This occurs more often in areas outside the Taiwan Strait, such as around the South China Sea islands. Instances of one side chasing the other's fishing boats out of claimed fishing waters have numbered in their thousands each year. But more serious incidents, involving collisions or seizures, have numbered only about twenty per year.¹³⁴

4. Customs

Customs vessels of China and Taiwan often come into contact with each other or with naval vessels of the other side. While some of these encounters are marked by tension and a mood of confrontation or rivalry, they also demonstrate the need and potential for some sort of code of conduct between the two sides on such contacts. An incident in 2001 is a good example. The Taiwan-registered *Tsaiifu No. 1* was intercepted by a Chinese customs vessel on 16 May 2001 outside Taiwan's claimed territorial sea and contiguous zone¹³⁵ off the islet of Pengchia on suspicion of having illegally sold diesel oil to Chinese fishing boats.¹³⁶ Two armed Chinese officers boarded the Taiwan-registered boat, intending to tow the vessel and its crew to China for questioning. Taiwan Coast guard ships and a navy frigate came to the aid of the Taiwan fishing boat, which was released only after hours of on-the-spot negotiations between the coast guard and customs officers from China.

Both China and Taiwan have a strong interest in suppressing smuggling, including of people, across the Taiwan Strait. There has been a vigorous illegal trade ever since Taiwan fishing boats were first allowed to visit the Chinese side. In fact, a former senior Taiwan political figure has acknowledged that many of the Taiwan fishing boats that visit China probably do more smuggling than fishing, but always return to Taiwan with just enough fish to maintain their cover as fishing boats.¹³⁷ Smuggling is in some respects the response of

market forces in a situation where direct shipping is for the most part prohibited.

Given the volume of trade between the two sides, the prospect of an opening of direct shipping links (beyond the 'mini-links' currently in place), and the contiguity of the maritime zones of China and Taiwan, it is inevitable that the two parties will have to increase their cooperation in customs affairs. They are edging toward this in part through their participation in the relevant APEC Working Group, with Taiwan having hosted an APEC Customs Academy in October and November 2002 in which Chinese customs officials joined their counterparts from other APEC countries in one month of intensive training in customs matters.¹³⁸

E. SOCIAL CONTACTS

As with other aspects of cross-Strait relations, the issue of social exchanges (people to people contacts) has always been and remains hostage to the political agendas of the two sides. China has since 1979 promoted social exchanges as a means of advancing its hope that people in Taiwan will not forget their roots in China and will support the notion that Taiwan and China are part of one country. Taiwan opened its doors in 1987 for Taiwanese to visit China legally for the first time since 1949, and this initial trickle of people turned into a massive flood. Hundreds of thousands of Taiwanese now live and work in China, and Taiwanese make millions of visits to China every year.¹³⁹ But Taiwan still kept some controls on this outward flow. For example, in October 2002, the MAC announced that athletes from Taiwan would be permitted for the first time to pursue their careers in professional sports leagues in China.¹⁴⁰ China imposes virtually no restriction of a discriminatory nature on Taiwanese wanting to visit China, except where it alleges an espionage or subversive intent in the intending applicant. But

¹³⁴ See John Deng, 'Cross-Strait Economic and Trade Relationship', undated speech citing MAC statistics to 2000 (www.roc.info.org/govt_position/891226.htm).

¹³⁵ Though in Taiwan's claimed EEZ.

¹³⁶ Taiwan.com.au <http://www.taiwan.com.au/Polieco/Trade/Agriculture/2001/0519.html>.

¹³⁷ ICG interview, October 2002.

¹³⁸ *Taiwan Economic News*, 21 October 2002.

¹³⁹ The term 'visit' here means a trip for which one entry to China was associated with an exit from Taiwan by a Taiwan citizen. The figure for visits to China from Taiwan by its citizens for 2001 was 4.6 million, some 64 per cent of all departures out of Taiwan by its citizens that year. See Agence France-Presse, 11 November 2002 (FBIS-CHI-2002-1111: 'AFP: Taiwan to Relax Restrictions on Chinese Tourists').

¹⁴⁰ David Brown, 'Economics is Still the Story', *Comparative Connections*, January 2002 http://www.csis.org/pacfor/cc/0104Qchina_taiwan.html.

even there, China remains relatively open to Taiwanese, reporting in October 2002 that some 1,500 Taiwan journalists are usually in China at any time.¹⁴¹

The reverse is however not the case. Taiwan has not wanted Chinese in Taiwan, and nor has China.

For Taiwan, the fear has been, in both KMT and DPP governments alike, that the more closely the businesses and people from the two sides entwine their interests, the 'greater will be the force of support for mainland China within Taiwan, and that Beijing could try taking advantage of this to influence our [Taiwan] government policy-making'.¹⁴² Security remains a genuine concern of Taiwan governments in restricting entry to Chinese. In the first nine months of 2002, only 154,000 Chinese from the mainland entered Taiwan. Of these only 1,000 were tourists. The remainder were visiting on family reunions, cultural and sports events, academic events and international conferences. It was not until February 2001 that Taiwan allowed Chinese journalists to work in Taiwan, and then only temporarily.¹⁴³ In recent years just under 200 Chinese students have visited Taiwan each year on exchange programs organised by the MAC.

In October 2001, Taipei substantially liberalised the conditions governing travel and residence by business visitors from the mainland.¹⁴⁴ It announced new regulations for the naturalisation of the roughly 60,000 mainland spouses of Taiwan citizens. In November 2001, Taipei announced plans to begin accepting tourist groups from China in January 2002, starting with two categories of people: Chinese citizens who have lived outside China for more than four years and who have obtained the nationality of their place of residence, and Chinese business people who come for a short visit via a third place.

For China, a flood of its citizens into Taiwan would have raised the spectre of mass defections, at least as long as Taiwan was a wealthier society. But even now that there is more parity in economic terms between parts of China and Taiwan there is still a huge wealth gap and, moreover, a much

bigger gap in terms of the degree of liberal pluralism in the two societies. As of November 2002, Taiwan was not on China's list of 23 country destinations approved for overseas travel by its citizens.¹⁴⁵ But discussions were held that month between the tourist industries of the two sides with a view to Taiwan's easing its restrictions on Chinese tourists if China added Taiwan to the list of approved destinations.

As for sports exchanges, specifically identified by China in 1981 as a desirable avenue of contact, there has been only limited relaxation. For example, sports exchanges 'have included sending people of colleges of physical education and sports to visit the Chinese mainland, attending cross-Strait sports terminology seminars and seminars on sports and leisure culture. People in sports or athletics from the Chinese mainland are allowed to apply for entry upon arrival in Taiwan. Between January 1999 and June 2000, 734 mainland visitors were allowed to come to Taiwan as table tennis players, bridge players, and judo athletes. In June 2000, the Chinese mainland basketball team came to Taipei to play two games with the ROC team.'¹⁴⁶

But the belief informing Chinese policy that people to people contact fosters better political relations is not one supported by political scientists who have studied cultural exchange.¹⁴⁷ Stories of the murder, robbery and other intimidation of Taiwanese in China, and a major disaster on a tourist boat in 1994 in which 24 Taiwanese visitors died, serve to temper many of the positive gains to China that do accrue from the flood of Taiwanese visitors, as does China's continuing repression of dissidents and religious minorities. And both sides continue to arrest citizens of the other for spying. China continues to identify Taiwan as a base for subversion of Communist Party rule.

But there are at least three more powerful factors shaping the attitude of Taiwanese to China. The first is the question of monetary gain. China is for

¹⁴¹ Xinhua, 16 October 2002 (FBIS-CHI-2002-1016).

¹⁴² Siew, 'Trade and Investment', op. cit.

¹⁴³ Xinhua, 16 October 2002 (FBIS-CHI-2002-1016).

¹⁴⁴ David Brown, 'Economics is Still the Story', op. cit.

¹⁴⁵ See Agence France-Presse, 11 November 2002, op. cit.

¹⁴⁶ *Republic of China Yearbook, Taiwan 2001*, Government Information Office (Taipei, 2001) <http://www.gio.gov.tw/taiwan-website/5-gp/yearbook/chpt23-9.htm>. A Chinese sports delegation led by the President of China's Olympic Committee, Yuan Weimin, attended the fourth seminar on sports exchanges in Taiwan in May 2001.

¹⁴⁷ See Greg Austin and Stuart Harris, *Japan and Greater China: Political Economy and Military Power in the Asian Century* (London, 2001), Chapters Two and Four.

many Taiwanese who go there nothing but a good place to make money in business, or increasingly, to get a job. Second is the question of national identity, which was discussed in ICG's first Taiwan Strait report.¹⁴⁸ The growing identification of many in Taiwan as Taiwanese first (by nationality), and Chinese second (by culture), obviates any positive political gain in support of reunification that China might hope to obtain from people to people contact. Third, and arguably the most powerful, China must compete as an object of cultural desire or as spiritual home with other parts of the world, such as the U.S. or even Europe, and in this contest, China comes a poor second to the U.S. and Europe as far as many of Taiwan's political leaders are concerned. Many have studied in the U.S., send their children to school or university there, or maintain very strong social and business ties .

III. PRIORITISING OBJECTIVES: LIVING WITH AMBIGUITY

All of the 'three links' and 'four exchanges' raised by China in 1981 as important in reducing tension between the two sides are either now in place or within a year or two of being in place, even as some of them remain quite limited or constrained. The establishment of these links over two decades is clear evidence that China and Taiwan have made huge progress toward reducing their antagonism. China can take some satisfaction from such progress, even as the two sides have grown apart on the substantive issue of sovereignty and 'one China'. The discussion so far in this report has made plain that there is a high degree of active cooperation between China and Taiwan, albeit not through direct contacts between high level officials. The discussion also shows that there is considerable room for more cooperation. The discussion so far lends considerable support to those who argue that, given time, China and Taiwan will eventually establish a normal and peaceful relationship premised largely on mutual economic interest and a degree of cultural affinity.

But the discussion has also made plain, especially in its discussion of direct transport links, that there is considerable scope for both sides, for political gains in what remains a tactical bargaining process, to manipulate this or that development, or to offer a concession or to stonewall as the case may be. , And as ICG's first two reports on the Taiwan Strait made plain, there are powerful countervailing forces, especially the emergence of a new Taiwan identity and the resuscitation of the U.S.-Taiwan military alliance. There is some risk, albeit still low, that the fundamental conflict between the two sides could deteriorate into a more hostile confrontation.

The remainder of this report looks at just how the two sides can harmonise their short-term goals in terms of practical politics without abandoning their longer-term positions, with a view to reducing the risk of a hostile military or politico-military confrontation. It also looks at the role of the international community in promoting this outcome. In this analysis, the position of China must be the starting point, because it is China's leaders who will decide whether there is to be an escalation of military confrontation and whether there is to be war or peace. Taiwan can be seen as

¹⁴⁸ *Taiwan Strait I: What's Left of 'One China'?*, op.cit.

the driver of the prospects for violent conflict at a tactical level, but it is China that is threatening use of force, not Taiwan.

A. CHINA'S MINIMUM DEMANDS AND SHORT TERM GOALS

ICG's first Taiwan Strait report noted that in February 2000, China laid down new short to medium term demands which are still operative:

- ❑ Taiwan's government must accept the 'one China' principle;
- ❑ Taiwan's government must enter serious talks aimed at reunification; and
- ❑ there must be progress on practical issues of reunification, such as comprehensive direct transportation links.¹⁴⁹

The three are inter-related but the bottom line is that further resort to force by China cannot be ruled out without sustained visible progress on at least one of these.

1. Visible Progress: Direct Links

It is in this context that the promising signs in 2002 and 2003 for the establishment of comprehensive direct links must be read. Even in the absence of any formal move by Taiwan back in the direction of a 'one China' policy, China's leaders see Taiwan's responsiveness on the establishment of comprehensive direct links this year and last as visible progress. They can represent it as such to key domestic interest groups, such as the PLA. Moreover, as this report demonstrates, the political significance of Taiwan's opening of direct links, albeit in a guarded and still constrained fashion, is underpinned by vibrant economic relations between both sides of the strait, and by the mutual participation of China and Taiwan in a number of international bodies, such as the World Trade Organization. The establishment of these relationships through the course of the sixteen years since 1987 is clear evidence that China and Taiwan have made huge progress toward reducing their antagonism.

The time taken to approach finalisation of the 'three links and four exchanges' has been protracted: just over 22 years since China's NPC proposed them, with still, on most estimates, a couple of years to go. And this is what China in 1981 described as the 'first step'. This slow progress is clear evidence of the protracted nature of the time frame involved in achieving an ultimate reconciliation between the two sides. But it is also evidence that China's leaders have considerable experience in, and have demonstrated considerable tolerance for, delay in achieving what they regard as appropriate milestones. But, as ICG's first report indicates, China's leaders continue to replay the idea, first introduced in 2002, of a major political step toward reunification 'at an early date'.

By the end of 2003, in advance of Taiwan's next presidential elections scheduled for March 2004, China will therefore be looking for progress from Taiwan on at least one of the other fronts: acceptance of the 'one China' principle, or resumption of talks. The two goals may in fact be one, since China appears to be insisting that talks can only resume on the basis of Taiwan's acceptance of 'one China'. But the signs are that China is prepared to reopen talks without Taiwan's explicit acceptance of 'one China' as long as it stops talking so openly, frequently and noisily about independence and stops so explicitly rejecting the 'one China idea'. For example, on 5 July 2002, China's Vice-Premier Qian Qichen told a delegation of 67 Taiwanese business leaders that if the 'three links' could be treated as an internal matter of one country, they could be implemented as soon as possible, and not relate to the political implications of 'one China'.¹⁵⁰ The approach was to circumvent the political issues of the relationship between China's (central) and Taiwan's (local or regional) government by using business groups to negotiate the details of the links.¹⁵¹ Taiwan's President Chen Shui-bian had cautiously welcomed the idea of letting business leaders negotiate an

¹⁴⁹ *Taiwan Strait I: What's Left of 'One China'?*, op.cit., section IV.C.

¹⁵⁰ 'Qian Qichen says direct links not related to 'one China'. July 5 2002', Taiwan News Headline, Central News Agency, 6 July 2002.

¹⁵¹ See statement by Li Bingcai, Deputy Director of the Taiwan Work Office of the Central Committee, 'Non-governmental organizations may pioneer 'Three Links': Official', *Xinhua News Agency*, June 24, 2002, p1008175h9850

agreement on direct links.¹⁵² There was, therefore, some prospect of a resumption of the high-level but informal Beijing-Taipei dialogue, started in 1992 but broken off in 1995, and then again in 1999 after a brief reinstatement in 1998.

The new emphasis on economic development should be recognised as two-sided. On the one hand, it provides positive direction for new moves in cross-Strait relations. The hope on China's part is that it can move from a strategy of coercion to one of gradual integration. On the other hand, emphasis on economic partnership is needed as a propaganda tool by Chinese leaders to give them breathing space to see if Taiwan is responsive to the new overtures. As a propaganda tool for a period of transition, it will continue to be accompanied by pressure of all sorts. Chinese commentaries on Qian's 2002 speech have stressed the positive side of new directions in economic cooperation, but they have also laid out China's expectations that Taiwan has to stop dragging its feet on the establishment of comprehensive direct links, and that Taiwan should agree with China now to open talks between relevant business associations (air and shipping) on such links.¹⁵³ And reliance on the motif of economic partnership should not conceal that for some time yet, China will continue to rely both on incentives and pressures because without the latter it does not trust Chen and does not regard him as responsive enough to its position.

2. What Would the Last Straw Look Like?

The other side of the coin is also very important. Is there a last straw? What moves by Taiwan would demonstrate to China its substantive and ultimate rejection of the new demand made by China in its February 2000 White Paper and thus provoke

¹⁵² Lin Miao-jung, 'Chen says "authorise" the private sector ... but MAC officials rush to clarify his comments', *Taipei Times*, 11 May 2002.

¹⁵³ For example, 'economic development has its own law, which also reflects the common aspirations of the people on both sides of the strait. But the Taiwan authorities drag their feet on removing obstacles that stand on the road of cross-Strait economic exchanges, leading to a lack of standards for the cross-Strait economic and trade exchange order'. Chen Binhua, 'A Positive Proposal Adapted to Developing Cross-Strait Economic Relations – An Interpretation of Vice Premier Qian Qichen's Latest Speech on Taiwan', *Xinhua Hong Kong Service (Radio)* 6 February 2002, FBIS-CHI-2002-0206.

China to escalate its military pressure? The White Paper mentions three possible triggers:

- 'a grave turn of events occurs leading to the separation of Taiwan from China in any name';
- 'if Taiwan is invaded and occupied by foreign countries'; and
- 'if the Taiwan authorities refuse, *sine die*, the peaceful settlement of cross-Straits reunification through negotiations'.¹⁵⁴

No matter how precise any of these three conditions look, they are all imprecise in their own way, and the first two of them are arguably somewhat artificial.

For example, on the first point, since Taiwan already enjoys and exercises *de facto* independence, and since China has been prepared to accept this, Taiwan can only be further separated from China in a *de jure* sense. And the only *de jure* sense in which 'separation' of the two can occur would be diplomatic recognition of Taiwan by the international community. But how many countries would need to recognise Taiwan? Would China immediately resort to force? Would China invade and occupy Taiwan to reverse diplomatic recognition by other states? In China's view, some domestic legislative or administrative act might be seen as a 'final separation'. One such act on which there has been considerable focus is a referendum on Taiwan's status. But it is inconceivable that China would attack Taiwan when a referendum was announced, or even after a negative result, unless the international community, particularly the U.S. and Japan, recognised Taiwan as an independent sovereign state. The same might be said about revision to Taiwan's constitution to remove the last negligible references to a link of sovereignty with the mainland. If Taiwan changed its formal name from Republic of China to 'Republic of Taiwan', this is also unlikely to be a trigger for war in the absence of a shift in recognition policies by the international community, given that China has never recognised Taiwan's use of the name Republic of China.

The second point, about invasion or occupation of Taiwan is reasonable in the sense of protecting

¹⁵⁴ For the text of the White Paper, see <http://www.china-embassy.org/eng/7128.html>

what China sees as its territorial integrity. But since it is highly unlikely that Taiwan would be subject to such action in a hostile sense, then it can only refer to possible stationing in Taiwan of U.S. military forces. Since that is only likely to come about as a result of a serious military escalation by China, then the point is also somewhat hypothetical or artificial.

The last point – probably the most important and substantial – was discussed in ICG's first Taiwan Strait report, and the conclusion reached that there is probably no firm deadline yet. But, as mentioned just now, China is looking for visible progress.

So, in the absence of highly unlikely events, such as the stationing of U.S. forces in Taiwan, it is quite difficult to see just what the last straw might look like. China does not really have a clear, practical reference point for what would constitute a trigger for further military pressure on Taiwan. This has both positive and negative aspects. The positive consideration is that until China sets a more specific ultimatum, further escalation of military pressure of a lethal variety is highly unlikely. This is the hope that Taiwan's leaders have been playing on for some time, and will continue to rely on. This is the situation which tempts many inside and outside Taiwan to ask 'why shouldn't Taiwan and the international community continue to call China's bluff', at least until it shows a different set of cards.

That is not a course to be recommended. China's leaders are growing impatient with Taiwan, and may just decide one day, without much warning, that they have had enough, especially since there is now almost no prospect of a return by Taiwan to the 'one China' principle in terms of accepting that Taiwan and China are now part of one country. One consideration that needs to be borne in mind is that since China has consistently used a very shrill level of rhetoric, frequently threatening over many years dire consequences that never come, it will be much harder for anyone outside a narrow circle of leaders in China to discern any change in its rhetoric as a sign of its decision to launch a new phase of military pressure. China has a potential advantage in terms of surprise that could be exploited with considerable success in certain scenarios.

B. TAIWAN: MANAGING PARTY POLITICS

At a general level, there is considerable overlap between the short to medium term policy goals of China and Taiwan. President Chen Shui-bian had laid the ground work for this in his inauguration speech in May 2000 when he gave a number of guarantees to avoid moves on independence that China would consider provocative.¹⁵⁵ But by May 2002, momentum for an even more positive détente between China and Taiwan was building. In his speech on Tatan Island on 9 May 2002, referred to above, President Chen was virtually repackaging what China had suggested in January 2002. He offered three guidelines for cross-Strait relations in the short to medium term: dialogue, speeding up trade liberalisation, and maintaining the goal of future 'political integration'.¹⁵⁶ Chen made the following points:

- The first step toward political integration across the Taiwan Strait is economic and cultural integration. We will not deviate from this goal, and this policy will not change.
- The two sides must reopen cross-Strait consultations to minimise the chances for misunderstandings and misjudgements.
- Establishing direct links across the Taiwan Strait is a necessity.

Chen was certainly eager to achieve a breakthrough on direct links and get credit for it from Taiwan's business community. Business support would broaden his political base and ease relations with the opposition. An all-party Economic Development Advisory Conference (EDAC) of government-officials, business leaders and academics in August 2001 had recommended the abolition of Lee Teng-hui's five year old policy of 'no haste, be patient' in developing cross-Strait economic relations, and had urged the government to aggressively pursue direct trade, transportation and communications links after China's and Taiwan's WTO accession. The business community was stepping up pressure on Chen to take action without further delay. President Chen suggested that in order to speed up things, the

¹⁵⁵ See *Taiwan Strait I: What's Left of 'One China'?*, *op.cit.*

¹⁵⁶ This interpretation of Chen's speech was offered by a senior official in Taipei. ICG interview, Taipei, May 2002.

government would consider authorising the private sector to negotiate the opening of direct links with China, thus picking up directly on Qian's offer.

As a result, prospects for an eventual Taiwan Strait détente had begun to look up. Taiwan looked set to satisfy China's longstanding call for the establishment of comprehensive direct links across the Strait and, as mentioned above, China had even given various indications that it might soften its insistence on Taiwan's prior acknowledgement of the 'one China principle' as a condition for the establishment of comprehensive direct links.

But Chen faced certain domestic constraints and began to reposition himself. Beginning in late July 2002, he made several controversial statements that threatened the breakthrough in cross-Strait relations that had seemed imminent in May. The first arose in reaction to the loss by Taiwan from its diplomatic list of Nauru, the least populous country in the world, when on 21 July 2002 Nauru signed with China a communique on the establishment of diplomatic relations and simultaneously broke diplomatic relations with Taiwan. This raised China's diplomatic corps to 165 embassies and cut Taiwan's dwindling band of diplomatic partners to 27. China appears to have deliberately timed things to coincide with President Chen's inauguration as chairman of the ruling Democratic Progressive Party (DPP), having reportedly spent U.S.\$136 million to poach the micro-statelet of 10,000 people away from Taiwan's diplomatic list.

Chen was furious about this calculated insult and according to eye-witnesses, later in the day, in an agitated mood, made a milestone statement on Taiwan's own destiny. In his inaugural address as chairman of the DPP to the Party Congress, he warned that if China didn't respond to his goodwill, Taiwan might turn its back on China. While avoiding the politically charged word 'independence' he said: 'We'll have to seriously consider whether to walk down our own road – walk down our own Taiwanese road to find Taiwan's future'. Beijing and Taiwan's two main opposition parties, the Kuomintang (KMT) and the People First Party (PFP), criticized Chen's statement along similar lines. All thought that the reborn, pragmatic moderate Chen of the last two years was gone and that the former Chen, the independence activist, had come out of the closet again. The presidential spokespersons came up with the spin that 'all Chen had meant with 'Taiwan's own road'

was the road of democracy, freedom and human rights.¹⁵⁷

On 3 August 2002, Chen delivered another sharp statement in the opening address via live video-link from Taipei to the 29th annual meeting of the World Federation of Taiwanese Associations (WFTA) in Tokyo. This statement provoked a diplomatic mini-crisis. The WFTA is the global organisation of Taiwanese who for decades had fought the KMT martial law regime from exile across the world. Chen told them:

Taiwan is our country, and our country cannot be bullied, downgraded, marginalised, nor treated as a local government. Taiwan is not part of any other country, nor is it a local government or province of another country... In short, Taiwan and China standing on opposite sides of the Strait, there is one country on each side. This should be clear.

... China's insistence on the 'one China principle' and 'one country – two systems' means a change of the status quo for Taiwan. The decision to change the status quo for Taiwan cannot be made for us by any country, any government, any political party, or any single individual. Only the 23 million people of Taiwan have the right to decide the future, fate and status of Taiwan... And should the need arise, how should this decision be made? It should be made by referendum. A referendum is a basic human right, and thus a basic human right of the 23 million people of Taiwan.¹⁵⁸

The opposition parties responded sharply. KMT chairman, Lien Chan, called Chen's two-state statement a 'horrible indiscretion and a bombshell of Taiwan independence that would put the welfare of Taiwan's 23 million people and the island's safety at stake'.¹⁵⁹ James Soong, chairman of the

¹⁵⁷ The prepared printed text of Chen's opening address to the Party Congress does not contain the 'walk down our own road' sentence, illustrating that he uttered it extemporaneously. Democratic Progressive Party, 10th National Party Congress, 'Opening address: Footprints of Democracy', 21 July 2002.

¹⁵⁸ The Office of the President of the Republic of China, 2002-08-03. <http://www.president.gov.tw/php-bin/prez/showenews.php4>.

¹⁵⁹ Jin Yang, 'Chen's comments upset status quo, opposition claims', *Taiwan News*, 5 August 2002.

PPF, commented that President Chen had turned his 'Four No's' (a reference to four commitments in Chen's inauguration speech not to take definitive moves on independence) into 'Nothing'. Soong dismissed Chen as a partisan politician in pursuit of a narrow agenda rather than the president of a nation whose responsibility it is to safeguard the constitution. 'We all love Taiwan, but loving Taiwan does not mean creating conflicts within society over our relationship with China'.¹⁶⁰ Shen Shih-hwei, convener of the PFP, added that the party 'is on the side of mainstream public opinion and will oppose Taiwan independence by all means', especially by torpedoing a referendum.

When the adverse responses were sinking in, the DPP issued a statement, saying that the referendum bill should be interpreted as a bill that provides for the rejection of reunification rather than a proactive vote for independence. Another interpretation came from Chen Chung-hsin, the new moderate China Affairs director of the DPP, who said it expressed a vote against reunification, not a vote for independence, because we are independent already.¹⁶¹ Trong R. Chai (67), one of the leading former exiles, independence fundamentalist and twelve-year militant activist for a Referendum Law, announced on 5 August that as a member of the Legislative Yuan, he would submit a new draft.¹⁶² The TSU also said that it would introduce its own referendum bill during the next legislative session that would include a change of name for the country from Republic of China to Taiwan (Republic of Taiwan). The TSU had previously warned the DPP that it would make its support for the government in parliament dependent on the DPP caucus's cooperation in introducing a referendum law. On the other hand, Chen Chung-hsin said that the DPP Legislative Caucus would discuss the issue with the opposition parties, expressing doubt that such a law was needed.¹⁶³

The MAC issued a position paper on how Chen's statements should be interpreted. According to Chen Ming-tong, vice-chairman of the MAC, the broad cross-Strait relations context in which President Chen made his statements was as follows: the CCP was in no hurry to establish the three links, because they didn't want to give credit to Chen Shui-bian – because it might help Chen to win his re-election in 2004.¹⁶⁴ They didn't want Chen to bypass the 'one China' principle or set the agenda for cross-Strait relations in the run-up to the next election. China wanted to create a road-block, and for this purpose it used the diplomatic coup of snatching Nauru from Taiwan's shrinking list of diplomatic partners. Chen Min-tong said that as a result, Chen decided that if Taiwan could not rely on its 'goodwill policy' to persuade China from renouncing the use of force, then Taiwan has to find another way. Chen was also adamant that since Taiwan is an independent sovereign country and since 80 per cent of the population is opposed to China's proposal of 'one country – two systems', two things need to happen. First, there needs to be a referendum to transform the poll sentiment into an expression of the general will (to continue opposing 'one country, two systems'). Secondly, there needs to be a special relationship with China as two sovereign states.

Chen Min-tong said that the President's mention of a referendum was not about independence since the DPP's 1991 independence platform has been relegated to history and has been overtaken by the party's 1999 Resolution on Taiwan's Future, which stipulated that 'Taiwan is already a sovereign, independent state whose name is the Republic of China'.¹⁶⁵ The mention of a national referendum was not to change the status quo, but to maintain the status quo and oppose 'one country – two systems'. The mass-media misinterpreted this as a referendum on independence. Chen Min-tong said: 'This is totally wrong!'

There was a fear in the DPP and elsewhere that Beijing would not be giving Taiwan any concession without a price. Qian's suggestion that direct links could be promptly established 'if they are viewed as domestic affairs by Taipei' was seen as just

¹⁶⁰ Jin Yang, 'Pro-Blue Force blasts Chen for Strait stance', *Taiwan News*, 5 August 2002.

¹⁶¹ Lin Miao-jung, 'Government won't formalize the DPP's cross-Strait stance', *Taipei Times*, 14 August 2002.

¹⁶² Trong R. Chai, 'Referendum Law could be precious weapon', *Taipei Times*, 7 August 2002.

¹⁶³ Crystal Hsu, 'Legislators propose softer Plebiscite Law', *Taipei Times*, 7 August 2002. Lin Miao-jung, 'Government won't formalise the DPP's cross-Strait stance', *Taipei Times*, 14 August 2002.

¹⁶⁴ Mainland Affairs Council, 'Explanation of President Chen Shui-bian's Remarks of 3 August 2002'. Elaboration by Chen Ming-tong in ICG interview, Taipei, August 20, 2002.

¹⁶⁵ DPP Documents (in Chinese), *Resolution on Taiwan's Future* (Taipei, 1999), pp. 38-41.

another way of luring Taiwan into saying yes to the 'one China' principle. The pro-independence hardliners within the DPP, the bedrock of Chen's support, were strongly dissatisfied with what they considered Chen's 'softpedalling' on China since his election. And there were other pressures: Taiwan's economy had been contracting for the first time in 26 years and unemployment hit a record high of 4.9 per cent. Labour groups had demonstrated at the EDAC venue that the business-exodus to China was aggravating unemployment further. And the independence fundamentalists dreaded the spectre that China's economic clout would draw Taiwan inexorably into political union. Various Taiwanese commentators, economists and politicians in the government's camp stepped up their warnings that comprehensive direct links would not produce the promised reinvigoration of Taiwan's shrinking economy. They warned of further 'hollowing out' of Taiwan's industries and an acceleration of the industrial and business exodus from Taiwan to the newly emerging metropolis of 21st century East Asia, Shanghai.¹⁶⁶

Opposition spokespersons and some independent analysts believe that the damage caused by President Chen to cross-Strait relations by these speeches has been a secondary concern for him.¹⁶⁷ They feel that his main concern now is re-election. Chen had been worrying that the pan-blue camp, KMT and PFP, by its cozying up to Beijing would become the prime movers and shakers in cross-Strait relations, and that the over-enthusiasm of the business community for the China market and the lack of progress on direct links would backfire on him and reduce his chances for re-election in 2004.

Chen was also under pressure from the political agitation of former president Lee Teng-hui, who had been upstaging Chen on several occasions in recent months as the real spiritual father of Taiwan's new identity. Lee had addressed the Tokyo WFTA meeting one day before Chen with a

renewed call for strengthening Taiwan's national consciousness, so as to overcome its internal divisiveness and its lack of international recognition.¹⁶⁸ Chen did not want to allow Lee to set the national agenda or to outshine him with a dramatic statement to the most ardent of the faithful. Among the members of WFTA are wealthy businesspeople and property developers who donate large amounts of money. The meeting was attended by many prominent independence hardliners from Taipei, who had turned sour on Chen's 'moderate' approach towards China.

But Chen was also being hemmed in by his own Administration. The cabinet-level MAC had gone so far as to 'correct' his suggestion that the government would authorise the private sector to negotiate the opening of direct links.¹⁶⁹ The MAC said instead that the government would merely seek the private sector's help in such negotiations. It was not the first time the MAC intervened and squelched the president's impromptu attempts to push for movement.¹⁷⁰

But numerous commentators attest that Chen is not simply being a hard-nosed politician. He is genuinely losing patience with China, as China is with him. According to several leading political commentators, Chen had wanted to make a major announcement on 20 May 2002, the second anniversary of his inauguration, and had sent emissaries to Beijing well before to sound out the Taiwan Affairs Office of China's State Council.¹⁷¹ The emissaries returned empty-handed because China saw Chen refusing to budge an inch on the 'one China' principle. Beijing was in no mood to give Chen credit for achieving a major breakthrough in cross-Strait relations without any movement by him on the 'one China' principle. Chen was angry and wanted to slap back at China. The switch of diplomatic recognition by Nauru from Taiwan to China on the very day of Chen's inauguration as DPP chairman added to Chen's

¹⁶⁶ Lin Mei-chun, 'Premier Yu Says Despite Opposition Claims, Direct Links must Wait', *Taipei Times*, 29 May 2002; Huang Tien-lin, 'National Policy Adviser to President Chen Shui-bian, Direct Links not a Panacea', *Taipei Times*, 4 June 2002; Peng Ming-min, 'Beware of Beijing's Direct Links Trap', *Taipei Times*, 5 June 2002; 'Say No to Direct Links With China', *Liberty Times*, Editorial, 7 July 2002; Lin Miao-jung, 'MAC decides Direct Links should only be approached as an Incremental Process', *Taipei Times*, 23 July 2002.

¹⁶⁷ ICG interviews, Taipei, August 2002.

¹⁶⁸ Lin Mei-chun, 'Lee Teng-hui calls for new country', *Taipei Times*, 3 August 2002.

¹⁶⁹ Lin Mao-jung, 'Chen says "authorise" the private sector ... but MAC officials rush to clarify his comments', *Taipei Times*, 11 May 2002.

¹⁷⁰ The first time was when he told a visiting American delegation in June 2000 that he was willing to accept the so-called 1992 consensus on the 'one China' principle. Chen was also then immediately corrected by Tsai Ing-wen, the influential MAC – Chairwoman.

¹⁷¹ ICG interviews, Taipei, September 2002.

anger, and retaliation was clearly uppermost in his mind.

Assuming (incorrectly) that the Bush Administration would come out in open or at least tacit support of Chen, the President's multiple purpose was to test the bottom line of US policy, to cool the 'mainland fever' in Taiwan by causing a mini-crisis, to regain the initiative in cross-Strait relations, and broaden his support base by winning back the full support of the pro-independence faithful.

At its most basic, Chen's repositioning can be attributed to his firm belief that in pursuing economic gains in cross-Strait relations for Taiwan, there has to be a political component. This is also the very firm view of the MAC. Taiwan's stop-start and go slow approach in implementing direct links with China has been shaped by this consideration – to gain as much as possible in terms of cross-Strait contact between officials of the two sides. In making his provocative speeches, Chen decided that he had to maximise the 'negotiation factor' through his preferred style of political bargaining: using confrontation and tension to produce a compromise. This meant that even though he shared some of the same short term goals as China, if he moved too quickly and too willingly on them, he would be corroding Taiwan's bargaining ability on the bigger long term issue of Taiwan's political status. He wanted a return to the situation where he would compromise on the short term goals of concrete cross-Strait relations only if he could get some gain in official contacts with his government and if, as a result, he could get some gain in the political standing of his party or himself.

Chen's actions immediately provoked reminders from China of its view that the two sides of the Taiwan Strait are part of China and that any separation of Taiwan from China could provoke military moves to reverse the situation.¹⁷² But China's response did not include any indication of a stepping up of its threat to use force. It concentrated instead on the economic impact, saying that Chen's rekindling of independence sentiment would 'influence Taiwan's economy, harm the overall interests of Taiwan and bring disaster to the island'. The statement by the Taiwan Affairs Office of the State Council accused a small

minority of imposing its views on the people as a whole.¹⁷³

The U.S. reacted as firmly, reminding Taiwan that maintenance of the political status quo was important both for continued peace and for continued U.S. support for Taiwan.¹⁷⁴ Since the chairwoman of the Mainland Affairs Council (MAC), Tsai Ing-wen, went to Washington DC on a hastily arranged trip, it was obvious that there was considerable concern there. Some U.S. officials did not conceal that they considered Chen Shui-bian a 'wild card' as a result of the recent speeches.¹⁷⁵ The State Department's public response was muted, confined to a one-liner: 'We have a 'one-China policy'. Nothing has changed in this regard'.¹⁷⁶

This August 2002 'mini-crisis', as it was dubbed, and some of the military moves that followed, provided a reminder of the high stakes involved in Taiwan's efforts to find the right path between asserting itself as an independent sovereign state and its need to appease China through some residual token support of the 'one China' principle. By mid-October, China had further signalled its displeasure by sending a warship on a voyage parallel to the east coast of the island of Taiwan – an unprecedented move for China – and just one more part of its remilitarisation of the dispute with Taiwan since it launched ballistic missiles into the sea nearby it in 1995 and 1996. [

Although a major crisis has been averted, due to backtracking and damage-control on the Taiwanese side, the restraining influence of the U.S., and moderation in Beijing, cross-Strait relations suffered considerable damage. Though China's propaganda typically gives an alarmist view of any negative event, the August mini-crisis highlights the fragile basis on which any cooperative relationships in concrete areas of policy exist. And Taiwan's government leaders persist in occasional 'finger in the eye' statements. For example, on 21 January 2003, Vice President Annette Lu told a Taiwanese news agency that Taiwan people 'refuse

¹⁷² See Willy Wo-Lap Lam, 'China: Taiwan's Future Lies in Reunification', *cnn.com*, 4 August 2002.

¹⁷³ Referendum of Taiwan Independence criticised, *Xinhua*, 5 August 2002.

¹⁷⁴ ICG interview, Taipei, August 2002.

¹⁷⁵ ICG interview, Beijing, September 2002.

¹⁷⁶ Statement by Philip Reeker, spokesperson, Department of State, Washington D.C., 5 August 2002.

firmly to be unified' or intimidated by China's economic power.¹⁷⁷

China has few answers for the domestic political wrangling and bureaucratic politics in this situation. Domestic politics in Taiwan are in turmoil. The various political parties, factions and ethnic groups are deeply divided about the future direction of the island.¹⁷⁸ The political system itself is still reeling from a decade of democratisation and associated constitutional revision, which has been less than ideal and hamstrung by the need to balance between the 'one China' idea and the search for a new Taiwan identity. Whether in all of these circumstances, the Beijing leadership should give up entirely on Chen Shui-bian as a dialogue partner for the remainder of his term is now an open question. What is clear is that there need to be some more consistently productive patterns established in Taiwan domestic politics when it comes to relations with the mainland if any stability is to be returned to cross-Strait relations and if the promise of détente so visible in the first half of 2002 is to be captured and further developed.

There is evidence that the Administration of Chen Shui-bian will deliver this discipline in the next twelve months at least. On 30 January 2003, MAC Chair, Tsai Ing-wen, said that she would make cross-Strait links a priority this year, and foresaw the possibility that negotiations would be held to this end within the first six months.¹⁷⁹ On 1 February 2003, Chen said he would do his utmost to boost cross-Strait rapprochement.¹⁸⁰

Chen's motivations are political, and not supportive at all of China's concept of 'one China'. He knows he needs a positive atmosphere in cross-Strait relations to promote Taiwan's economy and therefore help him win the next Presidential election in March 2004. He also knows that if he can deliver a major breakthrough in keeping the peace in the Taiwan Strait just prior to the election, then he will have a better chance of winning. The

main advantage the KMT and PFP have over Chen on cross-Strait issues is that they are regarded as the parties most likely to promote stable relations with China, while the DPP is the party most likely to promote unstable relations. Chen will look to change that image over the next year. As mentioned earlier, it is highly likely that he is hoping to open direct air links with China and expanded direct shipping links of some sort fairly close to the opening of the Presidential election campaign. Chen is even likely to contemplate another major symbolic breakthrough at the same time, and may be more sympathetic to a reopening of high level political contacts with China.

If such moves by Chen fail to dent KMT ambitions for the presidency and his campaign begins to falter, then there would be a reasonable likelihood that closer to the election Chen would play the Taiwan identity and independence cards, and the China threat card. This would involve some confrontation with China and some vilification of the KMT and PFP as tools of China.

C. TAIWAN'S INTERNATIONAL STATUS

For China, as discussed at length in ICG's first Taiwan Strait report, Taiwan is not a state and is not entitled to the rights and duties that flow from statehood. China will continue to send out strong signals that this is its formal position, and any state which demurs from that will face consequences in its bilateral relations with China. China will continue to treat very seriously any signs that major powers are resurrecting military relations with Taiwan, as the U.S. has been under the current Bush Administration. The decision by Japan to post a retired military officer to its unofficial embassy in Taipei in early 2003, coupled with calls by Taiwan's President Chen for a military alliance with Japan,¹⁸¹ and growing suspicion in Japan of China's long-term military intentions, will give China considerable anxiety on the issue of Taiwan's international status.

For its part, the Taiwan government will continue to work for any improvements in its international status that it can get. And it will continue to trumpet China's 'suppression' of Taiwan's

¹⁷⁷ Central News Agency, 19 January 2003 (FBIS-CHI-2003-0119).

¹⁷⁸ For a more extended discussion of the fractious state of Taiwan party politics, and the prospects of survival of the recently announced KMT-PFP ticket for the 2004 presidential election, see the ICG companion report *Taiwan Strait I: What's Left of 'One China'?*

¹⁷⁹ *Taiwan News*, 31 January 2003.

¹⁸⁰ *China Post*, 2 February 2003.

¹⁸¹ Central News Agency, 9 January 2003 (FBIS-CHI-2003-0109: 'CNA: Taiwan Willing to Forge Alliances with US, Japan').

international space as a major threat, as a good reason not to endorse the 'one China' principle, and as a good reason to stand alongside the U.S. in a quasi-alliance.

If one believed China's rhetoric, any easing up by the international community on Taiwan's participation in multilateral organisations is a recipe for an inevitable escalation of military pressure by it on Taiwan. This report has described already the likely triggers for such an escalation: marginal improvement by Taiwan in its international standing is not one of them, so long as the major powers do not move to formal recognition of Taiwan as a state. In spite of growing support in developed countries for Taiwan's participation in more international organisations, China certainly has the support of an overwhelming majority of states to deny Taiwan membership of any organisation, especially the UN and its agencies, where state sovereignty is normally a requirement for membership. Nevertheless, as the U.S. and Taiwan have argued for some time, greater robustness by the international community in resisting Chinese pressure on Taiwan's international status may have a positive effect on how China treats Taiwan's efforts to expand its participation, at other than state level, in international organisations.

There is certainly some circumstantial evidence that this may be the case. While China has always resisted efforts by Taiwan and its international supporters for it to become or remain a member of international organisations (APEC, ADB), it has in the final analysis eventually acquiesced in so many cases (provided that a suitable naming formula could be reached), that there is now an established pattern. China has also acquiesced in the long-standing practice where it tolerates quasi-diplomatic relations between Taiwan and other states, where these are confined to economic and cultural affairs. Again, and more significantly, China has been sending out signals through 2002 and 2003 that if Taiwan were prepared to acknowledge the 'one China' principle, China would be prepared to take a more flexible approach to Taiwan's participation in international organisations where statehood is not a requirement for membership.

So it is important not to attach too much long-term danger to what remains essentially a process of political bargaining by Taiwan to strengthen its

position in international organisations and by China to defend its position. In fact, it could be argued that a protracted bargaining process of this sort suits China's interest in deferring any final resolution until circumstances are more conducive to a settlement on its terms. One very decided advantage of Taiwan's efforts to join international organisations through such devices as observer status in the World Health Assembly (WHA), is that it provides a focal point for 'status sentiment' in Taiwan that is ongoing, but at the same time does not go to the heart of the China-Taiwan confrontation on sovereignty. If Taiwan can be preoccupied for the next decade or so with regular but drawn out campaigns to participate in this or that organisation as a non-state entity, with some success each two to three years, this may well contain 'status sentiment' from boiling over into an ultimate breach with China. This would be especially true if China itself were to be seen to play a part in achieving such breakthroughs.

There is plenty of scope for the expansion of Taiwan's membership of, or at least participation in, international organisations. Its main preoccupation in the period ahead will continue to be achieving some formally acknowledged role in WHA, the governing body of the World Health Organization (WHO). In January 2003, Taiwan announced that it would launch a new program of 'substantive and pragmatic health diplomacy' in an effort to speed up entry into WHO.¹⁸² For the time being, however, notwithstanding strong support from a number of countries, and the additional impact in 2003 of the SARS crisis, movement in this area continues to be blocked.¹⁸³ The issue is a particularly sensitive one for China, because the WHO is a UN agency, membership of which is available only to 'States'.¹⁸⁴ That said, Taiwan's bid not for membership of the organisation but merely "observer" status at its annual Assembly may well be one that could ultimately bear fruit: it would

¹⁸² Central News Agency, 16 January 2003 (FBIS-CHI-2003-0116).

¹⁸³ As discussed in ICG's first Taiwan Strait report. See *Taiwan Strait I: What's Left of 'One China'?*, p. 34.

¹⁸⁴ WHO Constitution Article 3: www.who.int/governance/en. Art. 8 also provides that 'territories... which are not responsible for the conduct of their international relations may be admitted as Associate Members... upon application made on [their] behalf by the Member or other authority having responsibility for their international relations', but this route is not likely to have much appeal to Taiwan.

certainly be helpful if China would consider relaxing its position to at least this extent.

While Taiwan's actual membership of the UN General Assembly, and all UN agencies, would appear to be denied it for the foreseeable future it does have contact with a number of UN agencies or UN-related agencies, and there appears some scope for this to be expanded. In the UN Industrial Development Organization (UNIDO), Taiwan makes donations to the organisation and is listed on its website as 'China, Taiwan Province' under China (PRC). In May 2000, UNESCO added 'Taiwan (China)' to its country codes on its website for Manifesto 2000 for a Culture of Peace and Non-Violence, a document which it allows both individuals and organisations to sign. Macao is an associate member of UNESCO's General Conference, under the rubric 'Macao, China', and Taiwan may be able to lobby for participation under a similar designation. Taiwan could apply for Associate Member status to the UN Economic and Social Commission for Asia and the Pacific, of which Macao and Hong Kong are both Associate Members, along with seven non-UN member states. Taiwan has support from key U.S. officials in its bid to participate in the International Civil Aviation Organization, whose standards it already voluntarily follows.

Outside the UN system, there seems to be even more scope. Hong Kong and Macao are members of a number of international organisations in their own right, though under designations that tie them to China ('Hong Kong, China' and 'Macao, China'). These organisations include the Universal Postal Union,¹⁸⁵ the World Tourist Organization's East Asia/Pacific Regional Commission, the World Meteorological Organization, and the International Organization for Standardization (IOS).¹⁸⁶ The

¹⁸⁵ Members are known as 'postal administrations' rather than states. 'Macao, China' and 'Hong Kong, China' are listed under the PRC, and like Taiwan have their own postal services.

¹⁸⁶ The IOS has three categories of members: member bodies, which is the national body "most representative of standardisation in its country"; correspondent members, which is "usually an organisation in a country which does not yet have a fully-developed national standards activity. Correspondent members do not take an active part in the technical and policy development work, but are entitled to be kept fully informed about the work of interest to them"; and subscriber members, a category which has been established for countries with very small economies.

World Customs Organization (WCO) is for governments only, defined in its charter as governments which have diplomatic responsibility for their territories. This would make it difficult for Taiwan, but the WCO does admit representatives of non-Member Governments or of international organisations in the capacity of observers. Taiwan has not been granted membership of the International Telecommunications Union, despite having been allocated its own dialling code, though it could perhaps begin by lobbying to be recognised as a 'sector member' (as is 'Hong Kong, China').

Taiwan organisations below state level can participate in a large variety of international organisations that are not interstate in character. These include the International Union of Local Authorities, of which Taipei City is a member.¹⁸⁷ In this vein, it would be highly desirable in coming years if China were to arrange for both the Beijing Olympic Committee and the International Olympic Committee to allow Taipei to host at least one Olympic event in 2008: an obvious candidate is baseball, about which, to the extent one can generalise, Taiwanese appear to care passionately and mainland Chinese not at all.

Even though Taiwan does not currently share China's view of 'one China', China can still probably afford to relax its position on Taiwan's international activities. By showing flexibility on this issue, China could undermine the visibly growing sentiment in Western countries to do more for Taiwan in terms of participation in a variety of international organisations, including those where state sovereignty is normally a requirement for membership. At the same time, if state sovereignty is not a requirement for membership, or for some other form of active participation in an international organisation, then there is little reason why Taiwan should not be permitted to join. Taiwan's push for membership of or participation in international organisations should not of itself be seen as especially provocative from the point of view of generating further conflict with China. But taken with other measures by countries such as the U.S. and Japan, support for Taiwan's efforts has definitely contributed to the rising dissatisfaction and impatience with Taiwan among China's leaders¹⁸⁸ that has led them to shift from a strategy

¹⁸⁷ See <http://www.taiwanheadlines.gov.tw/20000324/20000324s3.html>.

¹⁸⁸ ICG interviews, May 2002.

of peaceful resolution to a strategy based on giving greater prominence to military options. It is important, accordingly, that the issue be defused to the extent possible through all sides accepting the basic approach suggested in this report.

IV. CONCLUSION: MAINTAINING THE PEACE

This report has documented the deepening levels of economic and social integration across the Taiwan Strait and the bright prospects for this. This picture seems at first glance to contrast with the irreconcilable positions taken by both sides on the 'one China' principle (described in ICG's first Taiwan Strait report) and the threat of military action by China (analysed in ICG's second Taiwan Strait report). But this report has shown how practical politics on everyday issues, such as business, travel, fishing, energy development, and international trade policy are having a mollifying effect on otherwise hardened positions and threatening poses.

This report provides confirmation for the view in ICG's second report that China's strategy toward Taiwan is in the main political, not military. China relies on the military threat as part of a broader political strategy. It has signalled its willingness for the two sides to move forward in cooperative moves on concrete areas of policy without Taiwan's total surrender on the issue of its status. And it is moving more toward treating Taiwan as an equal, at least in negotiating terms if not in formal legal terms. This position is reflected in China's formulation, now a couple of years old, that the 'mainland and Taiwan are parts of one China', a phrase intended to step back from China's earlier position that Taiwan is a province of China. China wants to give the impression that it is no longer proceeding on the view that it should be the dominant partner.

Most importantly, the intensifying cooperation across the Taiwan Strait is likely to satisfy China's demand, first laid down in 2000, that Taiwan make visible progress to meeting China's position. Since becoming President in May 2000, Chen Shui-bian has shown his willingness to work pragmatically with China by avoiding highly provocative political acts such as conducting an independence-related referendum or changing the Constitution to create a 'Republic of Taiwan', and giving some attention to the as yet undefined concept of political integration with China.¹⁸⁹ In the past year or so, both sides have

¹⁸⁹ See *Taiwan Strait I: What's Left of 'One China'?*, op.cit, text at footnote 83.

shown new determination to find some common ground and have achieved concrete results: movement on direct transport links, and the opening at the WTO in Geneva in December 2002 of the first ever talks at officials' level.

But this report has also shown how intensely political the processes of cross-Strait interaction in economic and social matters can be. Both sides are locked in a fierce political contest. The nature of this contest has been demonstrated in the way that Taiwan continues to manipulate its own concessions on direct links with China in order to promote marginal gains in having China deal with Taiwanese government officials, rather than with private, ostensibly non-government organisations, such as industry associations. And China has shown its willingness to manipulate controls on Taiwan businesses in discrete areas of policy, such as fishing, as a means of putting pressure on Taiwan to be more responsive. As Taiwan's 2004 presidential election approaches, China will be looking for Chen to put some more meat on his concept of integration with China to ensure that his repetition of the unelaborated concept is not seen as empty posturing. China will continue to press for a resumption of high level political contacts in a way that it can represent as showing Taiwan's continuing willingness to contemplate the 'one China' idea.

This report has also shown how the Chen Shui-bian Administration has been positioning itself on these specific issues of cross-Strait cooperation in a way that is responsive to his perception of the ebb and flow of domestic politics. In particular, the 2004 presidential election will provide a lightning rod for possible dramatic changes in Taiwan's relations with China. On the one hand, Chen will be anxious to show that he can deliver stable and economically productive relations with China while not abandoning DPP core positions on Taiwan's status and not sacrificing Taiwan's long-term economic viability through hollowing out of manufacturing industry. Chen may well be saving his biggest concessions on direct links with China and a reopening of talks with China until the period just before the election. On the other hand, if Chen looks like losing to a joint KMT-PFP ticket in the next election, he may well play the Taiwan independence card – as Lee did in 1999 with his 'special state to state relationship' statement – in a way to provoke China. His aim would be to present himself to Taiwan voters as the only true protector

of Taiwan's independent status in the face of a bullying China.

Either way, domestic politics in Taiwan will dictate that Taiwan's concessions on issues like direct links will need to be accompanied by a continuing vigorous push by it for enhanced participation in international affairs. The international community has a role to play. Major powers should explore the scope for the expansion of Taiwan's membership in a variety of international organisations in ways that do not go to the heart of Taiwan's claimed status as a state. There appears to be plenty of scope for this, and a the process of bargaining on Taiwan's membership of these organisations where statehood is not an essential requirement for membership, or its participation in those organisations where it is, will provide an important outlet for 'status sentiment' that is not destabilising.

The report has documented significant overlap between the short to medium term goals of China and Taiwan in terms of practical, day to day issues. Sustained progress in these areas can provide a path to peace for a number of years yet.

**Beijing/Taipei/Washington/Brussels,
6 June 2003**

APPENDIX A:
MAP OF TAIWAN AND ADJACENT AREAS



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Courtesy of The General Libraries, The University of Texas at Austin

APPENDIX B:

LIST OF ACRONYMS

ADB	Asian Development Bank
APEC	Asia Pacific Economic Cooperation
ARATS	Association for Relations across the Taiwan Strait
ASEAN	Association of Southeast Asian Nations
ASEM	Asia Europe Meeting
C4I	Command Control, Communications Intelligence
CCP	Communist Party of China
CIA	Central Intelligence Agency
CSCAP	Council on Security and Cooperation in the Asia Pacific
DPP	Democratic Progressive Party
EEZ	Exclusive Economic Zone
EU	European Union
GDP	Gross Domestic Product
GNU	Guidelines on National Unification
IAEA	International Atomic Energy Agency
IISS	International Institute for Strategic Studies
IMF	International Monetary Fund
IOC	International Olympic Committee
IW	Information Warfare
KMT	Kuomintang (Nationalist Party)
MAC	Mainland Affairs Council
MND	Ministry for National Defence (Taiwan)
MSS	Ministry of state Security (China)
NATO	North Atlantic Treaty Organisation
NP	New Party
NPT	Nuclear Non-Proliferation Treaty
NPC	National People's Congress
NTU	National Taiwan University
NUC	National Unification Council (Taiwan)
PFP	People First Party
PLA	Chinese People's Liberation Army
PRC	People's Republic of China
ROC	Republic of China
ROCOT	Republic of China on Taiwan
SAR	Special Administrative Region
SCO	Shanghai Cooperation Organization
SEATO	South East Asia Treaty Organisation
SEF	Straits Exchange Foundations
SNTV	Single Non-transferable Vote
TAIP	Taiwan Independence Party

TRA	Taiwan Relations Act
TSU	Taiwan Solidarity Union
USSR	Union of Soviet Socialist Republics
WFTA	World Federation of Taiwanese Associations
WHO	World Health Organization
WHA	World Health Assembly
WTO	World Trade Organization
WUFI	World United Formosans for Independence