

# Accounting for Taiwan's Economic Policy toward China

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*This article explores the ideas, institutions, and interests in which Taiwan's economic policy toward China is embedded. The authors indicate that the ideas behind Taiwan's economic policy toward China are as vibrant as ever, the political foundation for a coherent and feasible policy is eroding, and commercial interests are digressing from the Taiwan government's policy goals. Political forces around ideas have strong hearing on the formation of Taiwan's economic policy toward China. The truthfulness or falseness of the security argument is of intrinsic value to Taiwan's decision makers. The authors also point out that in order to have a complete picture of cross-Strait economic relations, we need to specify how trade and investment with China influence Taiwan's distribution of political interests.*

## Introduction

In early April, Japanese consultant-turned-management guru Kenichi Ohmae and American lawyer-turned-China observer Gordon Chang sparred in Taipei over the future of China and, hence, Taiwan.<sup>1</sup> Ohmae makes it clear that China is to become an economic power and Taiwan should make good use of China's potential to develop itself. On the other hand, Chang believes that China now harbors high political and commercial risks and Taiwan should diversify its reliance on the Chinese market. These two opposing views epitomize the two lines of thinking in Taiwan's perennial policy debate regarding its economic relations with China. We will examine in this paper the ideas, institutions, and the interests in which Taiwan's economic policy toward China is embedded. A conclusion will then be drawn.

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1 *ZhongGuoShiBao* [China Times], (3 April 2003), p. 2.

## Ideas in Taiwan's economic policy toward China

Taiwan has long been hailed for its economic development. For example, the World Bank lists Taiwan as one of the East Asian economic miracles,<sup>2</sup> and many professional journal articles and books have probed the success formula of Taiwan—and other East Asian newly industrializing economies (NIEs) as well. While these academic researches differ in the details of East Asian NIEs' development trajectories, they generally agree that the states in these NIEs had practiced what Robert Wade calls 'governed market'.<sup>3</sup> The market-conforming policies adopted by the NIEs' states had strong effects in stimulating economic growth. While this 'developmental state' image was tarnished in the wake of the 1997 Asian financial crisis, Taiwan's economic developmental model still retained some luster, as Taiwan escaped the financial turmoil relatively unscathed.

Against this backdrop, we found that Taiwan's economic policy toward China before 1996 was truly market-conforming. The government did have some regulations on trade with and investment in China, but none seemed to be outright contradictory with market forces then prevailing. But as 1996 went on, Taiwan's economic policy toward China became more and more market-non-conforming, culminating in former President Lee's call for 'No Haste, Be Patient' (NHBP) toward the Chinese market in September of that year.

A chronicle of events in that year should be in order before our analysis. Taiwan held its first popular presidential election in March 1996. In the months leading to the election, China launched missiles into the water territories surrounding Taiwan, thus continuing tensions arising from Lee's visit to Cornell University in the previous year. The tensions tapered off once Lee became elected. Lee was inaugurated in May and, following Taiwan's political practice, he had to report to the National Assembly (a symbolic, constitutional institution that presumably functions to hold the president accountable). It was in this highly symbolic setting that Lee, in August 1996, called for the Executive *yuan* to review its China-centered blueprint for an Asia-Pacific Regional Operation Center (APROC). Coming into being in January 1995, the APROC served as the cornerstone of Premier Lien Chan's cabinet and general policy stance. The APROC, among other things, had in mind to use the Chinese mainland as a hinterland to develop Taiwan. Lee's call for a review of the APROC was tantamount to sacking the idea of a Taiwan-China development nexus. In September 1996, Lee, in a keynote speech to the National Association of Managers, urged the business community to adopt 'NHBP' in decisions to invest in China. In October 1996, Lee addressed the 11th Meeting of the National Reunification Committee in these words,

... To ensure the security and welfare of the 21 million fellowmen in Taiwan area is the bottom line of our survival and development. Therefore the starting point of our mainland policy must be to keep our roots in Taiwan, enhance construction, and

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2 World Bank, *The East Asian Miracle: Economic Growth and Public Policy* (New York, NY: Published for the World Bank by Oxford University Press, 1993).

3 Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (Princeton, NJ: Princeton University Press, 1990).

strengthen our national power. We must show no haste, be patient, move steadily, and then go far.

This is in stark contrast with what Lee said in the 10th Meeting of the same committee in April 1995,

In the face of global economic trends, the Chinese must complement and benefit each other by sharing experiences. Taiwan's economic development must make good use of China's market. And China can learn from Taiwan's experiences in economic development. With our trade with and investment in China, we can assist China in its way to economic prosperity.

Harking back to events and political discourses in 1996 and beyond, we find two ideas behind the change in Taiwan's economic policy toward China, one explicit, one implicit. The explicit idea is the security concern, the implicit Taiwan's nationalism. Concern with Taiwan's security was obvious in Lee's talks in occasions aforementioned. In its 'Policy Background Statement on Investment in China' issued by the Ministry of Economic Affairs in June 1997, the MoEA mentioned 'national security' or 'threat from China' five times. The statement concludes with this remark: '[b]ased on principles of national security and economic development the Ministry must reasonably regulate Taiwan's investment in China'.<sup>4</sup> Other agencies, like the Mainland Affairs Council, also echoed this security concern in their relevant policy statements. Even after NHBP was replaced by the current government's 'Active Opening, Effective Regulation' (AOER) policy regarding investment in China, the theme of security is still alive and well. In the 'Policy Background Statement on AOER regarding Investment in China', jointly issued in November 1991 by seven government agencies, terms like 'economic security' or 'economic strategy' are employed nine times to justify the new set of regulations.<sup>5</sup>

Taiwan's nationalism can also account for the economic policy shift. Broadly speaking, nationalism or some other related cultural ideas could have a strong impact on economic policy making.<sup>6</sup> Conversely, economic performance also bears upon the rise of nationalism.<sup>7</sup> The mutual influence between nationalism and economic performance can be traced back to the nation-states' pursuit of power and wealth since the seventeenth century.<sup>8</sup> Taiwan nationalism can be observed in two ways: Lee's expressions and the general trend in Taiwan identity. Lee had adroitly

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4 Ministry of Economic Affairs, Executive Yuan, Taiwan, *Policy Background Statement on Investment in China* (Taipei: MOEA, Executive Yuan, 1997).

5 Mainland Affairs Council *et al.*, Executive Yuan, Taiwan, *Policy Background Statement on AOER regarding Investment in China* (Taipei: MAC, Executive Yuan, 2001).

6 Harry G. Johnson, *Economic Nationalism in Old and New States* (Chicago, IL: University of Chicago Press, 1967); Paul Egon Rohrlrich, 'Economic culture and foreign policy: the cognitive analysis of economic policy making', *International Organization* 41(1), (1987), pp. 61-92; Stephen Shulman, 'Nationalist sources of international economic integration', *International Studies Quarterly* 44(3), (2000), pp. 365-390.

7 Eric Helleiner, 'National currencies and national identities', *American Behavioral Scientist* 41(10), (1998), pp. 1409-1436; George T. Crane, 'Imaging the economic nation: globalization in China', *New Political Economy* 4(2), (1999), pp. 215-232.

8 Jacob Viner, 'Power versus plenty as objectives of foreign policy in the seventeenth and eighteenth centuries', *World Politics* no. 1, (1948), pp. 1-29.

expressed Taiwan nationalism in terms of various political slogans and statements. Examples abound:<sup>9</sup>

- Taiwan as a 'Common-Fate Community' (1993);
- 'Taiwan's Sovereignty Belonging to the People' (1994);
- 'The Sadness of Being a Native Taiwanese' in a published interview with Japanese writer Shima Ritaro (1994);
- 'What the People Long for Is Always on My Mind', speech title in Cornell University (1995);
- 'New Taiwanese Principle' (1998);
- 'Special State-to-State Theory' (1998);
- 'Big Taiwan Nationalism' (1999).

Lee's symbolic uses of language are exactly what Edelman calls 'rhetorical evocations'.<sup>10</sup> Lee indeed has been instrumental in cultivating Taiwan nationalism.

It is not necessary for us to elaborate on the origin of Taiwan identity here. Suffice it to say that events since the 1895 Sino-Japanese War have formulated the collective memory and identity of Taiwanese.<sup>11</sup> What is interesting in the 1990s is that demographic groups (in terms of ethnicity, age, education, and gender) had all experienced an upward trend in Taiwan identity at the expense of Chinese identity. And it has been demonstrated that this trend toward Taiwan identity can best be attributed to periodic effects, that is, events in the 1990s caused the increase in Taiwan identity.<sup>12</sup> Being diplomatically isolated, Taiwan has long prided itself on economic development and democracy. We therefore surmise that the rise of Taiwan nationalism was not just coincidental with Taiwan's economic policy change toward China.

### **Institutions and Taiwan's economic policy toward China**

Scholars generally agree that Taiwan's economic performance benefited from the political foundation provided by the KMT party-state.<sup>13</sup> There were several components in this KMT-centered political foundation. First, by being the dominant party up until the year 2000 when the KMT lost the presidential election to the DPP, the KMT was powerful enough to draw a demarcation line between state bureaucracy and private interests. This means that the KMT was able to provide sufficient political protection for the bureaucracy to design and implement what it regarded as good industrial policies. Second, the KMT-controlled state was able to control every major section of the financial sector: the public banks, private banks,<sup>14</sup> local

9 Teng-huei Lee, *Taiwan's Assertions [Taiwan de ju chang]* (Taipei, Taiwan: Yuan-liu Publisher, 1999).

10 Murray Edelman, *Politics as Symbolic Action: Mass Arousal and Quiescence* (New York: Academic Press, 1971).

11 Yun-han Chu and Lin Jih-wen, 'Political development in 20th-century Taiwan: state-building, regime transformation and the construction of national identity', *China Quarterly* no. 165, (March 2001), pp. 102-129.

12 Szu-yin Ho and Liu I-chou, 'The Taiwanese/Chinese identity of the Taiwan people in the 1990s', *The American Asian Review* 20(2), (2002), pp. 29-74.

13 Wade, *Governing the Market*; Yun-han Chu, 'Surviving the East Asian financial storm: the political foundation of Taiwan's economic resilience', in T. J. Pempel, ed., *The Politics of the Asian Economic Crisis* (Ithaca, NY: Cornell University Press, 1999).

14 Tun-jen Cheng, 'Guarding the commanding heights: the state as banker in Taiwan', in Stephan Haggard, Chung H. Lee and Sylvia Maxfield, eds, *The Politics of Finance in Developing Countries* (Ithaca, NY: Cornell University Press, 1993).

financial institutions,<sup>15</sup> and a variety of finance companies. This control of finance, either through the regulatory regime or through the KMT party enterprises, gave the KMT tremendous leverage over the business community. Third, the state–business relationship is relatively flexible, which allowed for resilient adjustment capability.<sup>16</sup>

Against this institutional background, Lee was at the peak of his power when he made the policy turnaround in the summer of 1996. Being elected with 54% of the total votes as the first native president in the first popular presidential election in Taiwan, Lee had garnered a high degree of legitimacy. His KMT party held an overwhelming majority in the Legislative *yuan*, and the opposition DPP was basically Lee’s personal ally. He re-appointed his vice president, Lien Chan, as the Premier, further bolstering his grip on the Executive *yuan*. With political power and institutions centered in his presidency, Lee bypassed all relevant agencies in making the policy announcements. Given the scope and direction of this policy change, Lee never encountered much significant opposition from the bureaucracy, the legislature, the DPP, and even the business community. The reaction of the bureaucracy and the business community is worth mentioning. In the immediate wake of Lee’s call for reassessment of the APROC design, relevant agencies were scrambling to find words to reassure the public that the APROC was really compatible with Lee’s new policy. On one occasion, the Mainland Affairs Council (MAC) and the MoEA jointly stated that Taiwan’s economic relations with China should be on the conservative side. On the same day, a task force formed by the same two agencies sent their memo to the Executive *yuan* arguing for more opening toward China so as to enhance Taiwan’s competitiveness.<sup>17</sup> The MoEA didn’t issue its policy statement under the new policy until June 1997, some ten months after Lee fired the first policy-change salvo in August 1996. Several big businesses, including Tai Plastic and the President Enterprise, withdrew from the MoEA their applications for government approval for investment projects in China. Several top businessmen cautioned that government policy must be compatible with market forces lest many businesses will evade all government regulations—‘to go underground’, only to no avail.

When the DPP’s Chen assumed presidential office in 2000, he could not afford the institutional luxury his predecessor enjoyed. Chen was elected by less than 40% of the total votes. His party was vastly outnumbered in the legislature. The bureaucracy had never taken orders from a party that was not the KMT. Chen definitely needed time to consolidate his power. By the time Chen replaced the NHBP with his own ‘Active Opening, Effective Regulation’ policy in September 2001, many had already invested in the Chinese market, disregarding government

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15 Szu-yin Ho and Jih-chu Lee, ‘The political economy of local banking in Taiwan’, *Issues & Studies* 37(4), (2001), pp. 69–89.

16 Gary G. Hamilton, ‘Organization and market processes in Taiwan’s capitalist economy’, in Marco Orru, Nicole Woolsey Biggart and Gary G. Hamilton, eds, *The Economic Organization of East Asian Capitalism* (Thousand Oaks, CA: Sage Publications, 1999).

17 *LianHeBao* [United Daily], (11 September 1996), p. 3.

regulations. To many in the business community AOER is nothing more than a rationalization of *fait accompli*, as it is an open secret that many investors could simply route their money to a third country, then transfer the fund to China. Table 1 bears this out.

### **The booming economic interests between Taiwan and China**

Despite the institutional distortion and political intervention, economic interaction between Taiwan and China continued to boom in the past decade. Cross-Straits economic relations are characterized by 'civilian governance'.<sup>18</sup> The private sector takes the lead. Table 2 demonstrates the general trend of cross-Straits trade relations in the past five years. Overall trade value continues to grow at an impressive rate. In 2002, China surpassed the US and became the biggest market for Taiwanese exports. The 2002 data also shows that Taiwan's export to China constitutes more than one fifth of Taiwan's total exports, and enjoys 24.1% growth from the previous year. In contrast, Taiwanese imports from China are minimum to Taiwan's total imports. Taiwan's trade surplus to China reached US\$22.75 billion in 2002. In other words, Taiwan's international trade dynamics are boosted by its trade surplus with China. Without such trade surplus, Taiwan's international trade will certainly be in deficit. In the past five years, Taiwan's economic dependence on China has evolved from an estimation to reality.

The huge Taiwanese exports to mainland China are driven by the investment activities of Taiwanese business people. However, a huge gap exists between official estimation and real investment value to China. According to official statistics from Taiwan's Ministry of Economic Affairs released in July 2002, the Taiwanese have invested 22.1 billion US dollars in China since 1992. The mainland Chinese authorities estimate that the 'negotiated value' of Taiwanese investments has reached US\$59.9 billion.<sup>19</sup> According to Peng Huai-nan, Chairman of the Central Bank of Taiwan, the accumulated Taiwanese investments to China in the past decade may be around US\$104.5 billion.<sup>20</sup> Peng's estimation reconfirms the huge gap existing between official data and business activities across the Taiwan Straits. In other words, the real economic dynamics across the Taiwan Straits come from autonomous actions from the business community. Governmental interventions from Taiwan play only a marginal role in regulating this unique economic relationship.

The following pages will introduce the cases of semi-conductor industries, notebook PC production, and venture capital to demonstrate the gap between top-down incentives and bottom-up dynamics of cross-Strait economic relations.

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<sup>18</sup> Tse-Kang Leng, 'Sovereignty at bay? Business networking and domestic politics of informal integration between Taiwan and mainland China', in Philip Regnier and Fu-Kuo Liu, eds, *Regionalism in East Asia: Paradigm Shifting?* (London: Curzon/Routledge, 2003), ch. 10, p. 177; Tse-Kang Leng, 'Securing cross-Straits economic relations: new challenges and opportunities', *Journal of Contemporary China* 11(31), (April 2002), p. 267.

<sup>19</sup> *ZhongGuoShiBao* [China Times], (19 September 2002).

<sup>20</sup> *ZhongYiangShe* [Central News Agency], (18 March 2002).

**Table 1.** Taiwan's approved outward investment by country (area) (unit: US\$ million, %)

Period Area	1992-2001		January-August 2002			Accumulation Amount	Percentage by amount
	Cases	Amount	Percentage by amount	Cases	Amount		
British Central America	1,202	10,884.1	21.24	129	861.7	11,745.8	20.88
Mainland China	24,160	19,886.7	38.82	1,503	3,018.9	22,905.6	40.73
USA	3,571	6,522.8	12.73	290	310.5	6,833.4	12.15
Singapore	342	1,769.3	3.45	16	14.4	1,783.7	3.17
Panama	54	810.0	1.58	1	35.7	875.7	1.56
Japan	275	784.1	1.53	22	11.7	795.8	1.41
Thailand	350	1,059.8	2.07	6	0.6	1,060.4	1.89
HK	657	1,216.9	2.38	39	103.9	1,320.8	2.35
Korea	83	200.9	0.39	9	4.0	204.9	0.36
Vietnam	290	829.2	1.62	10	33.5	862.6	1.53
Philippines	149	622.0	1.21	1	72.9	694.8	1.24
Germany	97	94.5	0.18	4	16.3	110.8	0.20
Others	1,261	6,533.9	12.79	84	495.2	7,049.2	12.53
Total	32,365	51,234.4	100.00	2,114	5,009.2	56,243.5	100.00

Source: *Cross-Straits Economic Statistics Monthly* (Mainland Affairs Council, Taipei, August 2002), p. 29.

**Table 2. Taiwan's foreign trade with China, US and Japan (unit: US\$ billion, %)**

		1998	1999	2000	2001	2002	
Trade	Value	49,054	50,593	59,940	45,884	44,862	
		US	42,490	55,156	38,607	39,260	
		Japan	25,748	32,39	29,96	36,990	
		China	22.8	21.8	20.8	19.9	18.5
	Percentage to total trade	US	18.3	18.3	19.1	16.8	16.1
		China	11.1	11.1	11.2	13.0	15.2
Export	Growth rate %	US	3.1	18.5	-23.5	-2.2	
		Japan	17.0	29.8	-30.0	1.7	
		China	14.5	25.8	-7.4	23.5	
	Value	US	29,376	30,902	34,815	27,654	26,764
		Japan	9,324	11,900	16,599	12,759	11,984
		China	18,380	21,221	26,16	24,06	29,87
Import	Percentage to total export	US	25.4	23.5	22.5	20.5	
		Japan	8.3	9.8	11.2	10.4	9.2
		China	16.6	17.5	17.6	19.6	22.9
	Growth rate %	US	-0.59	5.19	12.66	-20.57	-3.22
		Japan	-20.2	27.6	39.5	-23.1	-6.1
		China	-10.4	15.5	23.3	-8.0	24.1
Import	Value	19,678	19,692	25,125	18,229	18,098	
		US	27,000	30,590	38,557	25,848	27,277
		Japan	4,111	4,526	6,22	5,90	7,12
		China	18.8	17.8	17.9	17.0	16.1
	Percentage to total import	US	25.8	27.6	27.5	24.1	24.2
		China	3.9	4.1	4.4	5.5	6.3
Growth rate %	US	-15.3	0.1	27.6	-27.5	-0.7	
	Japan	-6.7	13.3	26.0	-32.9	5.5	
	China	5.0	10.0	37.5	-5.2	20.7	

Sources: <http://www.mof.gov.tw/statistic/trade/2301.htm>; <http://www.mof.gov.tw/statistic/trade/2311.htm>; [http://www.mof.gov.tw/~ecobook/eco/9201eco.doc](http://cus.trade.gov.tw/cgi-bin/pbisa60.dll/customs/uo_base/of_start); and Authors' calculations.

## **'Hybrid' Taiwanese firms and economic statecraft**

Semi-conductor production plays a key role in Taiwan's information technology industry that is closely linked with Taiwan's economic security. The long-delayed decision by the Taiwanese government to allow semi-conductor companies to invest in China was settled in April 2002 with the final decision being a compromise between the two national goals.

The pro-open globalists in Taiwan argue that the mainland initiatives should be regarded as one crucial step in Taiwan's globalization strategy vis-à-vis IT development. Since the size of the Chinese market and the lower costs of production there enhance China's competitive advantages, the expansion of Taiwanese IT firms to China seems to be a rational choice as far as strengthening Taiwan's competitiveness goes. There is little question that Chinese firms will learn or even 'borrow' Taiwanese technology and know-how in IC production and design. To cope with such challenges from the mainland, Taiwan must upgrade its R&D capacities instead of isolating itself from the global division of labor. Furthermore, since Taiwan does not control the key technologies in the global supply chain, China may obtain know-how from the US, Japan and other advanced nations if it cannot be obtained from Taiwan firms. Once China establishes direct links with key component holders and excludes Taiwan's participation, Taiwan's strategy of globalization will, most assuredly, be put in jeopardy. At the current stage, the entry of the Taiwanese IC industry into the Chinese market will consolidate Taiwan's strategic role in global IC design and manufacturing.

The hard-core conservatives have made national security the first item of priority on the policy-making agenda. They claim that Taiwanese technology and know-how in silicon wafer manufacturing will be lost to China after the 'cluster effects' are realized in major Chinese production centers. The 'cluster effects' also refer to the moving out of the whole supply chain in the IT industry in general, and silicon wafer production in particular. The mass movement of foundries to China will also cause serious unemployment problems in Taiwan. Given the fact that Taiwan does not control key technology in the production process, the cluster effect will facilitate the process for the Chinese to become leading IC manufacturers in a short period of time. Once China becomes the dominant force in IC design and production, Taiwan's economy will be controlled and dependent on China, and Taiwan's national security will be in great danger. The 'magnet attraction' of China will destroy Taiwan's grand strategy of globalization if Taiwan does not adopt balancing acts.

Adopting a principle of 'active opening, effective regulation', Taiwan's Cabinet announced four guidelines in governing semi-conductor industries:

1. before 2005, Taiwanese firms will be allowed to establish only three silicon wafer foundries on mainland China;
2. the level of technology is limited to 8-inch wafers or below;
3. whoever invest in 8-inch wafers in mainland China must launch a new investment project on 12-inch wafers in Taiwan; and
4. the production of key components and R&D capacities must be kept in Taiwan.<sup>21</sup>

The first case under review in the new regulative scheme was the application of TSMC to set up wafer foundries in Shanghai. After 10 months of bureaucratic deliberation, the Taiwanese government finally finished the 'first stage' procedure of approval. Subsequent reviewing on other related details such as financial matters may take another six months. In the real world, however, IT producers such as TSMC cannot wait for such a long time for final approval. The Sunjiang township, the targeted location of TSMC's wafer foundry in Shanghai, had already made the necessary arrangements for the arrival of TSMC well before approval from the Taiwan side. Facing the cut-throat competition in global wafer production, the Taiwanese wafer makers have no choice but to take early initiatives in the mainland market. The reason for the early move is to 'deter' domestic and foreign wafers from market shares by occupying a strategic position in China. Taiwanese IT companies have their own estimation and strategies to explore the mainland Chinese market. Waiting for the final approval from the Taiwanese government could only delay their business arrangements of global division of labor.

Furthermore, the new regulatory scheme fails to recognize the reality that Taiwanese wafer makers have transformed themselves into 'hybrid' firms in China. In other words, the target of regulation on 'Taiwanese firms' has become unclear. Founded in April 2000, Semiconductor Manufacturing International Corporation (SMIC, or *Zhongxin*), a US\$1.46 billion worth Taiwanese semi-conductor company located in Shanghai's Zhangjiang High-Tech Park, is a good example. Registered as an American company, SMIC is treated by the Chinese government as a leading indicator of domestic IC development. In addition to attracting human resources from leading Taiwanese semi-conductor firms, such as Taiwan Semiconductor Manufacturing Corp (TSMC) and United Microelectronics Corp (UMC) with which SMIC has a working relationship, SMIC's major human resources come from overseas Chinese and returning mainland Chinese students trained abroad. SMIC has attracted at least 70 senior Taiwanese IC engineers from major US IT firms, such as Intel, AT&T, Motorola, Texas Instruments (TI), Hewlett-Packard (HP) and Micron. SMIC's technical team consists of 2,500 talented IC designers and managers.<sup>22</sup>

The SMIC case also demonstrates that even though Taiwan has established strict limitations with regard to talent and technology transformation to China, 'hybrid' companies, such as SMIC, still have plenty of channels in which to grow. The Taiwanese IT firms are also clever in establishing international and local networks. Since SMIC is registered as an American company, many Taiwanese regulations governing cross-Strait investment are not applicable. To cope with the new Taiwanese laws regulating IT talent flows to China, SMIC plans to help Taiwanese engineers obtain passports from the third country.<sup>23</sup> In the year 2002, SMIC reached agreements with Toshiba and Chartered Semi-Conductor Manufacturing (CSM) of Singapore to improve its production capacity and introduce advanced technologies. Toshiba will transfer its 8-inch foundry, while CSM will transfer its 0.18 micron

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22 Tse-Kang Leng, *Zixun Chanye Quanqiuhua de Zhengzhi Fenxi: Yi Shanghai Shi Fazhan Weili* [A Political Analysis of Information Technology Industries: Shanghai in Global Perspective] (Taipei: Ink, 2002), p. 246.

23 *LianHeBao* [United Daily News], (24 July 2002).

technology to SMIC. In exchange, Toshiba and CSM is each expected to hold 5% of SMIC's stock.<sup>24</sup> At the current stage, the Taiwanese government only allows 0.25 micron technology to be transferred to China.

The case of the semi-conductor industry demonstrates that the 'hybrid' type of IC firms play the role of integrating technology, know-how, and human resources in the global Chinese community. The ultimate goal of these global-oriented firms is to localize the human power and establish webs of state-business relationship in China. Companies like SMIC could not be classified as a pure 'Taiwanese', 'Chinese', or 'American' firm. In the long run, strategies of localization will help sustain SMIC's power base on mainland China while pursuing global goals of networking.

### **The loophole of regulation? Venture capital and global networking**

Another emerging driver to boost cross-Straits economic relations is the active venture capitalists and their companies. This case also demonstrates that the global operation of VC is out of the reach of the Taiwanese state. In the past decade, Taiwanese VC has added fuel and helped create global networks for mainland Chinese and Taiwanese firms. Taiwanese professional managers have become fundamental pillars in the development of the Chinese market for international VC firms. The common practice of these firms is to register as an American or Hong Kong VC company and attract capital from the Greater China region and international sources. For instance, the Taiwan-based H&Q Asia Pacific is among the first foreign VC pioneers in China. With a total US\$1.6 billion fund, H&Q Asia Pacific has invested more than \$US200 million in China. Major targets of investment include the two largest Taiwanese semiconductor manufacturers in Shanghai—Zhang Rujing's SMIC and Winston Wong's Grace Semiconductor Manufacturing Corp (GSMC). In the past ten years, H&Q has introduced American VC experiences as well as sophisticated, well-trained and gifted experts from Taiwan to mainland China. Not only capital but also human resources are undeniably the two necessary pillars of the scaffolding in the building of global networks of IT production.

The common characteristic of Taiwanese VC companies is in the globalization of their funding and management. In many cases, capital from mainland Chinese sources constitutes half of the total. In the global visions of such VC firms, one criterion for selecting Taiwanese start-up investment projects is their potential to expand and prosper in China. At the same time, these Taiwanese VC firms have established branches in major Chinese cities and trained first-generation VC managers there. American venture capitalists are becoming bridges to link Taiwanese and Chinese companies. Warburg Pincus, an American VC company, has established strategic alliances with Taiwanese venture capitalists to develop the Chinese market. One crucial goal of Warburg Pincus is to help to promote cooperation among high-tech firms across the Taiwan Strait.

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<sup>24</sup> *GongShangShiBao* [Commercial Times], (24 September 2002); *LianHeBao* [United Daily News], (24 July 2002).

Taiwanese VC investment could closely link up with China's drives for globalization and capital-market reform. In the initial stage, China's VC companies were organized by local governments, but these companies, for the most part, lacked professional personnel and marketing capacity. Recently China has begun to acknowledge the importance of attracting foreign VC to link Chinese start-up companies with international talent, sales routes, and capital markets,<sup>25</sup> and as a consequence, state-backed VC firms are being restructured like those in the West in order to compete in the market. For one, Shanghai Venture Capital Corporation (SVCC), a Shanghai city-owned VC firm, enjoys considerable autonomy in operating in accordance with market mechanisms, and SVCC has begun establishing strategic links with other Chinese VC firms, such as Shanghai New Margin Venture Capital (SNMVC), controlled by Chinese President Jiang Zemin's son, Jiang Mianheng. The complex networking with local and international technology centers gives Taiwan a unique advantage to compete with other Asian nations in the VC market in China.<sup>26</sup>

Taiwanese VC companies also play an important role in helping to enhance state-business relationships across the Taiwan Straits. In the case of GSMC, the alliance between Winston Wong, son of the Taiwanese tycoon Wang Yung-ching, and Jiang Mianheng demonstrates the foundation of GSMC's political networks in China. GSMC has, in the meantime, also succeeded in attracting support from Crimson Asian Capital and Crimson Velocity, both of which belong to the Crimson Fund. Founder of the Crimson Fund Gu Zhongliang is the son of Gu Liansong, head of Taiwan's prestigious China Trust Group. In addition to introducing global networks of manufacturing and management, Taiwanese VCs help strengthen local networks of relationships. In the era of globalization, this 'localization' of networks is still the key to success in China.

Given the fact stated above, the Taiwanese state lacks effective instruments to regulate or even punish 'illegal' Taiwanese VC activities in China. The only substantial instrument is to prohibit governmental development funds from investing on mainland China-oriented VCs. In late 2002 and early 2003, the Taiwanese government forced two Taiwanese VCs with governmental fund shares to withdraw new projects from GSMC and SMIC in Shanghai. For those who attract funds from international sources, the state can only use indirect ways or resort to moral principles to persuade them.

Just like the case of semi-conductor and notebook PC companies, the major problem of Taiwan's regulatory scheme is the difficulty in defining the target. In addition to their capacities in attracting global funds, Taiwanese venture capitalists endeavor to localize their operation and establish complex state-business networking in China. The real 'target' for regulation should be the momentum and long-term ambition of these venture capitalists in utilizing the mainland Chinese market as the power house of global operation. Such activities combining strategies of globalization and localization are not constrained by the governmental interven-

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25 *RenMingReBao* [*People's Daily*], (30 December 2000).

26 Tse-Kang Leng, 'Economic globalization and IT talent flows: the Taipei/Shanghai/Silicon Valley triangle', *Asian Survey* 42(2), (March/April 2002), pp. 230-250.

tion, especially regulations from the investors' home country. Actions by the Taiwanese state to punish illegal venture capital activities only serve as a symbol to demonstrate the willingness of the government to balance national security and economic benefits.

## Conclusion

In conclusion, we find that the ideas behind Taiwan's economic policy toward China are as vibrant as ever, the political foundation for a coherent and feasible policy is eroding, and commercial interests are digressing from Taiwan government's policy goals. This picture, however, is far from being complete. To further understand Taiwan's economic policy toward China, we may want to probe the following points.

First, ideas' role in policy-forming stage. The economic historian Trentmann, in observing the idea of free trade in its inceptive stage in the late Victorian and Edwardian era, has this to say, '... free trade can be conceptualized as a convergence of ideas about liberal politics and society sufficient to *generate collective allegiance and action*'.<sup>27</sup> That is, whether free trade is true or false isn't really the point. The point is that ideas can serve as a rally point where political forces would converge and interact. Almost daily, one can observe Taiwan's political discourses surrounding on identity, on Taiwan Independence, on 'love for Taiwan', and so on. These ideas, or more precisely, the political forces around these ideas, have strong bearing on the formation of Taiwan's economic policy toward China. The Taiwan Solidarity Union's (a political party formed by Lee after he was expelled from the KMT) vehement opposition to the DPP government's decision to open 8-inch wafer investment is a case in point.

Secondly, the truthfulness or falseness of the 'security' argument in Taiwan's economic policy toward China. The security argument was always couched in Hirschmanian terms,<sup>28</sup> even though we now know that Hirschman's argument may have to be qualified in important ways.<sup>29</sup> But being so intuitively true, the security argument is by and large taken at its face value. Indeed, we are yet to see much meaningful debate regarding the security argument. The truthfulness or falseness of the 'security' argument is of intrinsic value to Taiwan's decision-makers, as they have to take ultimate responsibility for the strategic-political implications of economic relations with China.

Thirdly, the 'boomerang' effect on Taiwan's domestic politics of economic relations with China. Whether in the realms of trade and investment, we need better specify how trade (and investment in) with China influences Taiwan's distribution, and, hence, its politics. Taiwan-specific studies along the lines suggested by scholars like Rogowski or Frieden are far and between.<sup>30</sup>

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27 Frank Trentmann, 'Political culture and political economy: interest, ideology, and free trade', *Review of International Political Economy* 5(2), (1998), pp. 217–251.

28 Albert O. Hirschman, *National Power and the Structure of Foreign Trade* (Berkeley, CA: University of California Press, 1945).

29 A. O. Ritschl, 'Nazi economic imperialism and the exploitation of the small: evidence from Germany's secret foreign exchange balances, 1938–1940', *The Economic History Review* 56(2), (2001), pp. 324–345.

30 Ronald Rogowski, *Commerce and Coalitions* (Princeton, NJ: Princeton University Press, 1989); Jeffrey A. Frieden, 'Invested interests: the politics of national economic policies in a world of global finance', *International Organization* no. 45, (1991), pp. 425–451.

Finally, we need to better understand the high politics involved in making economic policy toward China. The relative position of relevant agencies in this policy realm, in our view, is of particular importance. We therefore call for more studies in this aspect.