

Chapter I

Introduction

The cross-Strait relations between Taiwan and mainland China have been an interesting topic for social scientists, economists, military experts, and historians for a long time. Many believe that the Taiwan Strait is still the most dangerous place on Earth, where the USA, the only global superpower, is on the verge of military conflict with the People's Republic of China (PRC), a rising economic and military power.

Cross-Strait relations have many complicated sub-topics. Two of them stand out as more important than others. First is the issue of sovereignty. Is Taiwan a part of China or not? If it is a part of China, should it become a part of the PRC? And if it is not a part of China, should it become an independent country? The second question is about the pace of economic relations. These two topics form two axes in Taiwan domestic politics. The first axis is unification vs. independence, and the second is the national security vs. increasing economic relations axis. This paper tries to analyze the second of these axes. These two problems, however, are very closely related. Sometimes they are even described as Siamese twins (Su 2002) and it is difficult to say, where one ends and the other begins. This paper will describe the changes that have happened during these 19 years and also find the main ideas that bear continuity in cross-Strait economic relations.

By the late 1980s, the confrontation across the Strait and in the international arena had gone on for so long that no one remembered anything else. Everything had to start anew in 1987 when Taiwan eased restrictions on traveling to the Mainland. Everyone had to learn rapidly. At first, Taiwanese small and medium-sized enterprises (SME) started using new opportunities. In the late 1980s and early 1990s SME started

to invest in labor intensive sectors such as garments, shoe making, and low end consumer electronics, looking to recover their capital within two or three years. Larger firms gradually followed them, investing bigger amounts with a longer perspective. As Taiwanese businessmen pumped more and more capital into China, the government in Taiwan launched the “Go South” policy in 1994. The purpose was to lead Taiwanese investment away from mainland China, which was, in President Lee’s opinion, a hostile country.

Lee’s visit to Cornell University in 1995 and the following crisis and military exercises during 1995 and 1996 adversely affected Taiwan’s investment on the mainland and trade between the two sides. The effects, however, were only fugacious. Soon after Lee started his second term, the Taiwanese business community headed towards China again. In the end of the 1990s the picture was changing rapidly. More than half of the companies listed on Taiwan's stock exchange had invested in the Mainland. The Taiwanese IT sector started to move to Mainland, too. Warning that unregulated capital flow to the mainland would drain Taiwan’s savings, Lee formally introduced the “no haste, be patient” policy to restrain Taiwan’s investment in the mainland. This policy prohibited any participation in the infrastructure sector on the mainland, restricted investment in high-tech industry there, and subjected mainland-bound projects of any type exceeding US\$50 million to approval on a case-by-case basis. However, it was too late to stop the train. Taiwanese companies have always found a way. When they were not allowed to invest in the Mainland directly, they went there through third countries. Another possibility was to invest just a small portion of the whole and to raise funds in the Mainland, using local or foreign capital. Investing through subsidiaries has also occurred quite often. Lee’s idea of a “state-to-state” relationship slowed down the trade and investment again, but the effect was only temporary.

When Chen Shui-bian assumed the presidency in 2000, he could not stop the trend, either. Actually, in the first year and a half, he did not try. The three mini-links were opened, Lee's "no haste, be patient" was replaced by his own "active opening, effective management" policy in September 2001, and many restrictions on investment in Mainland were eased. However, he soon adapted more conservative approach on the national security vs. economic relations axis. In August 2002, he announced that there was "one country on either side" of the Taiwan Strait. A political ice-age began that lasts to this day.

Economic connections, however, were booming. The growing investments lead to increasing trade between the two sides. Many Taiwanese investors on the Mainland imported their intermediate products from their factories in Taiwan and Taiwan enjoined a huge trade surplus with mainland China. In 2002, mainland China surpassed the United States to become Taiwan's largest trading partner. 55,000 Taiwan enterprises had a cumulated investment of \$100 billion on the Mainland; 3 million Taiwanese visited the Mainland; and another million worked on the Mainland. The greater Shanghai area alone attracted half a million Taiwanese and 80,000 had purchased properties there.¹

The hardest blow to government's restrictive Mainland policy and concerns about national security was dealt by the IC industry, the crown jewel of Taiwanese information technology, when it moved to the Mainland. As we see from the graph (appendix I) the amount of Taiwanese investment in Mainland China has grown steadily. The same goes with cross-Strait trade (appendix II). There have been some temporary slow-downs but they have always been followed by rapid growth.

¹ Ho Szu yin, Leng Tse-kang. 2004. Accounting for Taiwan's Economic Policy toward China. (*Journal of Contemporary China*).13(41).738

Now, it takes two to trade. My research, however, focuses on Taiwan side only, starting from the year 1987, when the Kuomintang government abolished martial law and allowed her citizens to visit their relatives in China. It was beginning of a trading *regime*. By *regime* I hereby mean the set of rules, both formal and informal, that regulates the operations of government and its interaction with the economy and society.

As this work focuses on Taiwan side only, data given by Taiwanese government and organizations is used. Tables that contain both Taiwanese and Chinese statistics are presented. We may sometimes find that differences are rather stunning. However, this paper contends that the information of Taiwanese agencies is mainly accurate and uses it as a benchmark. The most useful sources of statistics and implemented policies are the Ministry of Economic Affairs, the Mainland Affairs Council, the Strait Exchange Foundation, and the Investment Commission. There are also many articles and books about this topic, written by Taiwanese, Mainland, and Western scholars.

To analyze the interactions between the main players of the policy making process, I use Graham Allison's ideas from his bestseller "Essence of Decision." He states that there are three different Models to describe the policy making process: the Rational Actor, Organizational Process and Governmental (Bureaucratic) politics models. The rational Actor model counts the Government as a unitary player and its actions as the most rational choice at the time. The organizational process model sees governmental action as an organizational output and according to it there is no such single entity as government. Governmental action is an organizational output rather than rational choice. The governmental (Bureaucratic) politics model sees governmental action as a political resultant. Governmental action is neither a rational choice from list of options nor an organizational output. It is more likely a resultant of

bargaining. What happens is not chosen as a solution to a problem but rather results from compromise, conflict and confusion of officials with diverse interests and unequal influence. I use them to analyze the role of different players in the game called cross-Strait economic relations. On different occasions they are all useful tools to understand the process and implementation of Taiwan's cross-Strait economic policy.

This paper seeks to show that all of these models can be used on different occasions to understand the complicated issue of economic ties between two sides of Taiwan Strait. In order to do that, the roles of leadership, political parties, bureaucracy, and private players are analyzed using Allison's models. However, even if we understand the policy making process and its implementation well, we still have to explain the huge difference between the policy and the real outcome in terms of volume of Taiwanese investment in mainland China. Only by using the Governmental politics model can other factors that determine the actual volume of investing and trading be taken into consideration. China's huge domestic market, its cheap labor and land, and cultural proximity are the factors that pull Taiwanese companies there. There is also a pushing factor, especially in the IT sector. Most Taiwanese companies are sub-contractors to world-known brand marketers. In the era of globalization and vertical disintegration, Taiwanese firms have no option but to move to mainland China to be closer to their partners. The alternative is to quit business or remain a SME, both of which are unacceptable for most Taiwanese big companies.

In order to explain this, this paper has the following parts. Chapter I is introduction to the topic, a general overview of cross-Strait trade, method and hypothesis. Chapter II gives an analytical framework, introduces different models given by Allison and adjusts it to cross-Strait trading between Taiwan and Mainland. Chapter III deals with leadership. Three different Presidents, three different stories,

and three different set of values need to be explained. Chapter IV is about political parties as influential players in the policy making process. Chapter V analyzes bureaucracy as an essential part of government's policy making. Organizations may have acted differently under different regimes and thus caused different outputs. Chapter VI is about private actors. Private companies have often had some influence on policy making. However, it is the result of their actions that has lead to the real outcome of cross-Strait economic relations. The electorate has its own role, although it is minor in terms of both policy making and real outcome. Chapter 7 provides some final thoughts.