

Taiwan and China Make Strides: Can America Respond?

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Introduction

On March 22, 2008, Taiwan voters went to the polls and declared a return to Kuomintang (KMT) rule. The KMT's Ma Ying-jeou won a landslide election against Frank Hsieh of the incumbent Democratic Progressive Party (DPP), and the end result was rarely in question as voter frustration over DPP rule – accumulated over 8 years – spilled over into a convincing 58.45 percent victory for Ma and his running mate Vincent Siew.

Ma's contention that Taiwan's economy had fared poorly from 2000-2008 played well to Taiwan's electorate - somewhat unfairly, as in fact Taiwan enjoyed average annual GDP growth of 3.63 percent during that period, according to the National Statistics Database maintained by Taiwan's Directorate-General of Budget, Accounting and Statistics (DGBAS). But voter perception was centered on missed opportunities and a Taiwan that had mostly stood still for eight years while its regional competitors advanced their interests.

But Ma won the election also by highlighting the angst that former President Chen Shui-bian had caused Taiwan's most important interlocutors – China and the United States. China was never interested in offering President Chen a dialogue during his 8 years as president of Taiwan, other than under terms and conditions that ran contrary to DPP principles. However, President Chen's diplomatic isolation was exacerbated by his rhetoric that so often caught policymakers in Beijing and Washington off guard. This left the Chinese increasingly concerned about Chen's intentions – even in the face of obvious constitutional limitations on his power – and left the U.S. frustrated both with constant Chinese harping and Chen's erratic behavior. This tense situation appeared to cast a shadow over much else that the Bush administration was attempting to accomplish in its relationship with China.

Fairly or unfairly, the picture that evolved – particularly after Chen's second election victory in March of 2004 – was of a Taiwan actively undermining peace and security in north Asia, and by extension hurting its own commercial and diplomatic interests. This perception neatly teed up candidate Ma's campaign, where he pitched Taiwan voters on the importance of returning to the safe and steady hands of the technocratic KMT and of addressing Taiwan's core economic, domestic and foreign relationships.

Ma's Campaign Commitments

Candidate Ma's general campaign pitch was a return to balanced and experienced rule under the KMT. He focused acutely on the perception that Taiwan had been treading water during a period of global economic expansion, thereby missing opportunities to grow global markets as well as to reform domestically. In addition, he noted that Taiwan's global diplomatic isolation had increased under the DPP, and contended that the course of confrontation with China and the U.S. was unsustainable. Ma argued that it was essential to reach a new accommodation with China that would allow for meaningful representation of Taiwan in global organizations – including but not limited to the World Health Assembly (WHA).

Candidate Ma's choice for vice president spoke volumes for his campaign's focus on the economy. Vincent Siew is a former premier and was Minister of Economic Affairs under former president Lee Teng-hui. His role would be to spearhead both comprehensive domestic economic reform, including further deregulation of services like banking; and to take charge of implementing the i-Taiwan 12 projects – a large infrastructure package valued at approximately US\$117 billion over 8 years. In addition, Vincent Siew is strongly identified with the concept of a Cross-Strait Common Market, an idea that he formulated and championed over several years. Ma even incorporated this initiative into his election manifesto as a central goal in a plan to harmonize commercial activity between Taiwan and what is now Taiwan's largest market, China.

Cross-Strait economic engagement had another equally important deliverable for the Ma camp; it was a natural platform to reduce tensions and map a more reasonable path for increased cooperation with China, while staving off the need to engage on pricklier matters concerning sovereignty. The Ma campaign promised that this issue, often and rather simplistically viewed through the logistical challenge of flying between Taiwan and China, was to be tackled early on through an incremental resumption of cross-Strait transportation links, coupled with more comprehensive agreements on air travel and mail. Ma and Siew also saw an increase in mainland tourists visiting the island as an important objective, given their potential impact on a broad cross-section of Taiwan's economy.

During his campaign, Ma also articulated the need to improve relations with the United States, with which ties had soured terribly since about 2003. Chen's erratic behavior, coupled with a Bush team more interested in improving relations with China, made for a difficult set of circumstances and an increasingly reflexive urge to press Taiwan into a box. While this attitude was initially focused on Chen and his colleagues, it drifted into an overall view of Taiwan that drew no distinctions. In the end, Taiwan could do no right. Ma noted that Taiwan-U.S. relations would likely improve simply as a function of improved Taiwan relations with China. However, he also put great weight on improved communications between Taipei and Washington, and the need to avoid surprising and confrontational actions.

Policies & Developments

President Ma hit the ground running when he assumed office on May 20, 2008.

The newly appointed chairman of the Strait Exchange Foundation (SEF), Chiang Pin-kung, went to China in mid-June of 2008 to consummate an initial deal on cross-Strait transportation as promised by the Ma campaign. The deal allowed for an expanded charter flight schedule, based on the holiday flight framework already in place. While the agreement included a limited number of direct routes on weekends only – and involved aircraft flying over Hong Kong airspace but not alighting – the agreement also stipulated that both sides would work toward normalized passenger and cargo air traffic with direct routes. This early triumph was seen in all three capitals as a positive sign and raised hopes that a more sustainable relationship might be within their grasp.

However, the Ma government had not seen cross-Strait transportation links as the only low-hanging fruit. To remain committed to his election platform, Ma quickly expanded his SEF - Association for Relations Across the Taiwan Straits (ARATS) dialogue to include:

- Opening currency exchanges for Chinese Yuan/New Taiwan Dollar trade
- Loosening of capital restriction for Chinese investment in Taiwan equities, companies, and property
- An agreement on tourists that hypothetically could dramatically increase the number of Chinese citizens visiting Taiwan daily
- Signing agreements for direct cross-Strait sea, air, and mail travel
- Simplifying procedures for Chinese professionals to visit and work for limited periods in Taiwan.

In addition, the Ma administration launched negotiations to allow Chinese students to visit and study in Taiwan, and a whole host of smaller initiatives have been negotiated and are in the early stages of implementation. This is a substantive and impressive body of work for approximately 8 months of dialogue. That said, Ma upped the ante substantially in late February when he and his colleagues responded positively to Chinese President Hu Jintao's offer to negotiate and sign a Comprehensive Economic Cooperation Agreement (CECA) with Taiwan, now referred to on the island as the Economic Cooperation Framework Agreement (ECFA).

Despite this improvement in cross-Strait relations, Ma did not see the early gains he might have hoped for with the United States. By President Bush's last year in office, the fact that Chen Shui-bian was no longer president of Taiwan was immaterial. America's positive relationship with China was viewed as an important part of President Bush's legacy, and the change in leadership in Taipei did not automatically change Taiwan's value in the equation. President Ma was treated with minimal cordiality, and as he left office President Bush's penultimate substantive Taiwan action – an October 3, 2008 decision to notify several weapons systems to Congress – created more confusion and frustration over the breakdown in the arms sales process on the U.S. side. Thus America's defense relationship with Taiwan was bequeathed with unaddressed platforms and a broken arms sales process, a mess that President Obama and his colleagues will have to address.

China's Role

From China's perspective, Taiwan's democratic transition has been decidedly unpleasant. Chen Shui-bian's actions and statements were deemed highly provocative, and he replaced the reviled Lee Teng-hui whose late 1990s statements had made him persona non-grata with Beijing. So China stewed for the past eight years, happy only when President Bush or one of his colleagues made a statement or undertook an action or non-action that China saw as contrary to Taiwan's interests, or beneficial to China at Taiwan's expense. While the short term approach of demonizing Taiwan presidents might have played well in Beijing, it was having a profoundly negative effect on the view of China from Taiwan.

This was not China's "Taiwan policy" per se. China mostly understood that Taiwan's democratization and demographic changes were undermining what support existed on Taiwan for unification with China. A sustained churlish attitude toward the island would only accelerate these trends, making the possibility of resolution of the fundamental dispute that much more remote. Therefore, Ma's election placed great import on the need to put China's relations with Taiwan back on a path that at least held the possibility of peaceful resolution. President Hu and his civilian colleagues viewed Ma's policy of economic engagement as a positive and reasonable momentum builder for relations. So under the guidance of ARATS's chairman Chen Yunlin, China responded substantively to Ma's outreached hand.

In a December 31, 2008 speech commemorating the 30th anniversary of an important Taiwan policy speech, China's President Hu expanded the possibilities in bilateral cross-Straits relations when he made a six point proposal that included, 1) scrupulously abiding by the One-China principle and enhancing political mutual trust; 2) strengthening commercial ties, partly through negotiating an economic cooperation agreement; 3) promoting personnel exchanges of personnel between the two sides; 4) highlighting common cultural links; 5) allowing Taiwan's "reasonable" participation in international organizations and 6) the negotiation of a peace agreement.

The notion of China's "One-China Principle" – that there is only one China, it is the People's Republic of China, and Taiwan is a part of it – is anathema to a majority of the people of Taiwan. According to the latest Mainland Affairs Council poll, 91 percent of Taiwan citizens support the status quo with less than 10 percent in favor of unification with the mainland. But President Hu's Points 2 and 5 were well received in Taiwan by the current leadership and its supporters, if not by the entire population. If his policies are going to enjoy majority support in Taiwan, Ma must be seen domestically to be making progress with China and he needs for China to be viewed as making real concessions. As argued in his election campaign, Ma places great stock in maximizing Taiwan's economic relationship with China while reconstituting Taiwan's global diplomatic position in a more sustainable and accommodating framework under improved relations with China. The overall outcome should also meet another of Ma's campaign commitments – improved security through increased economic opportunity as well as a reduction in the overall threat from China after 6 plus years of heightened tension.

However, as noted below China's continued massive military modernization efforts and the degree to which their efforts are focused on Taiwan remains a major barrier to sustainable security improvements in the Taiwan Strait.

Evidence of improved relations are already manifest, with clear progress on economic cooperation but with nascent diplomatic progress as well. A small but positive action was Taiwan's inclusion in the International Health Regulations (IHR) under the World Health Organization (WHO), which will allow the island to contact the body directly. That said, a far larger test will come this spring with Taiwan's annual attempt to gain observer status at the World Health Assembly (WHA). It's an important moment for China, one which it must seize both to serve its own interests on Taiwan through an improved view of its attitude, as well as to reinforce Ma's ability to maintain domestic support for cross-Strait engagement by making a substantive concession.

Finally, it is important to highlight an inconsistency in China's recent attitude toward Taiwan and a major challenge for the U.S. While Beijing's civilian leadership continues to frame a positive path for Taiwan-China relations, China's military modernization continues unabated and actively undermines these gains. There has been no Chinese slowing in defense spending, training, or deployment of forces directed at Taiwan. This marks a stark contrast to the political and economic efforts, and creates a genuine conundrum for Ma as well as for the Obama administration. How do they maintain positive engagement while discouraging China from pursuing such a provocative military posture?

President Obama should certainly use resumed military-to-military exchanges to impress upon the People's Liberation Army that there is a direct correlation between Chinese force modernization and U.S. support for Taiwan's defense, including arms sales. In addition, continued material support for President Ma's move to an all volunteer force, coupled with a more integrated and modern military, will require continued supplies of modern weaponry. This support will positively underpin Taiwan's engagement with China and will provide continued legitimacy to Ma's efforts – a dynamic Ma himself understands well, as he continues to make the case for replacement fighters through a second tranche of F-16s, Black Hawk helicopters, and other modern equipment.

The Global Recession & Trade Policy

The Economist Intelligence Unit (EIU) recently noted that of the 55 major global economies tracked in detail, Taiwan has been hit harder than almost anyone else by the global downturn. Based on industrial production alone, Taiwan's output has fallen by 32 percent in the 12 months to December 2008. GDP figures released on February 18, 2009 showed that Taiwan's economy contracted by approximately 8.4 percent in Q4 2008, basically wiping away the last two and a half years of economic expansion. Taiwan's DGBAS is predicting economic contraction of approximately 3 percent in 2009, while the aggregate analyst prediction is closer to 6 percent. Taiwan exports 70 percent of its industrial production, and with its main markets America, China, Japan, and the European Union all experiencing degrees of economic distress, Taiwan is affected

acutely. This has added greatly to the urgency of Ma's domestic economic reform, liberalization, and trade liberalization agenda.

The Ma administration has responded to the crisis, albeit with mixed results to date. The Taiwan government has issued spending vouchers worth approximately US\$100 per citizen, vouchers intended to act as a catalyst for domestic demand. Taiwan's Central Bank of China (CBC) has cut rates aggressively – 7 times since last September – with the latest cut bringing Taiwan interest rates to 1.25 percent. The government has also hastened to implement the 12 i-Taiwan infrastructure projects. In addition, it has allowed Taiwan's currency to continue to depreciate against its major trading partners, down to a 6 year low against the U.S. dollar. These actions, except for the currency depreciation, are commensurate with those of other major global economies. That said, Taiwan has a high savings rate, and nothing suggests that Taiwan citizens are going to drop the savings habit in order to increase domestic demand for goods and services. Therefore, it seems likely that the Taiwan government will combine a loose economic policy with infrastructure investment, and then wait for its major trading partners to recover.

Taiwan did achieve two major trade policy goals over the past quarter, one being its signing of the Agreement on Government Procurement (GPA) at the World Trade Organization (WTO) in December, and the second being its removal from the United States Trade Representative's Special 301 Watch List for IPR violators in mid January of 2009. With the GPA, President Ma has signed an agreement that will give Taiwan companies access to government procurement contracts in over 40 global economies, thereby increasing market access dramatically. It will also open Taiwan's market to increasing competition and competitiveness, as well as to new foreign direct investment. The removal from USTR's Special 301 Watch List is the culmination of 4-5 years of hard work, and considerable credit must also be given to the Chen administration for implementing many of the policies that resulted in this positive development. While Taiwan's IPR regime is now well placed to manage the bulk of the challenges, IPR theft remains a massive global problem. Taiwan will be looked to for leadership, particularly in Asia.

President Ma's economic team views renewed efforts to liberalize Taiwan's major trading markets as essential to recovery and increased future growth. It is also a way to break out of its current economic isolation, absent of any meaningful role for Taiwan in bilateral and multilateral regional trade liberalization efforts. The Ma government views the ECFA not as a goal unto itself, nor only in the narrow prism of Taiwan-China relations, but as a part of its overall global trade strategy. Both the Taiwan government and businesses are particularly concerned about the impact of ASEAN +1 and ASEAN +3 on Taiwan's competitiveness in the China market. President Ma also believes that improved Taiwan-China relations and the willingness of China to engage in free trade negotiations will assist Taiwan in breaking out of its trade liberalization isolation and allow it to sign FTAs with the U.S., Japan, Singapore, and other major trading partners. China's offer of an ECFA has been well received, but it is but a part of what should also be an appropriate U.S. and pan-Asian response to Taiwan's efforts to liberalize its markets in the shadow of improved Taiwan-China relations.

At this time, Taiwan has a Trade and Investment Framework Agreement (TIFA) with the United States that has acted as a periodic platform for discussing bilateral economic issues. This mechanism is a modest foundation that allows America and its trading partners to manage the myriad trade issues that characterize large commercial relationships. That said, for the second time in 5 years America has frozen the TIFA – in this instance due to its displeasure over Taiwan’s restrictions on imports of American beef. While beef, and indeed rice and pork too, are important export commodities for America, they represent a relatively small percentage of our bilateral trade – in the case of beef it’s considerably less than 1 percent of bilateral trade. The Bush administration felt that it had been misled over commitments to re-open aspects of the beef market (some beef is already being sold), and shut the TIFA process down in 2008 until those commitments were fulfilled. Now we must wait until the Obama administration trade team is confirmed and in place before we can ascertain its intentions on the TIFA freeze. Whatever the outcome, however, America’s last foray into such a freeze – in 2003-2004 over IPR – was generally viewed to have been a failure. Furthermore, as in the case of last year’s arms sales freeze, there are no other cases of global partners being treated in this fashion.

At such time as beef imports resume, or President Obama’s trade team decides to resume the TIFA prior to such a resolution, Taiwan and the Obama administration must look for ways to allow the relationship to mature. America has treated Taiwan in uniquely punitive ways, to the increasing detriment of our interests in this major market. If we cannot find a way to respond to Taiwan and China’s detente, we run the very real risk of adding wind to the economic impetuses that are pushing this top 10 U.S. market further into the purview of China’s economic embrace. A good place to start would be adding consistency to our approach to Taiwan and begin treating it the same way we do our other major trading partners, even when we disagree. In the longer term, we need to start representing our equities more assertively with Taiwan, not, as in the past, in reaction to Beijing’s displeasure on any number of issues but in substantive strategic ways such as free trade agreements. America needs to look at what it can accomplish in the light of improved Taiwan-China relations.

The subject of FTAs at this time may seem ridiculous given the lack of support for such agreements amongst America’s ruling party. However, it is likely that as President Obama grows more comfortable in his new post he’ll look to shape a trade policy consensus that will allow his government to support global trade liberalization. This will be particularly needed in Asia, which continues to remove barriers to trade and accelerate integration. In the absence of U.S. leadership, or even basic participation, this process will continue to center around the China market at the expense of our own. If China and Taiwan see fit to negotiate a free trade agreement then what possible reason should America have for not doing likewise with Taiwan?

In addition, it is certainly time for the U.S. to return to the policy of sending economic cabinet officers to Taiwan annually to boost our interests in the market. This policy was started by President Bush in 1992 with the visit of then United States Trade

Representative Carla Hills, and continued throughout the 1990s under President Clinton. While the recent Bush administration had legitimate concerns over how President Chen would react to the presence of such a high ranking U.S. official, now is the time to re-engage this policy. Other countries see high-level interaction with Taiwan as in their economic interest: the U.K.'s commerce secretary visited Taipei within a month of Taiwan's acceptance of GPA commitments, for example. In light of Ma's commitment to spend almost US\$120 billion on infrastructure in the coming 8 years, the U.S. should also be making every effort to promote its own companies in the market.

What's Next?

For Taiwan, like with the United States, there are considerable unknowns associated with this latest economic recession. While Taiwan's financial institutions are not burdened to the same extent with the toxic assets weighting down our own institutions, the notion that Asian economies have decoupled from the U.S. and Europe is nonsense. Asia shares our economic pain, and cannot hope to launch a sustained recovery until America and Europe turn the corner and its export markets return. In the meantime, President Ma will continue to focus on what he can control – namely domestic efforts to increase investment, along with external efforts to open new markets or address trade-diverting developments such as FTAs from which Taiwan has been excluded.

The CECA, or Comprehensive Economic Cooperation Agreement as referred to by President Hu in his recent speech, with China has very real legs, and we can expect to hear a great deal more on this matter as Ma moves it through the Taiwan court of public opinion and shapes a policy response that P.K. Chiang can take into SEF-ARATS negotiations. Indeed, President Ma has already made a significant adjustment by changing the name with which Taiwan will refer to such an agreement to Economic Cooperation Framework Agreement (ECFA). This adjustment was made in response to early domestic criticism of the effort and the similarity of the CECA name to Hong Kong and Macau's Closer Economic Partnership Agreement (or CEPA) with China. I believe that Ma has made the decision to proceed with the ECFA with a basic framework agreed to and signed with the Chinese at the end of 2009, and the specifics to be worked out in a series of SEF-ARATS negotiations running several years. This will generate much discussion about what sovereignty positions are being sacrificed to secure preferential market access and how transparent the process will be. However, I believe that Ma will work hard to mitigate both negative public perceptions as well as any real attempts by China to use this economic initiative to move the sovereignty line. China wants this agreement too, and this provides real leverage for Ma to strike a good deal for Taiwan.

The ECFA provides a tremendous opportunity for the U.S. as well. We have large interests in the Taiwan market, and the triangular economic relationship between America, Taiwan, and China comes only behind Europe and NAFTA in its strategic importance to U.S. economic prosperity. If China and Taiwan are genuinely seeking a free trade agreement with one another, albeit under a different name, then the United States must seize this opportunity and likewise engage Taiwan. America is not without

equities in this discussion; preferential market access for China in the Taiwan market and vice versa should press the U.S. to respond in kind. In addition, the U.S. is vested in continued Taiwan-China rapprochement. But as the negotiations expand so will domestic angst on Taiwan. If the U.S. agrees to negotiate its own FTA with Taiwan, that could assuage domestic Taiwan concerns that this is part of a KMT effort to promote unification with China, and would thereby provide Taiwan's people with options and a semblance of balance, calming fears and keeping support for improved cross-Strait relations on the right track.

President Obama and his team haven't yet had an opportunity to shape a cohesive trade policy, but as he ventures out into the world in his capacity as president he will quickly note the importance of U.S. leadership on trade – both in setting sound examples for trade policy as well as leading on trade liberalization. America does not have the luxury of taking a trade “timeout,” particularly with the rest of the global economy looking for ways to accelerate bilateral, regional multilateral, and global trade liberalization.

President Ma's election and his cross-Strait policies have markedly improved cross-Strait relations. But to what ultimate end, if all parties including the United States cannot use this period to move away from past policies that have retarded the maturing of this complex triumvirate? Taiwan and China are not missing this opportunity to allow their relationship to mature, and America shouldn't either.