Recent Developments in China's Relations with Taiwan and North Korea

Panel I: Cross-Strait Economic and Political Issues

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Taiwan: Cross-Strait Economic & Political Issues

The global financial crisis of 2008 and subsequent recession hit Taiwan's economy hard, and it has struggled since to fully recover. Taiwan faces relatively low unemployment, but wage growth is flat, upward mobility is difficult, and sky-high property prices keep young adults living at home. Taiwan's citizens are confronting many of the same social challenges that their counterparts in Europe and the U.S. are also dealing with. In Taiwan, however, the recession and subsequent weak global rebound has also been coupled with a continued growth in the overall trade imbalance with and economic reliance on China.

It has now been six years since Ma Ying-jeou was elected President of Taiwan. Upon taking office, President Ma was committed to addressing that trade imbalance in Taiwan's relationship with China. He made some dramatic moves in his first two years; normalizing cross-Strait flights, opening up tourism, and launching the Economic Cooperation Framework Agreement (ECFA) with China in 2010.

Throughout this process, President Ma has sought to institutionalize a degree of stability in cross-Strait relations by normalizing commercial and cultural relations, doing so in a way that future governments of Taiwan would find difficult – and even undesirable – to roll back. He has sought to engage with China in order to reduce tensions, buy Taiwan an open-ended period of time in its cross-Strait dealings, and to attempt to provide the citizens of Taiwan with commercial opportunities in China. For China, on the other hand, the objective of this policy course is unification – to draw Taiwan into the full embrace of the PRC – an outcome rejected by greater than 80% of the people of Taiwan.

The Ma government and its Beijing interlocutors have made progress on cultural relations, and yet the main driver over the past several years has been a series of commercial agreements designed to normalize and liberalize cross-Strait trade and commerce. These agreements originally met little resistance in Taiwan due to the way they were structured, which weighted their economic benefits toward Taiwan.

Taiwan's most recent agreement with China – the Cross-Strait Service Trade Agreement (CSSTA) – was signed in the summer of 2013. The CSSTA is a fully comprehensive agreement designed to liberalize the service sector, agreeing to open 80 sectors in China and 64 in Taiwan to competition from across the Taiwan Strait. The service sectors covered by the agreement include banking, telecommunications, construction, healthcare, tourism, transportation, finance, and entertainment. The agreement again appears structured to favor the Taiwan side, and yet the feeling in Taiwan is that without a clear trade-transition package in place, the agreement will hurt smaller industries – such as travel, transportation, and printing – in Taiwan.

The signing of the CSSTA appeared to catalyze the deep angst in Taiwan, particularly among the young, over their future commercial and political fortunes – both of which seem inexorably intertwined with China's insatiable territorial ambitions. In the spring of 2014, this angst galvanized into what is known as the "Sunflower Movement," and resulted in a 3-week occupation of the legislature and a mass-protest with over a hundred thousand Taiwan citizens demonstrating against the agreement. This display was more organic than simple political opportunism, as some have argued. The genesis of the pushback on the CSSTA – and of the broader concern over the trajectory of the cross-Strait relationship – is the seeming absence of any policies that keep Taiwan's non-China relationships, particularly the U.S. and Japan, equally as well positioned as commercial partners for Taiwan.

While President Ma has sought to institutionalize cross-Strait stability, those policies now run the risk of instead creating ongoing instability if Taiwan remains unable to similarly engage with its other major trading partners. If the concerns raised by large constituencies on the island are marginalized and/or ignored, that instability could radicalize Taiwan politics and will leave civil unrest and political violence as options for the two major political parties.

Forging an Economic Consensus on the Island

Taiwan is primarily an export-driven economy, but the debate over free trade remains active in Taiwan due to significant differences in attitudes toward wealth and its creation. Both the Kuomintang (KMT) and the Democratic Progressive Party (DPP) are vocal supporters of Taiwan's bid to join the Trans Pacific Partnership (TPP), and support the reforms required to prepare Taiwan for accession to the TPP. The two parties disagree on the best way to get there, however, and that is where complications arise.

President Ma's global trade strategy sequences engagement with China as the precursor to a more active and meaningful role for Taiwan in regional bilateral and multilateral trade agreements. The underlying thesis appears sound; beginning with China and then moving on to the rest of the world helps mitigate against potential Beijing objections, based on their sovereignty claims, to expanded Taiwan participation in the global trading system.

Nevertheless, a major issue with President Ma's "China first" trade policy is how it increases the disquiet and grows the divide between the two major political parties, as the policy directly contradicts the commitment on the part of the DPP to chart a more autonomous path forward for Taiwan. In addition, while the deals signed with China so far appear to have been broadly beneficial to Taiwan, they also increase the island's economic dependence on the mainland. Moreover, they fit neatly with China's stated intent of using economic engagement as a tool to promote political unification.

Despite the early successes for President Ma, his Taiwan-China trade policy agenda has now been all but halted, stalled as part of the debate concerning the CSSTA – as well as more broadly due to the absence of a formal mechanism to assess the efficacy of cross-Strait trade agreements prior to ratification. The KMT had planned to move the CSSTA through the Legislative Yuan this past spring, but that effort ran into a wall of popular protests, along with DPP legislative objections over the way the agreement had been negotiated and the extent to which the winners and losers of the agreement had been adequately identified. The hold-up has also negatively impacted a proposed merchandise trade agreement, which along with the services trade pact was to be signed this year as a follow-up to the ECFA.

President Ma and his allies in the KMT are likely to attempt to consummate a legislative agreement with the DPP that handles present and future China agreements – a version of fast-track authority dedicated to China-specific legislation. Such an agreement will help in addressing the ratification of trade agreements, but it will not address the underlying concerns that many in Taiwan have over the tilt toward China that has taken place since President Ma took office in 2008. Addressing those concerns will come only through an equally robust non-China foreign and economic policy that includes major Free Trade Agreements with countries like Australia, Indonesia, and India, as well as membership in multilateral agreements such as the Trans-Pacific Partnership (TPP) and the Regional Comprehensive Economic Partnership (RCEP).

In 2013, President Ma tapped former Vice President Vincent Siew to assemble and lead a committee of industry leaders, NGO heads, and former government officials to focus on constructing greater economic consensus on the island. As part of his efforts, in November 2013 Vice President Siew also led a delegation of senior Taiwan industry leaders to the United States, hoping to re-energize discussions about bilateral investment. This trip was a major success, and was broadly celebrated in both the U.S. and Taiwan as an excellent first step in improving commercial ties – which could help counteract Taiwan's growing reliance on China.

As for a broader consensus on economic matters, that is likely to remain as divisive a debate in Taiwan as it is in any other major liberal democracy.

Risk of U.S. Misunderstanding of the Pan-Green Alliance

Taiwan's public angst over the services agreement, on stark display in the spring of 2014, is not partisan puppeteering as some have argued. Instead, it is a reflection of far deeper and broader concerns over the apparent growing imbalance in Taiwan's external relations toward China, an imbalance that is reflected both in the myriad cross-Strait agreements, as well as in statistics such as changes in overall trade flows.[1]

If the United States misunderstands the organic nature and source of Taiwan's growing disquiet, it will be ill equipped to properly understand the changes in Taiwan and how best to handle the priorities of future Taiwan governments. Irrespective of which party wins the January 2016 presidential election, the presidential candidates will likely spend considerable energy arguing how to provide more balance in Taiwan's external relations. The incoming president will have less flexibility in dealings with China, and will be under more pressure to extend Taiwan's global reach.

China is very different today than during the Chen Shui-bian era, when it leaned on the U.S. in an attempt to influence Chen's behavior. Now we face a China far more willing to throw its weight around both in the region and globally. If the U.S. mistakenly believes that the inability of a sitting Taiwan president to move more decisively toward Beijing's interests is a result of pan-Green partisanship – rather than due to broader concerns within Taiwan's society – then it will find itself both surprised and with limited maneuvering room.

The Importance of the Energy Sector

Taiwan's economy has thrived over the past several decades on the back of entrepreneurialism and hard work, and its greatest natural resource remains its people. Without enough domestic sources to meet its needs, Taiwan must import almost 98% of its energy - including fuel for its four nuclear power plants, liquid natural gas, oil, and coal.

In the post-Fukushima era, the Taiwan government has committed itself to moving away from nuclear power. However, the Lungmen Nuclear Power Plant has just been completed at a cost of almost US$10 billion, and the demands imposed on the energy grid by Taiwan's continued growth require that the plant begin operations soon – particularly given the schedule for closing Taiwan's three other plants in the coming decade. Domestic opposition to such an outcome is strong, but not insurmountable. That said, however, the new plant may never be turned on.

Taiwan made a significant error when it chose to impose state control over its energy supplies, and the state now controls the principal energy purchaser in CPC Corporation, Taiwan[2] and the principal energy distributor in Taiwan Power Company (Taipower). The state subsidizes energy consumption at both the commercial and consumer level, and the resulting debt has been placed primarily on Taipower's books; its high debt to equity ratio means that the company is already bankrupt in all but name. If the Lungmen plant never begins operations, capex spending for the plant will be added to Taipower's already substantial accumulated liabilities of US$45 billion[3] – throwing the utility into crisis, and presenting the Taiwan government with a bill of close to US$55 billion.

Taiwan faces a tremendous challenge on energy, as there appears to be no strategic plan to address the island's long-term energy needs. It becomes a social issue that could potentially impact the welfare of the Taiwan populace, as well as a tremendous commercial issue that could negatively affect some of Taiwan's leading industries – such as semiconductors.

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[1] See *Chart: Taiwan Trade with the U.S. and China, 1999-2013* and *Table: U.S.-Taiwan Trade, 1999-2013*

[2] The government plans for CPC to be privatized by 2017, with over 55% of ownership in private hands. Nevertheless, the state will likely remain the largest shareholder, and therefore the main player in the company.

[3] Liao, Huei-chu and Sih Ting Jhou, "*Taiwan's Severe Energy Security Challenges*," The Brookings Institution, September 2013.

Energy is also a security concern, given the threat that China poses to Taiwan's sovereignty. In the absence of any meaningful strategic reserves, a blockade of Taiwan would leave the island with less than two weeks of viable energy production.

There are ways that may allow Taiwan to better address its energy needs. Taiwan has an overall requirement to become more involved in global organizations that provide the island with access to information and relationships that can help it properly address the needs of its people. Excellent examples of such involvement are Taiwan's observer status at the United Nations World Health Organization (WHO) and its participation in the International Civil Aviation Organization (ICAO). Taiwan's energy security is every bit as important, and participation in international organizations dedicated to energy issues could be an important step forward. Such participation includes:

- Observer status at the International Atomic Energy Agency (IAEA), which would be consistent with Taiwan's WHO status
- Membership in the International Energy Agency (IEA)
- Membership in the World Energy Council (WEC)

There may be additional organizations that Taiwan would also benefit from joining, and that would benefit from having Taiwan as a member.

Given the crucial role that Congress plays on these issues, I would counsel active and vocal Congressional support for Taiwan's inclusion in several energy based organizations. The House Committee on Energy & Commerce and the Senate Committee on Energy & Natural Resources would have important insights into how to elevate Taiwan's access to energy technology, and to ensure better integration into the world's energy infrastructure.

Impact of Taiwan-China Agreements on Taiwan & U.S. Companies

The Economic Cooperation Framework Agreement (ECFA), signed between Taiwan and China in 2010, included provisions for a so-called "early harvest" list, reducing tariffs on specific goods on a three-year set schedule.[4] The early harvest agreement was intended to help Taiwan compete in the Chinese market against ASEAN-made products, to provide market opportunities for Taiwan companies, and to help increase their market share.

In 2012, the Budget Center of the Legislative Yuan (LY) released a report that seemed to indicate that Taiwan was not seeing the types of benefits that had been promised as a result of the ECFA early harvest, but rather that China was primarily reaping the dividends of the agreement. The report stated that market share for Taiwan's early harvest products had shrunk for five consecutive years, despite the ECFA.[5] According to an investigation by CommonWealth Magazine in the spring of 2014, early indications had been that growth of exports from products on the early harvest list had outpaced the overall growth of exports from Taiwan to China during the designated period. However, while sales had increased, market share for those products had declined. In addition, the investigation found that some changes associated with the early harvest list had severe unintended consequences for certain products, such as the stainless steel industry dealing with alleged Chinese dumping, and small/medium agriculture and aquaculture companies suffering due to increased competition from larger, China-backed companies and middlemen.[6]

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[4] See *Table: ECFA "Early Harvest" Products & Industries Affected*, and *Table: ECFA "Early Harvest" Tariff Reduction Schedules*

[5] Lee Yu-hsin and Stacy Hsu, "*ECFA benefits mostly China: report*," Taipei Times, October 2, 2012.

[6] Chang, Hsiang-Yi, "*Demystifying ECFA: The Early Harvest List, 3 Years On*," CommonWealth Magazine, May 2, 2014 (No.546). english.cw.com.tw/article.do?action=show&id=14757

The United States has welcomed the reduction of cross-Strait tensions and has been supportive of increased dialogue between Taiwan and China on economic matters. An increase in political stability, along with the ability to travel directly between Taiwan and China, has been broadly beneficial. In July 2010, then Deputy Assistant Secretary of State David Shear said that "if ECFA is to be a truly successful arrangement, firms from the United States and other countries must also be able to benefit,"[7] and yet it is not clear how – or even if – cross-Strait agreements such as ECFA have been beneficial to U.S. and other foreign firms in Taiwan.

In its 2014 Business Climate Survey report, the American Chamber of Commerce in Taipei (AmCham) indicated that its corporate members continue to be broadly satisfied with the ECFA, even though the positive sentiment has decreased over the past few years. According to the 2014 survey respondents, 44% saw a positive or very positive effect of the ECFA on their business. A further 41% reported a neither positive nor negative effect, 6% saw some or a very negative effect, and 9% did not know or could not say. It is interesting to note that in 2011, the corresponding numbers were 57% positive, 27% neutral, 9% negative and 8% unknown.[8]

Transportation is one sector where U.S. and other foreign businesses in Taiwan appear to be at a disadvantage despite the economic liberalization. Cross-Strait flights are the domain of Taiwan and Chinese airlines, with U.S. and other foreign airlines on the sidelines. Direct shipping links have also been closed to foreign carriers.

Taiwan Arms Sales

The US-Taiwan Business Council is the leading non-government organization advocating on behalf of U.S.-Taiwan arms sales. We have played a key role in promoting what became the large arms sales packages of 2008, 2010 and 2011, and believe that ongoing arms sales are of tremendous importance to the defense and security needs of both Taiwan and the United States.

The U.S. has expressed its concerns that Taiwan under President Ma has not given sufficient priority to investing in defense, and has urged Taiwan to increase its defense budget to a level where it adequately reflects the extent of its security challenges. This has been a U.S. concern, as Taiwan cut its defense budget in 2009, 2010, and 2011 until a small increase in 2012. The 2013 budget was again reduced, as was Taiwan's 2014 defense budget. The 2014 budget corresponds to approximately 2.0% of GDP – a far cry from the campaign promise made by President Ma to maintain defense spending at 3% of GDP.

Yet since President Obama took office in January 2009, his government has accepted only one Letter of Request (LOR) from Taiwan for Significant Military Equipment (SME).[9] This is an unprecedented period since the switch in recognition in 1979. We are now in the longest period since 1979 in which the U.S. has not sold weapons to Taiwan, and there is little prospect of any new arms sales in the coming 12-18 months.

Taiwan is apparently under instruction not to submit any new LORs unless it is the "right time" to do so, which – of course – it never is. Not receiving any new LORs gives the administration the ability to truthfully state that there are no sales under consideration. By keeping programs out of the system, it ensures that Congress cannot identify programs to support and thereby make demands that they be notified. This strategy ensures that in the absence of arms sales, the U.S. government does not have to deal with any resulting tantrums by China. The administration has apparently made the false choice between U.S.-China military-to-military relations, and selling weapons to Taiwan.

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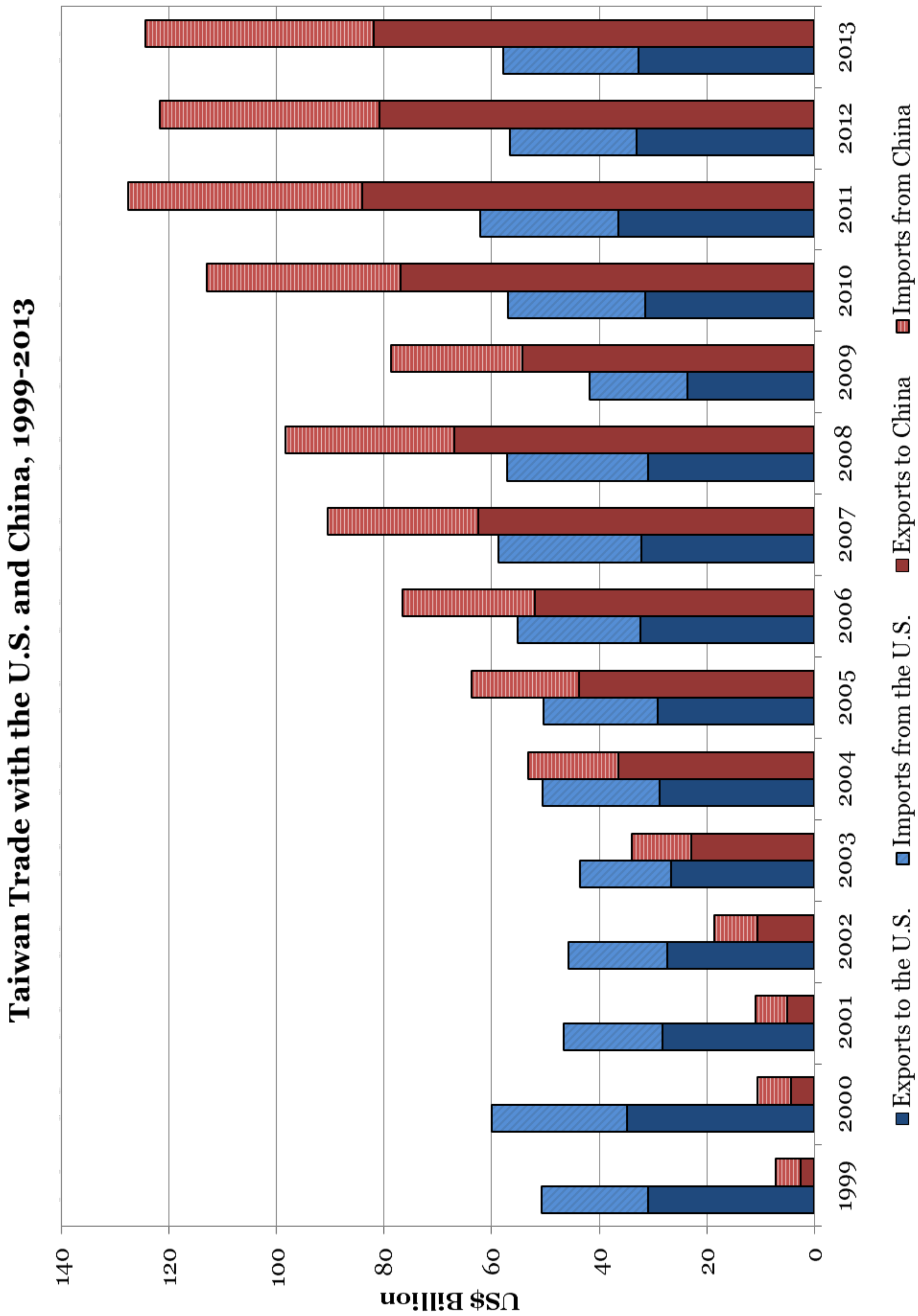
7 Shear, David B., "*Cross-Strait Relations in a New Era of Negotiation*," Remarks at the Carnegie Endowment for International Peace, July 7, 2010.

8 American Chamber of Commerce in Taipei, "*2014 Business Climate Survey*," January 9, 2014. www.amcham.com.tw/publications/bcs

9 SME refers to a program worth over US$50 million, and therefore required to be notified to Congress.



Source: Taiwan Bureau of Foreign Trade (BOFT)

Table: U.S.-Taiwan Trade, 1999-2013

Year	Imports from Taiwan	Exports to Taiwan	Trade Balance
1999	35,204	19,131	-16,073
2000	40,503	24,406	-16,097
2001	33,374	18,122	-15,253
2002	32,148	18,382	-13,766
2003	31,599	17,448	-14,152
2004	34,624	21,585	-13,038
2005	34,826	21,614	-13,211
2006	38,212	22,709	-15,502
2007	38,278	25,829	-12,449
2008	36,326	24,926	-11,400
2009	28,362	18,486	-9,877
2010	35,847	26,050	-9,797
2011	41,406	25,885	-15,520
2012	38,858	24,349	-14,509
2013	37,931	25,639	-12,292

Source: U.S. Census Bureau, Foreign Trade. "U.S. trade in goods with Taiwan."
Figures in US$ million on a nominal basis, not seasonally adjusted.
www.census.gov/foreign-trade/balance/c5830.html

Table: ECFA "Early Harvest" Products & Industries Affected

Industry	Number of Products Included	
	In China	*In Taiwan*
Petrochemicals	88	42
Textiles	136	22
Machinery	107	69
Transportation Equipment	50	17
Other	140	117
Agriculture	18	n/a
Total	**539**	**267**

Table: ECFA "Early Harvest" Tariff Reduction Schedules

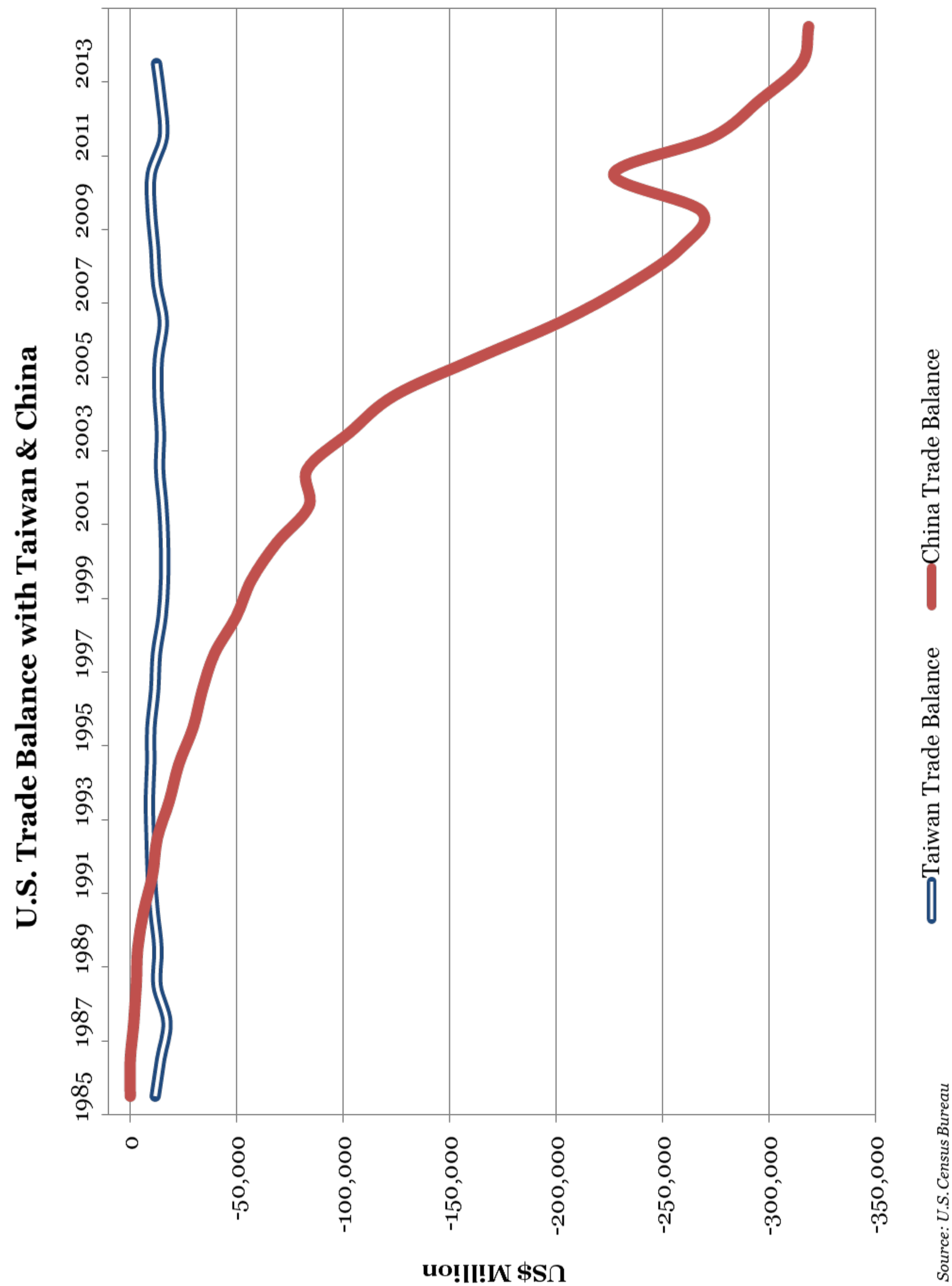
China's Planned Tariff Reduction Schedule

Original	Year 1 (January 2011)	Year 2 (January 2012)	Year 3 (January 2013)
0%	0%		
5%	5%	0%	
15%	10%	5%	0%

Taiwan's Planned Tariff Reduction Schedule

Original	Year 1 (January 2011)	Year 2 (January 2012)	Year 3 (January 2013)
0%	0%		
2.5%	2.50%	0%	
7.5%	5%	2.50%	0%

Source for ECFA Tables: Mainland Affairs Council & Industrial Development Bureau, MOEA. "Early Harvest List for Trade in Goods and Tariff Reduction Arrangements." www.mac.gov.tw/ct.asp?xItem=85849&ctNode=6256&mp=3


U.S. Trade Balance with Taiwan & China
1985
1987
1989
1991
1993
1995
1997
1999
2001
2003
2005
2007
2009
2011
2013
0
-50,000
-100,000
-150,000
-200,000
-250,000
-300,000
-350,000
US$ Million
Taiwan Trade Balance
China Trade Balance
Source: U.S. Census Bureau