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Gregory W. Noble

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Gregory W. Noble
Institute of Social Science
University of Tokyo
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In all of East Asia, the Taiwan Strait represents the preeminent combination of incomplete democratization and unreconciled rivalries over national sovereignty and national identity. As Tucker (2005) has noted, in no other place in the world, not even the Korean peninsula, which suffers similar tensions, is the danger of a military confrontation between superpowers so great. Naturally enough, the tensions between the governments of the People's Republic of China (PRC) and the Republic of China on Taiwan (ROC) are typically seen as an impediment both to economic cooperation between Taiwan and mainland China, and to regional cooperation more broadly (see e.g. Lincoln 2004). Observers also worry that Taiwan's growing economic dependence on China will enhance the ability of the mainland to impose a political solution to unification that could threaten Taiwan's autonomy and democracy. Already, divisions over cross-Strait economic policy are a major source of partisan and social conflict in Taiwan, and complicate relations with foreign companies and governments (Cheng 2005; Tanner 2007).

Tricky and potentially dangerous as the situation is, a somewhat more optimistic interpretation of cross-Strait economic ties may be in order. Within Taiwan, recurrent noisy squabbles over politics and policy have tended to obscure a considerable degree of continuity and openness in policy. After exhaustive public and private debates, Taiwan's leaders have reluctantly concluded that they cannot significantly slow or reverse the tides of trade and investment across the Strait, and generally should not try to do so. Remaining controls on export of technology are limited (and probably counterproductive); only Taiwan's ban on direct air transport links and restrictive policies toward issuing visas to mainland citizens; cumulative mainland investments exceeding 40 percent of a company's capital; and establishment of bank branches on the mainland remain as serious impediments to many forms of economic transactions. Instead, the government has expanded on existing programs and institutions to improve the investment environment and technological capabilities on the island. Despite the heated debates over Taiwanese identity and the desirability and feasibility of trying to "de-Sinicize" Taiwan, in economic policy the continuity between the Kuomintang (KMT) government under President Lee Teng-hui in the 1990, and the Democratic Progressive Party (DPP) cabinets under President Chen Shuibian since 2000 has been considerable.

Indeed, the real drag on Taiwan's responsiveness to the rise of the mainland as a global economic powerhouse has not been simply the clash of views on cross-Strait policy, but the reluctance of both KMT and DPP governments to take the bold steps necessary to strengthen support from foreign firms and governments and to strengthen the ability of Taiwan's firms to move beyond dependence on the mainland. Both the DPP and the KMT claim to believe in promoting Taiwan's connections with the global economy, rather than simply relying on the mainland as assembly shop and (increasingly) as final destination for Taiwan's goods, yet under both parties policy has tended to remain focused, and stuck, on the cross-Strait relationship. After reviewing the problems of incomplete democratization and unreconciled rivalries over sovereignty and identity in Taiwan, and their divisive impact on international relations and attempts at regional cooperation in East Asia, this paper will focus on debates in Taiwan over cross-Strait strategy and (more briefly) the challenge posed by the mainland's growing power and sophistication, as well as the dog that is not barking: many areas in which Taiwanese policy has failed to elicit foreign support or even actively alienated foreign partners.

Incomplete democratization and unreconciled rivalries over sovereignty and national identity

Despite considerable bureaucratic rationalization, a relatively smooth transition to new leadership, and even limited institution of elections at lower levels, the Chinese government strictly limits political expression and has not implemented the rule of law, much less democracy. Even the most optimistic observers expect democratization to take at least another decade or so (Gilley 2004). In contrast, Taiwan has largely completed the transition to a democratic system that respects human rights and political freedoms, and for most citizens, democracy has become the only conceivable game in town (Shin et al. 2005).

To the extent that Taiwan's democracy is not fully consolidated (Cheng 2003), it is largely because relations with the threatening and much larger mainland remain unsettled (Chu 2005).

Struggles over the sovereign and identity of Taiwan date back to the nearly simultaneous arrival of large numbers of Han immigrants from the mainland and traders and would-be colonizers from Spain and the Netherlands in the first half of the 17th century (and indeed the indigenous people, though soon reduced to less than two percent of the population, were far from unified or passive; Rubinstein ed. 1999). Initially uncertain what to do with the island, the imperial court of the new Qing regime eventually concluded that leaving Taiwan in the hands of ethnic Chinese at least nominally committed to restoring the Ming dynasty would be dangerous, and in 1683 conquered the island and turned it into a county of Fujian Province. In Taiwan, as in other frontier areas of the empire, the stratum of gentry scholars ruling Taiwan (and occasionally serving on the mainland) remained thin. Taiwan only became a province in 1885 in response to increasing pressures from Japan and the West. Active efforts at economic development under Governor Liu Mingchuan were too little and too late, and Meiji Japan seized Taiwan as the spoils of the Sino-Japanese war of 1894-95. Japanese colonial rule isolated Taiwan from the harrowing formative events of modern Chinese nationalism, from revolution, cultural ferment and warlordism, to Japanese invasion and civil war.

Initial happiness at the return of Taiwan to China at the end of World War II soon gave way to disillusionment and bitterness at the repression and corruption of KMT rule and the cultural conflicts between former Japanese colonial subjects in Taiwan and the victims of a vicious eight year war of occupation on the mainland. The sweeping repression after the uprising of February 28. 1947 and the "white terror" of the years immediately after Chiang Kai-shek's retreat to Taiwan in 1949 left great bitterness against Chinese nationalist rule and convinced the more radical advocates of independence that China was nothing but a new colonial regime. The sudden outbreak of the Korean War in June 1950 interrupted the plans of the PRC to invade Taiwan, and renewed once-fading American support for the KMT regime. The San Francisco Peace Treaty of 1952 encapsulated the convenient new American contention that the international legal status of Taiwan remained undetermined (Bush 2004). The U.S. forced Japan to relinquish claim to Taiwan without specifying a recipient, and to enter into diplomatic relations with the KMT.

For the next half century of KMT rule in Taiwan, the government promoted Mandarin education and promulgated Chinese cultural values while serving as part of the American-led anti-communist alliance designed to limit the influence of both the Soviet Union and communist China. Once again, as under the Qing and the Japanese, formal institutions such as school and government excluded the languages spoken by the large majority of the population (roughly 70 percent speaking Hok-lo, also known as Hokkien, Southern Min or just "Taiwanese," plus another 15 percent speaking Hakka). From the KMT's perspective, Taiwan's status as part of China was both convenient, since it helped justify KMT rule, and a matter of common sense. Taiwan was ninety-eight percent populated by ethnic Chinese who ate with chopsticks, wrote Chinese characters, and burned paper money to support their ancestors in the afterlife. For more than 200 years Taiwan belonged to the Chinese empire, and if the Qing government sent officials from the mainland to govern Taiwan, scholar-gentry from Taiwan also periodically served as officials in mainland provinces. The United Nations, the United States and most major countries recognized the KMT government on Taiwan as the legitimate representative of China. For the KMT, the 2-28 Incident was regrettable, but only one of many tragic incidents in more than a decade of international and civil war.

With the loss of Taiwan's UN seat in 1971 and the gradual dying off of the old KMT leadership, including Chiang Kai-shek himself, contesting voices grew more prominent. Advocates of Taiwanese independence emphasized cultural and historical differences between the mainland and Taiwan, which they referred to by its Portuguese name, Formosa, and assailed what they perceived as "great Han chauvinism" and casual dismissal of Taiwan's local culture. They celebrated the frontier independence and pluck of their ancestors, and claimed that many had intermarried with aboriginals. They downplayed Taiwan's economic and cultural ties to the mainland, and contrasted the strife and chaos on the mainland to the developmental gains made under Japanese colonialism, though many independence advocates also paid homage to the recurrent movements of resistance to Japanese colonial exploitation and repression. They did share, however, at least three attributes with their KMT rulers: an abiding antipathy toward communism that had been a constant feature of Japanese and KMT rule and American influence, pride in Taiwan's superior economic development and gradual transition to democracy, and fear and anger at the attempts of communist China to isolate and subjugate Taiwan.

Among Taiwanese, interpretations of separateness vary considerably: for some, Taiwan is culturally and perhaps (rather more dubiously) ethnically distinct from China. For many--probably most--Taiwan is culturally Chinese, but is not, and does not have to be, politically part of the Chinese polity. For some, Taiwan has more authentically preserved Chinese culture than the mainland has; for others, “Chineseness” itself is problematic, and democratic Taiwan is in some ways quite different from traditional Confucian China. Polls show that the percentage of the population considering itself only Chinese and not Taiwanese has declined sharply, while the proportion considering itself only Taiwanese has steadily risen to challenge the group considering itself both Taiwanese and Chinese (Ho and Liu 2002). Thus, some Taiwanese remain open to considering some form of political relation with a democratized China (whether an evolutionary version of the PRC or a one-and-future “third China”), while for others even a democratic China would be a foreign country; for many in both groups, attitudes are conditioned on perceptions of costs (risk of war) and benefits (or at least ameliorating circumstances, such as democratization in China; Niou 2005). Despite these important differences, a good deal of agreement binds the varying conceptions of identity when it comes to the imperatives of practical policy: rely on the United States, attempt to hold on to Taiwan’s slowly dwindling base of diplomatic support, and strive to expand Taiwan’s “international space.” All sides emphatically note that communist China had never governed any part of the territory currently controlled by the government of the Republic of China.

The PRC government shares the traditional conviction of the KMT that Taiwan has always been an integral part of Chinese history, citing ancient texts that may or may not have referred to what we now know as Taiwan, as well as undisputed early references to the strategically vital Penghu (Pescadore) Islands off Taiwan’s southwest coast, while paying little attention to the scattered and outnumbered aboriginal groups (Taiwan Affairs Office and the Information Office of the State Council [People’s Republic of China] 2000). For China, the Taiwan problem stems from illegitimate interference in China’s domestic affairs, first by Japanese imperialists, then by the post-war American campaign to contain communism. The savagery of the 2-28 incident and the brutality and corruption of the initial period of KMT rule in Taiwan were unfortunate, but not (from China’s perspective) the fault of the PRC and not indicative of some innate Chinese evil or hegemony.

The PRC sweeps aside references to the San Francisco Peace Treaty as irrelevant, since the United States maneuvered to exclude most of the interested countries, including both the PRC and the ROC, from participating in the treaty conference, and one-sidedly imposed a settlement on Japan. The fact that Japan failed to specify a recipient to Taiwan was irrelevant, since by then the status of Taiwan was firmly settled and internationally recognized. Under the terms of surrender of September 2, 1945, Japan explicitly accepted the Potsdam Proclamation and agreed to return Taiwan and other "stolen" territories to the Republic of China. The next month the ROC became a founding member of the UN, and assumed one of the five permanent seats on the US Security Council. So by 1952 Japan—not yet a member of the United Nations--was in no position to comment on the sovereignty of Taiwan or any other part of Chinese territory. By this logic, when mainland China replaced the ROC in the United Nations, and convinced virtually all countries, including the United States and Japan, to acknowledge and respect the PRC's position that sovereignty over Taiwan passed to the PRC, the Republic of China ceased to exist. Since Japan established formal diplomatic relations with the PRC in 1972, virtually all joint statements issued by the two countries have included one or more reiterations by Japan of its promise to accept the terms of normalization, and thus indirectly the Potsdam Proclamation's decision to return Taiwan to China. When advocates of Taiwanese independence point to passages in the UN Charter extolling the right of self-determination, the PRC points to other passages linking self-determination to de-colonization, and expressing support for territorial integrity.

The exact balance of incentives behind the PRC's legalistic insistence on its sovereignty over Taiwan is difficult for outsiders to calculate, but it appears to include the symbolic importance of wiping out China's century (and more) of humiliation at the hands of Western and Japanese imperialism; the fear that granting (or acknowledging) Taiwan's independence could encourage separatist tendencies in Tibet, Xinjiang and other parts of China; and the potential military value of Taiwan as a gateway to both the Taiwan Strait and the Pacific. On both sides, the sheer momentum built up by years of conflict and the symbolic importance of the Taiwan issue to the legitimacy of the communist party and the PRC regime is not to be underestimated. Having dedicated itself for over half a century to gaining recognition of its sovereign authority over Taiwan, the PRC is unlikely to surrender its claim easily, while Taiwanese, having finally created a tolerably democratic political system, are not anxious to grant ultimate authority over it to an authoritarian and potentially unstable regime.

Despite its ostensible generosity, the PRC's proposal to govern Taiwan under a "one country, two systems" arrangement finds few takers in Taiwan. Advocates of Taiwanese independence reject it out of hand. Even those that might find the terms a theoretically acceptable solution to decades of tension argue that no multilateral mechanism exists to commit the PRC credibly to maintain a separate and democratic system on Taiwan. Thus, the irresistible force of China's rapidly growing economic and military capabilities increasingly bumps against the immovable object of democratization and a contested but growing sense of independent Taiwanese identity. The tension between China and Taiwan thus encapsulates both incomplete democratization (in China) and unreconciled rivalry over national territory.

The Impact of Cross-Strait Tensions on Regional Cooperation

The rivalry between Beijing and Taipei complicates efforts at East Asian regional cooperation in several ways. Most obviously, the two sides not only jockey for position in every regional organization and project, but they also seek to mobilize their friends and allies to block the machinations of the other side. Typically, the PRC seeks to exclude Taiwan from regional organizations on the grounds that Taiwan is not a country, just as it has kept Taiwan out of the UN and affiliated organizations such as the World Health Organization. These efforts have been largely successful: ASEAN Plus Three, for example, excludes Taiwan. If the PRC is unable to block Taiwan's participation completely, the struggle moves toward the name and conditions under which Taiwan will participate. The government of Taiwan seeks to use the title "The Republic of China on Taiwan" or some variation thereof, while the PRC attempts to impose its preferred title of Zhongguo Taibei (Chinese Taipei or Taipei, China). In the case of the Asian Development Bank, for instance, the Republic of China was a founding member, but after admission of the PRC, Taiwan had to accept the designation "Taipei, China" or risk expulsion. Taiwan's most valuable regional affiliation is APEC, which emerged immediately after repression of the June 4, 1989 demonstrations weakened China's international standing. Even though participation is nominally based on "member economies" rather than nation-states, Taiwan still had to accept designation as "Chinese Taipei." The extent to which Taiwan should sacrifice substantive relations in global and regional organizations in order to resist the suggestion that it is subordinate to the mainland in regional and global fora remains a controversial issue in Taiwan (see e.g. Song 2004: 364).

For Beijing, the need to constrain Taiwan complicates efforts to assure the rest of the region that rapid growth in China's economic and military capabilities will not constitute a threat. When Chinese scholars developed the concept of "peaceful rise" (heping jueqi 和平崛起) to reassure the rest of the region (and the United States) of China's benign intentions, government leaders initially were receptive. Beijing's decision to revise this beguiling phrase reportedly stemmed from a fear that excessive emphasis on China's peaceful intentions could undermine its credibility and flexibility in responding to challenges over Taiwan (Suettinger 2004: 6). Similarly, China's deep skepticism about Japan's honesty and intentions stems not only from tension over clashing perceptions of the history of the 1930s and 1940s, but also from Japan's increasing tendency to bend beyond all recognition its pledge to restrict its dealings with Taiwan to strictly private matters. China sees Japan as violating solemn and repeated obligations, while many Japanese chafe at what they consider interference in Japan's "internal" affairs (Noble 2005).

From the perspective of other members, the Taipei-Beijing struggle is a recurring distraction from the substantive business at hand. Since Taiwan is an important player in many regional economic issues, excluding or alienating Taiwan is a costly loss. On the other hand, Chinese participation is vital to virtually all cooperative ventures in Asia, from reduction of greenhouses gases to dealing with the North Korean nuclear program (Kim 2004), and for most countries most of the time, tussling with China over the terms of admission for Taiwan is not worth the trouble and the possibility of retaliation.

The competition between the two sides of the Taiwan Strait is not always inimical to regional cooperation. Each side, but especially Taiwan, is highly motivated to secure an honored position in regional organizations, and to prove that it is a worthier member than the other side. Sometimes the congruence of economic interests draws the two sides into a tacit alliance. Taiwan strongly supported speedy admission of China into the World Trade Organization (WTO), for example, both because the PRC insisted that Taiwan not be allowed in before China, and because of Taiwan's extensive investments in the mainland. Support from Taiwan (and Hong Kong), in turn, helped dampen resistance from conservatives in the US and elsewhere who otherwise might have struggled to exclude communist China. Often the impact is mixed. In the South Pacific, for example, the jousting for diplomatic recognition and international influence has created complications, but it has also helped raise the profile and bargaining power of small island states that the United States, in particular, has increasingly ignored in recent years (Henderson and Reilly 2003).

Overall, however, the impact of the Beijing-Taipei wresting match has been indirect and negative. The cooperation of major powers is essential for most forms of regional cooperation (Webber 2001; Krauss 2003), but relations among the powers been greatly strained by the struggle over Taiwan. China, the United States, and (more quietly) Japan have all justified a significant buildup of naval capabilities in terms of the need to react to any possible contingencies in or around the Taiwan Strait. Thus, while competition across the Taiwan Strait has not been entirely destructive, on balance, the more smoothly China and Taiwan can get along, the easier it is for other players to focus on larger cooperative enterprises.

Taiwan's evolving response to the dangers of asymmetric dependence

Far from a new development, the intensive trade between Taiwan and the mainland that has developed over the last couple of decades marks a reversion to the historical norm (Lin 1994). Even after the communist victory in 1949 and the outbreak of the Korean War in 1950, fisherman continued to smuggle Chinese medicines and other products across the Strait. After China moved to a policy of "reform and opening" in late 1978, economic interchanges quickly accelerated, and by the late 1980s surging land prices and the appreciation of the New Taiwan Dollar (NTD) led Taiwanese business executives surreptitiously to invest billions of dollars in the mainland. Unable to stem the tide of investments by innumerable small businesses, usually shunted through Hong Kong, the British Virgin Islands, or other third countries, and aware that many businesses would go under if they were not allowed to seek cheaper labor and land on the mainland, the Taiwan government decided in the early 1990s to declare an amnesty under which businesses would be allowed to register their investments without penalty.

While accepting the reality of cross-strait investment, the government of Taiwan sought ways to regulate and slow the pace of interaction so as to alleviate fears of industrial "hollowing out" in Taiwan, and avoid helping to accelerate the pace of economic development in Taiwan's great rival. In 1994, President Lee Teng-hui announced the “Look South” policy (南向政策) to promote investment in Southeast Asia as an alternative to putting all of Taiwan’s eggs in the enemy’s basket. The KMT and the Taiwan government invested considerable sums in Vietnam, the Philippines, and other Southeast Asian countries, and strongly encouraged the private sector to go along. The Go South policy failed to stem a shift in global investment flows from Southeast Asia to China, and the outbreak of Asian financial crisis in 1997 paralyzed much of Southeast Asia while barely affecting China. After Southeast Asia began to recover in 1998 and 1999, the Taiwanese government renewed its commitment to the Go South policy, as did the new DPP government from 2000 (Zhongyang Tongxunshe 2001: 174-75, 2002: 177). Nonetheless, in the early years of the new century, investments from Taiwan to all the rest of Asia averaged only about a fifth to a tenth those directed at China, even without considering the substantial amount routed to China through Hong Kong and other safe havens (Council for Economic Planning and Development 2006: 270-272).

In 1995 the Council for Economic Planning and Development (CEPD) pioneered another, more ambitious effort to deflect attention from the mainland: a plan to build Taiwan into a hub for six “Asia-Pacific regional operating centers” (APROC): finance, manufacturing, sea and air transport, telecommunications, and media (Noble 1997; Zhongyang Tongxunshe 2001: 174; 2002: 177). Though ostensibly aimed at convincing foreign multinationals to base their East Asian operating headquarters in Taiwan, the plan was at least as much aimed at two other goals: persuading Taiwanese companies to keep their headquarters and research & development activities in Taiwan and providing a national security justification for overcoming obstacles to further economic liberalization. Pursued with unusual vigor and aggressiveness, APROC attracted considerable attention, but also a good deal of skepticism at home and abroad that Taiwan could lure many foreign companies away from the efficient, English-speaking havens of Hong Kong and Singapore. The APROC campaign also effectively absorbed another program begun a year earlier to lure foreign multinationals to enter into strategic alliances with the Taiwan government, or Taiwan-based firms. As of late 2000, American companies such as GE, IBM, and Lucent constituted over half of participants, while most of the others were European. Two Australian firms signed agreements, but not a single company from Japan or any other Asian country found the advantages sufficiently compelling to risk retaliation by the PRC (Zhongyang Tongxun She 2001: 187-88).

In the end, though, the coup de grace to the APROC plan came from politics. During the presidential campaign of 2000 the DPP assailed APROC as excessively oriented to developing links from Taiwan to the mainland. The new DPP government immediately put on the brakes, and in February 2001, officially ended the APROC program, folding the uncompleted portions into two new plans: the knowledge economy development plan and the tellingly named global operations development plan. The implication was clear: rather than focusing on interactions with an Asian-region increasingly dominated by contacts with China, Taiwan would strengthen its own capacities, and build up its links with the rest of the world, not just Asia, much less China.

Restraining ties with China proved difficult. In 1996, a year after the initiation of the APROC program, President Lee Teng-hui introduced a more restrictive approach to stemming the growing flood of investments in the mainland. Taiwan, Lee declared, must "restrain haste and exercise patience" (jieji yongren 戒急用忍) by placing limits on the size and technology content of mainland investments. The business community immediately assailed Lee's pronouncement as ineffective and counterproductive, but he held firm though the end of his term. By the 2000 presidential campaign, all three of the leading candidates signaled that they would significantly modify Lee's policy of restraining haste. Once in power, however, the Chen government initially took a cautious stance, not least because Chen appointed to head the CEPD Chen Bozhi, an economist and technocrat known for his support of Taiwanese independence. The government loosened a number of the restrictions, partly to accommodate the entrance of both Taiwan and mainland into the World Trade Organization, but it refrained from a thorough overhaul.

In the face of continuing criticism from the business community, economic slowdown caused by the collapse of the global information technology bubble, and bruising conflicts over nuclear power, President Chen decided to convene a National Economic Development Conference in January 2002. For two days, over a hundred bureaucrats, scholars and politicians debated a range of economic issues, but no clear consensus on fundamentally relaxing cross-strait economic ties was forthcoming. Six months later, Chen tried again, appointing 120 members, this time including a healthy contingent of leading business executives, to a month long seminar climaxing in a three-day plenary session that garnered saturation news coverage. The Presidential Consultative Committee on Economic Development (總統府 經濟發展諮詢委員會) passed over 300 resolutions, the most important of which called for replacing Lee's "restrain haste" policy with a new mantra of "active opening with effective management." The committee also agreed that the government should seek to negotiate with the mainland as soon as possible about establishing direct air links. The committee's proposals effectively established a new national consensus and overcame vocal opposition from the independence activists in the DPP and its more extreme ally the Taiwan Solidarity Union (TWU 台灣聯盟). The change was hardly revolutionary, however. The committee also established two new principles aimed at lessening dependence on the mainland: "Taiwan first" and "global deployment" (台灣優先; 全球佈局). Moreover, the committee's resolutions did nothing to break the deadlock between Taiwan and the mainland over direct flights. Taiwan insisted on direct, equal government-to-government negotiations, while the mainland proposed sidestepping disputes over sovereignty by delegating negotiating authority to nominally private aviation associations.

Nor did the evolution of political rhetoric solve all of the pressing disputes over investment in fast-moving technology industries. In March 2002, the government convened yet another meeting, this time to discuss investments in advanced fabrication plants by Taiwan's semiconductor industry that had first been mooted in 2000 (Cheng 2005: 116-126). Taiwan Semiconductor Manufacturing Corporation (TSMC), the inventor of the "pure play foundry" model of investing in huge new plants focused only on fabrication while leaving design to specialist companies, argued that the explosion of demand for semiconductors in China would soon encourage the growth of mainland competitors. Its leading rival, United Microelectronics (UMC), the world's second largest pure fab, agreed. Better to invest earlier and stake out a dominant place in the market, argued the two companies (both, coincidentally, headed by mainlanders). Alarmed advocates of Taiwanese independence countered that erection of massive new high tech factories in the mainland would undermine investment in Taiwan and would soon draw along a host of suppliers from Taiwan, creating a sort of reverse economy of agglomeration that would undermine and eventually hollow out the dense network of specialized suppliers that had brought Taiwan to prominence in the global electronics industry.

This debate split Taiwan down the middle, with political parties, engineers, and economists gravitating to opposing sides. For example, the Chung-hua Institution for Economic Research [中華—i.e. China--經濟研究院],

Taiwan's preeminent policy-oriented economics think tank, supported the industry, while the slightly less prestigious and more locally oriented Taiwan Institute for Economic Research sided with the TSU and other opponents of investment. In the end, the conference reached a compromise. The industry would be allowed to invest in mainstream 8" fabrication plants in the mainland, but only after reaching mass production from cutting edge 12" plants in Taiwan. Investments in the mainland would be subject to careful case-by-case review, and future investments in the mainland would remain contingent upon continuing (and larger) investments in Taiwan.

In principle, this compromise was generally acceptable to all involved. In practice, the long period of debate and the lengthy screening process delayed investments sufficiently to allow for surprisingly rapid catch-up by the mainland's fledgling semiconductor fabrication companies, which captured many of the customers that TSMC and UMC were unable to service (author interview with Chen Shinhong, Chung-hua Institution for Economic Research, July 28, 2005; on the rapid development of the mainland's semiconductor industry in the early years of this century, see Chase, Pollpeter, and Mulvenon 2004).

Nor did the March 2002 compromise end all ambiguities. In 2005 the government began investigations into the intimate connections between UMC and He Jian, the most important of the new mainland competitors. Much to the outrage of Taiwanese nationalists, He Jian was led by a former executive at UMC who had taken many of the company's most ambitious engineers with him to Shanghai, arguably as an adjunct or advance unit of UMC. The government fined UMC for evading regulations on mainland investments and technology transfer, while the company claimed that it had abided by the rule of the law and had merely established a business alliance with He Jian (*Financial Times* February 24, 2005; *Taipei Times*, April 22, 2005). The government denied widespread claims that the relationship was hardly new, and that the government chose to undertake an investigation because UMC bet on the wrong horse in the exceedingly close and controversial 2004 presidential campaign (*Taipei Times*, February 18; confidential author interview in Taiwan, July 2005).

Eventually the government indicted UMC's Chairman, Robert Tsao (Cao Xingcheng), long a central figure in Taiwan's public and private electronics networks, and Vice-Chairman John Hsuan (宣明智) for allegedly making illegal investments in China. The two men immediately resigned their positions but remained advisors to the company (EETimes 11 January 2006). At the same time, the giant and exceedingly well-connected Washington conglomerate Carlyle Group announced that it had made a multi-billion dollar bid for Taiwan's Advanced Semiconductor Engineering (ASE; 日月光半導體), the world's largest semiconductor testing and packaging company. Industry observers pointed out that rivals in Korea and elsewhere were investing aggressively in China, putting ASE at a competitive disadvantage. Ironically, news of the offer drove up the price of ASE up much that Carlyle dropped out (IDG News, April 18, 2007), but in the meantime, it became clear to all involved that if the government of Taiwan insisted on excessively strict controls, companies could get round them by selling themselves off to foreign investors such as Carlyle, which has extensive operations in mainland China, hardly the response the government hoped to stimulate (IEEE Spectrum Online, February 2007).

After 2004 the intensity of the debate over investments in the mainland by Taiwan's semiconductor companies gradually eased a bit, as it became clearer that China's efforts to catch up in the expensive and cutthroat world of semiconductor manufacture faced numerous obstacles, not least competing with Taiwan's efficient and well-established fabs (EETimes March 26, 2007). After all the debates and conferences, the Chen government largely reiterated its approach, affirming the policy of controlled opening; stressing the primacy of global over Chinese markets; and committing to a sharp increase in public R&D spending and aggressive use of the Industrial Technology Research Institute (ITRI). This DPP policy line essentially continued the policies of the KMT under Lee Teng-hui in the 1990s, which in turn largely followed the successful high-tech promotional policies initiated by technocrats Sun Yunxuan and Li Guoding (KT Li) back in the 1970s and 1980s. Particularly in semiconductors and computer assembly, Taiwan-based firms such as TSMC, UMC, Hon Hai Precision (Hong Hai; the world's largest contract electronics company, better known under its trade name of Foxconn), Acer, and Quanta (Guangda; world's largest producer of notebook computers) carved out formidable leads even as the computer makers (and to a small extent, the semiconductor firms) shifted production facilities to the mainland. Thus, despite all the *sturm und drang*, and all the contending fears that Taiwan would either be "hollowed out" if stricter controls were not implemented, or "lose out" in the crucial Chinese market if existing limits on investment, trade, direct flights, and visas for Chinese citizens to come to Taiwan for business meetings were not relaxed, in the short run Taiwan's long-established economic model proved flexible and robust, particularly in the crucial electronics industry.

The question is whether Taiwan can maintain regional and global importance as new products appear in which Taiwan has not already staked out a commanding position. Here, there is more room for doubt. First is the growing significance of the PRC as a market and as a potential competitor. For all the talk, not just by the DPP and TSU, about "globalization," the reality is that the vast bulk of production, investment and distribution/trade is either national or regional, not global. "Multinational companies" are almost without exception national firms that receive the vast bulk of their revenues from the country (or at most region) in which their headquarters are located; genuinely global companies are vanishingly small (Rugman 2005). Consumer electronics, Taiwan's most important industry, is only a partial exception. Within Taiwan's region of East Asia, China has clearly surpassed Japan not only as the leading exporter, but also as the leading absorber of imports from other Asian countries (WTO, *International Trade Statistics 2006*: 90-91; in nominal terms Japan's economy is still about two and a half times as large as China's, but it is much less open to trade). In 2007 China is on track to surpass the United States as the world's second largest trader, and by 2010 should overcome Germany to become the largest.

The talk of "globalization, not exclusive focus on China," or "rely on India rather than China" ignores the fact that China is already a dominant force in East Asia, has an economy three times as large as India's, and continues to grow faster, while India remains a minor force in East Asia. The United States may still have a much larger economy than China's, but for Korea, Taiwan, and soon even Japan, China is a more important export destination (cf. Garner 2005 on the rise of China as a consumption market). China will by no means be the only significant market, but for Taiwan and other economies in East Asia, it is already the most important, and in coming years its position will only grow stronger.

Skeptics insist that a number of caveats must be attached. Most of China's exports, particularly in electronics, are created by foreign subsidiaries, particularly subsidiaries of Taiwanese firms. Chinese firms are badly managed and weak in innovation (Gilboy 2004). China is also only beginning to engage in outward foreign investment, and remains a minor player in the setting of technological standards.

Yet each of these caveats is equally subject to rebuttal, particularly when it comes to future developments. Chinese firms are becoming more efficient, better managed and more innovative (see e.g. the discussion of Huawei in Ernst and Naughton 2005), and are likely both for firm-specific and macroeconomic reasons to expand their direct foreign investment. Chinese semiconductor firms may still lag well behind Taiwan's TSMC and UMC, but industry observers agree that the long-term tendency for China to catch-up has not altered, not least because overseas students from China have largely surpassed Taiwanese both as an input to Silicon Valley, and as a source of entrepreneurship in Asia. Taiwan's ties with Silicon Valley have weakened somewhat as more Taiwanese students stay home, while China's have greatly increased (EETimes, April 2, 2007; Leng 2002; Leng 2005; National Science Foundation 2006: 2-32). Foreign firms operating in China have opened hundreds of R&D labs, Chinese patent activity is increasing rapidly, and the presence of Chinese-based authors in leading international journals of science and technology has increased rapidly, far eclipsing India and closing in on Japan and the leading European countries (Taiwan has also improved rapidly, tripling its share between 1988 and 2003, but China's share quadrupled over the same period, and is now more than three times larger; National Science Foundation 2006: 5-85, 5-88). That Taiwan has done well in holding its place in the East Asian economic environment despite sustained rapid growth in China is impressive, but it provides no guarantee that Taiwan will not be pulled into the orbit of an increasingly ascendant China.

Taiwan's vulnerability to the rise of China is not merely a function of geographic, cultural and historical proximity, but also of weaknesses in Taiwan's developmental model, particularly the reliance on small and medium-sized firms and the lack of brand power even among Taiwan's leading companies. Research and development spending has surged, as has patenting activity, but the "R&D" is almost all "D" and no "R", while the patents are mostly defensive and of low quality. Basic research and research by government and universities have increased at a far lower rate (and even in Taiwan's universities most "basic" research is not all that basic). In 2004, Taiwan suffered a remarkable 13 to 1 disparity in technology trade (Guojia Kexue Weiyuanhui 2006: 2-2-4; 3-3-1; 7-4; 7-5; author interview with Chen Xinhong and Wang Wenjuan, 中華經濟研究院, July 28, 2005).

As Amsden and Chu (2003) note, Taiwan's economy is no longer bereft of large firms: a number of electronics companies have scaled up at impressive speed, and business groups such dominate large swaths of the domestic service sector. Unlike the case in Korea, however, very few of these companies and groups, have developed brands and international management techniques that can survive outside Taiwan. For Amsden and Chu (2003: 169), China is not the antithesis of the global market but the necessary stepping stone to it:

> The effectiveness of incentives to applied research by the private sector depends on brand-name marketing. Without an innovation, it is difficult for a company to establish its own brand name for "mass" marketing (the mass depending on the innovation), and without mass marketing, the costs of applied research are prohibitive. The resolution of this dilemma for Taiwan companies lies in developing brand-name recognition in the large China market. The competitive advantages of Taiwan companies in China are obvious: language and cultural commonalities. The disadvantages to the government of tighter economic ties with China are presumably political. The economic returns to removing controls on Taiwan investments in China, however, are likely to be very large if Taiwan firms can use China to establish their reputations, with a view toward global brand-name marketing.

For now, Taiwanese companies like Hon Hai (Foxconn) can move most of their production to China while keeping their headquarters and R&D centers in Taiwan because their mainland competitors are inexperienced, badly managed, and less fully integrated into the production networks of American, Japanese and European giants. As Chinese firms mature and improve, however, Taiwanese firms will find themselves pressured to move an increasing share of higher-end activities to the mainland. If the government persists in maintaining controls, some may become increasingly alienated from Taiwan (Leng 2005); even if it adopts a more open attitude, the irreplaceable position Taiwanese firms currently occupy in international production networks is likely to suffer a gradual erosion as new products emerge. The window of opportunity for the remedy proposed by Amsden and Chu (2003) is gradually closing, as the progress of Chinese companies like Huawei and ZTF (Ernst and Naughton 2005) suggests. Taiwan's economy is unlikely to collapse and may not even decline, but unless Taiwanese firms develop stronger brands and a more prominent international presence of their own, they are likely to fade in prominence on the greater East Asian and global stage, thus weakening Taiwan's economic appeal to other firms and countries.

Taiwan's failure to maximize multilateral support

Taiwan's problem is not simply the difficulty of countering, and where possible taking advantage of, the rise of China as a market. For all the talk of embracing globalism rather than simply relying on the China market, domestic political and economic concerns repeatedly have caused Taiwan to fumble opportunities to enhance multilateral support, often falling back into a bilateral competition with China that it places it at a structural disadvantage. Of course, the prime cause of Taiwan's isolation is the PRC's relentless campaign to deprive Taiwan of "international space," a campaign that often alienates or at least inconveniences third parties, but nonetheless has proven to be quite successful.

The best-known failure to maintain external support is the protracted embargo that the "pan-blues" (KMT and People First Party)-dominated Legislative Yuan has carried out against the proposed special budget to acquire three sets of defensive weaponry from the United States: six PAC-3 Patriot anti-missile systems, eight conventional submarines and 12 P-3C patrol aircraft. The KMT and its allies in the "pan-blue" alliance have made several arguments against the weapons purchases, claiming that the weapons are too expensive for Taiwan's strapped budgets and overpriced relative to their capabilities; that the submarines, which the United States no longer produces and would have to acquire elsewhere, would arrive too late; and that Taiwan should focus on political negotiations with China rather than becoming embroiled in an arms race that would heighten tensions and that in the end Taiwan would certainly lose anyway. Debates about the utility of the various systems, the fairness of their pricing, and the wisdom of focusing on special procurements are lively, and even some Americans in the security policy community accept the argument that Taiwan should consider dropping some or all of the systems (e.g. presentation at Brookings Institution by Bernard Cole, January 18, 2007; see also Cole 2006). Even within the pan-blues, opinion is split. Some simply hope to show that they can get a better deal for the voters, while others fundamentally question the whole point of acquiring more weapons and exacerbating relations with the mainland.

Whatever the military wisdom of procuring specific systems, it is clear that the pan-blue tactic of blocking all special procurements, and restraining increases in the defense budget, has incurred a heavy price in decreased U.S. support for Taiwan (passage of a small part of the package only slightly mollified the U.S. *Washington Post*, June 16, 2007). American policymakers question whether Taiwan can be trusted to stand up to the mainland, and ask why Americans should take increasingly grave risks on behalf of Taiwan if the island's residents are unwilling to defend themselves. Nor do appeals to budgetary constraints convince many Americans: the share of Taiwan's economy and government budget have steadily declined while the threat from the mainland has increased, especially since about 2000; the KMT and DPP have happily competed to introduce and expand expensive social programs such as pensions and national health insurance; and Taiwan's public debt burden, while rising, is still lower than that of the United States. Republicans are especially critical, but it looks to a wide range of American observers as if the pan-blues are sacrificing responsible defense policy in large measure to prevent the DPP from scoring a policy achievement, and to pander to voters who do not trust Taiwan's scandal-tainted military and would prefer that American taxpayers foot the bill for Taiwan's defense (Swaine 2005; Chase 2005; Needham and Tkacik 2006; Schriver 2007).

On the other side of the partisan balance, American and European business interests are increasingly aggressive in assailing the limits on cross-strait ties implemented by the DPP, often under pressure from the more aggressively pro-independence Taiwan Solidarity Union (TSU). From their perspective, it makes little sense to talk of upgrading Taiwan's participation in global production networks if lack of direct flights, onerous procedures and time-consuming delays in issuing visas to PRC citizens working in western subsidiaries, and bans and high tariffs on mainland products combine to make it impossible to integrate the operations of Taiwan subsidiaries with those on the ever-more-important China mainland. According to the American Chamber of Commerce in Taipei's *2006 Taiwan White Paper* (p. 4):

> To be internationally competitive... It is absolutely necessary to remove obstacles to international hiring practices and to further streamline all visa, work permit, and related processes, packaging them in a manner that encourages the free flow of talent from overseas, especially from China.…The long-standing government position that identifies Taiwan as a gateway to China needs to be put into concrete practice. Cross-Strait economic policy should be focused on a "win-win" approach to maximizing synergies with China, as well as building aggressively on niche areas where Taiwan can add value for domestic and international investors in the region.

While investment in the mainland has skyrocketed, foreign investment in Taiwan and membership in the foreign chambers of commerce at best has remained stagnant (CENS, November 25, 2005), and after years of complaining about the necessity for direct cross-strait ties, foreign business executives in Taiwan have largely despaired of influencing the domestic political debate on economic ties with China (author interview, Am-Cham, November 2005).

The preferred response of Taiwan's government to the rise of China is diversification to less threatening locations. The way it has pursued that objective, however, has often done more to alienate potential partners than to protect Taiwan's economy or shore up diplomatic support. For example, after 2000 the new administration of Chen Shui-bian changed the direction of the "Look South" policy, deemphasizing investment and invigorating attempts to make diplomatic breakthroughs. When Taiwan's Vice-President Lü Xiulian (Annette Lü) suddenly showed up at Jakarta's international airport in 2002, the government of Indonesia, which has no diplomatic relations with Taiwan, blocked her from entering the capital, pushing her off to Bali on the dubious grounds that she was "in transit" to a third country. After two days in Bali, Lü sneaked back to Jakarta for another two days, but failed to meet with members of the Indonesian administration. Lü's aggressive approach boosted her support ratings back in Taiwan, but diplomatically it backfired, undermining Taiwan's standing in Indonesia. When news surfaced in December 2002 of an attempted trip by President Chen, the Indonesian government immediately issued a statement that it would never accept a visit from the president of Taiwan (BBC News 15 August 2002; *Taipei Times* October 3, 2005).

Chen was not deterred, however. In October 2005, as he finished up a diplomatic tour in Abu Dhabi, two dramatic events delayed his return: typhoon Longwang moved across Taiwan, and several terrorist bombings rocked the Indonesian resort island of Bali. The government in Taiwan closed the island's airports. Rather than delay the President's departure, Chen's team sought to take advantage of the opportunity. After debate, they decided against Okinawa and Singapore as stayovers on the putative grounds that the PRC would object to a visit by the Taiwanese leader, and chose Bali instead, though they knew that China would complain to Indonesia, as well. More likely, they sought to take advantage of the bombings, which brought Indonesia's top leaders to Bali. The captain only announced the change of plans halfway through the flight, surprising the accompanying business executives and journalists. According to

Presidential Office Deputy Secretary-General James Huang (黃志芳), the diversion was "entirely due to the bad weather in Taiwan. After carrying out a safety evaluation seriously, we respect China Airlines' decision, which was made professionally." (*Taipei Times*, October 3, 2005). The ministry of foreign affairs later stated clearly, however, that the decision to fly elsewhere had been made before departure from Abu Dhabi (*Taiwan News*, October 3, 2005), though apparently not communicated to the passengers, the citizenry, or the government of Indonesia. While in Bali, Chen met with Taiwanese investors in Indonesia, and toured local sights. He claimed a foreign policy breakthrough at home, at the cost of alienating the Indonesian government.

But Chen was not finished. In May, 2006, the presidential plane stopped off at the Indonesian island of Batam on the pretext of refueling, but proceeded to stay overnight. President Chen met with an Indonesian lawmaker, and toured local factories, prompting the Indonesian government to call the incident "regrettable" and "an abuse of the permit that was given" (AFP, May 12, 2005). Once again, domestic credit-claiming triumphed over building multilateral support. Over time, this opportunistic approach to "diplomacy under constraints" has undermined support for Taiwan in the region. One of the most authoritative scholars of international relations in Southeast Asia, once quite sympathetic to Taiwan, which he visited frequently, forcefully castigated the Chen government for not paying attention to the needs and concerns of ASEAN governments, and for considering only Taiwan's political needs (personal communication, August 21, 2004).

As part of the "Look South" policy, the government of Taiwan said that it would strengthen academic and policy-oriented studies of Southeast Asia in Taiwan, including plans for an institute of Southeast Asian studies at the Academia Sinica, Taiwan's premier academic institute. Once again, however, both the KMT government of Lee Teng-hui and the DPP government of Chen Shui-bian proved more committed to flashy announcements and domestic politics than actually strengthening Taiwan's multilateral relations. The mooted institute of Southeast Asian studies never appeared. Instead, the government only supported a small program at the Academia Sinica headed by Michael Hsin-Huang Hsiao, a well-known sociologist, but not an expert on Southeast Asian studies. The program received only one full-time position, with no guarantee that it would be permanent.

With an initiative from Hsiao and support from the two universities with centers for the study of Southeast Asia (Tamkang/Danjiang and Jinan International), in 2005 Taiwan finally founded an association for the study of Southeast Asian studies (台灣東南亞學會), and inaugurated a series of conferences, including participants from Southeast Asia. In November 2005 it also launched the first issue (forty pages in length) of a new biennial journal, 南向 (which the association translates as "Go South"). Both the journal and the association focused heavily on sociological topics, particularly the two topics of greatest relevance to Taiwan's domestic politics: the role of foreign laborers, and the sudden influx of foreign brides, mostly from Vietnam (along with mainland China). With rare exceptions, mostly at Tamkang, few scholars of Southeast Asian affairs study the political, economic, and business issues of most relevance to Taiwan's multilateral relations. The government has provided virtually no support for fieldwork or even study of Southeast Asian languages, so that the few Taiwanese students and scholars interested in the region overwhelmingly rely on English and Chinese sources. The ironic result is that the most popular topics and research techniques focus on the "overseas Chinese" in Southeast Asia, most of whom have no direct connection or loyalty to Taiwan. Similarly, lacking a solid tradition or support in funding, applications for grants to study Southeast Asia typically lose to proposals for projects on mainland China (author interviews with Michael Hsin-huang and Wang Hong-zen, December 2006).

After more than a decade, some modest progress in studying and establishing links with Southeast Asia has been made, mostly thanks to the efforts of a few individual scholars and universities, but nothing like the amount that would be necessary to counter the momentum created by the rise of the PRC, as highlighted most dramatically by the agreement to create a Free Trade Agreement between China and ASEAN; in contrast, Taiwan has gotten nowhere in its efforts to sign FTAs in Southeast Asian countries (or anyplace else). Even in Vietnam, where Taiwan was an early and dominant investor, failure to provide vigorous follow-up has contributed to a sharp decline in Taiwan's relative position (中國時報 December 13, 2006). For all the talk of "looking South," both KMT and DPP governments have focused on, and fought over, domestic politics and relations with mainland China, largely ignoring multilateral relations with Southeast Asia.

Changes in policy toward "overseas compatriots" (僑胞) contributed to the loosening of bonds with Southeast Asian countries. Under the KMT, “overseas compatriots” were defined as “overseas Chinese” (華僑), including a range of dialect groups (principally Cantonese, Taishan, Chaozhou/Tajiew, Hoklo [“Taiwanese”], and Fuzhou/Minbei, combined with a smattering of Mandarin speakers) with distinct historical experiences. Many of these groups were linguistically or historically unrelated to Taiwan, but business and cultural relations with Taiwan, combined with discrimination faced in such home countries as Indonesia and Malaysia, provided a significant link. Special admissions quotas and occasional financial assistance encouraged many overseas Chinese from Southeast to send their children to Taiwan for high school or university education.

By the late KMT period, policies favoring overseas Chinese, particularly university admissions quotas, came in for nearly universal criticism that transcended the usual blue-green divides. In the popular perception, many overseas Chinese students were lazy playboys who coasted in without studying hard, and yet unlike locals (or at least local men) did not have to submit to military service. Clearly, some adjustment was in order. The government discontinued the quotas and in 1995 established a new university to accommodate overseas compatriots. Rather than putting resources into a new, enticing university and campus that would attract as many Southeast Asian students as possible, the government allowed particularistic politics to rule the day, and placed the university in Nantou County’s Puli, a beautiful but isolated spot in the mountains of central Taiwan. Nor did the awkward and infelicitous name help: 國立濟南國際大學(literally “National Jinan International University”; in English, National Chi Nan University). In mainland China, the first thing that comes to mind when one hears “Jinan” or “Jinan University” is the capital of Shandong province, but in Taiwan, the first association in the mind of virtually all young people is an unfortunate homonym: “male prostitute.”

Even with special help and discounted fees, the university attracted almost no students from Southeast Asia. Nor did the incoming DPP administration undertake any special measures to remedy the situation. A decade after establishment, Jinan International University still had a total of fewer than 4,000 students, many of them locals from central Taiwan, but almost none from outside of Taiwan (author interview, Wang Hong-zen, Jinan International University, December 2006). While overseas Chinese students (including from Taiwan) studying in the mainland increased rapidly starting in the 1990s, the number of overseas compatriots studying in Taiwan stagnated at around 11,000 (Zhongyang Tongxunshe 2006: 335).

A second element of policy toward overseas compatriots was more controversial. Rather than uphold ties with any "overseas Chinese" that might be willing to maintain a relationship with Taiwan, the new government determined to focus more of its resource on the much smaller group of Taiwanese compatriots, particularly Taiwanese doing business in Southeast Asia. Immediately upon entering office, the DPP's new head of overseas compatriot affairs, Zhang Fumei, cleansed the enrollment books of groups deemed to be only marginally related to Taiwan, leading to a major decline in affiliated groups in Southeast Asia (Zhongyang Tongxunshe 2006: 333-335). The DPP adopted a more aggressively "pro-Taiwan" policy, just as the lure of the mainland's extraordinary growth, entry to the WTO, and increasing emigration tilted the balance among overseas Chinese groups (including in the United States) away from Taipei and toward Beijing. Maintaining support for Taiwan would have been difficult under the best of circumstances, but the government chose to downplay those with only a weak affiliation to Taiwan, thus undermining multilateral support for Taiwan and encouraging an "either Chinese or Taiwanese" mentality that exacerbated Taiwan's one-on-one struggle with a much more powerful rival. Of Taiwan's five leading electronics companies, for example, only Acer (Hongji) was founded by an ethnic Taiwanese (Stan Shih; Shi Zhenrong), and two were founded by ethnic Chinese who did not move to Taiwan until they were adults (TSMC's Morris Chang [Zhang Zhongmou] and Quanta's Barry Lam [Lin Baili]).

Nor was the problem of alienating or simply abandoning former friends and allies limited to relations with Southeast Asia. Two striking examples involve primarily Westerners, especially Americans. From the early 1960s, when residence in the mainland was either impossible or so restricted as to inhibit language learning, Taiwan established a reputation as the best place in the world to study Chinese. Important language training centers appeared from private firms, National Taiwan Normal University, and quasi-governmental agencies. The most advanced language center for Westerners was the Inter-university Program for Chinese Language Studies, popularly known as the Stanford Center. Founded in 1963 at National Taiwan University, for more than three decades it trained the majority of American specialists on China, earning a stellar reputation for professional competence, and creating a generation or more of highly influential academics, journalists, business executives and government officials who enjoyed mostly quite positive relations with Taiwan.

Many were critical of the authoritarianism of KMT rule, but few were immune to the friendliness of the population, or unaware of the pressures they faced from mainland China.

In the mid-1990s, as the rise of China created a growing demand for Chinese studies, and the opening of the mainland expanded the list of options available to those who would learn Chinese, the Stanford Center sought to renegotiate its contract with National Taiwan University. The Ministry of Education insisted on cutting subsidies for the center, despite a widespread debate in the press and complaints from the Ministry of Foreign Affairs (http://www.hartford-hwp.com/archives/55/643.html). The Center then signed a contract with Qinghua University in Beijing, and left Taiwan. While it was probably inevitable that leading American universities would establish some sort of center in the mainland, departure from Taiwan was not. According to faculty at the university, the dispute, which occurred before the inauguration of the DPP, was not primarily ideological—it did not, for example, reflect the later tendency of pro-independence forces to try to distance Taiwan from things Chinese—but neither were the consequences carefully anticipated. Officials in Taiwan's newly democratic and increasingly wealthy environment felt that they no longer had to make concessions to the powerful Americans, without, apparently, fully recognizing the options open to the Stanford Center, or the consequences of fumbling away one of the most important sources of elite support for Taiwan in the United States. Nor did top-level politicians step in to provide extra resources to the Ministry of Education, or help NTU to convince the Center to stay in Taiwan (author interview, 彭鏡禧, Dean, Faculty of Arts, National Taiwan University 2005 [Professor Peng was on the Faculty but not Dean at the time the decision to let Stanford go was made], July 26, 2005).

The reorganized "International Chinese Language Program" (國際華語研習所) at NTU still provides excellent Chinese language training, and the worldwide boom in Chinese studies has swelled the influx of students coming to Taiwan, but the increase pales next to that of the mainland. From 1990 to 2005, the number of registered foreign students in Taiwan doubled from 5,900 to 11,035, while enrollments in the mainland increased at 20 percent a year, surpassing 140,000 in 2005 (Zhongyang Tongxunshe 2006; Xinhua, March 2, 2007). Moreover, the most advanced students in social sciences, journalism and business virtually all look to the mainland for training. At the time, only a few insiders seemed to care about the loss of the Stanford Center, but today, academics and government officials on both sides of the spectrum acknowledge that letting the Stanford Center slip away was a major mistake (range of author interviews in Taiwan, 2005-2006).

With the arrival of the DPP administration, placing priority on domestic politics over maintenance and enhancement of multilateral ties became even more severe, both because of the DPP's "Taiwan first" attitude, and because of the increasingly nasty struggle between the DPP, which dominated the executive, and the KMT-PFP forces that controlled a majority in the Legislative Yuan. A small, but telling, example is the controversy over Romanization of Chinese characters. Language and historical memory, not ethnicity, class, or religion, are the key issues dividing "native Taiwanese," especially the 70 percent or so of the population that speaks (or whose ancestors spoke) Hoklo, from mainlanders (and to a lesser extent Hakka and aboriginal peoples). Banning Japanese from public life was a major contributing factor to the tensions that led to the 2-28 incident (since it marginalized the bulk of the Taiwanese intelligentsia, which had been educated in Japanese), and many Taiwanese retained bitter memories of the years in which speaking Taiwanese at school resulted in fines and belittlement. For years, Taiwanese politicians addressed election rallies in the Taiwanese (Hoklo) language to burnish their nativist images.

Somewhat surprisingly, perhaps, the arrival of the DPP administration did not immediately lead to changes in language policy. The position of Mandarin (*guoyu*, "the national language," known in the mainland as *putonghua*—"the common language") was firmly established in schools, science and technology, and other areas of public life. Since Hoklo had never been an official medium of education (classical Chinese was used under the Qing, Japanese during the colonial period, and Mandarin after 1945), it lacked a full-blown modern vocabulary. Moreover, divergent language practices divided the society. Mandarin had made major inroads among youth, women, and the well-educated, and became common in northern Taiwan, while Taiwanese remained dominant in the south, among older men, and in many informal situations. Surrounded by tricky cross-currents, the DPP attempted to please everyone by limiting itself to adding a couple of weeks of loosely-taught "mother tongue" language courses to the school curriculum. Most parents were far more interested in assuring that their children mastered English than adding formal instruction in various "mother tongues," and most accepted, with varying degrees of enthusiasm, that Mandarin Chinese was a vital language of international trade and diplomacy, while Hoklo was restricted to Taiwan, the southern part of Fujian province on the mainland, and a few enclaves in Southeast Asia.

Given the high and increasing levels of partisan tension, however, language remained a potent symbol of the blue-green divide, and staunch Taiwanese nationalists continued to agitate for the government to do more. The most radical called for abolition of Chinese characters, as in Vietnam and North Korea, though that idea that gathered virtually no popular support in Taiwan. Interest in writing Taiwanese is higher, but there is no agreement on which of the half dozen or more systems to use to represent the sounds of Taiwanese, and indeed which dialect of Taiwanese should be deemed "standard." When the question of how to Romanize Chinese characters arose, however, the ideologues played a powerful role, since Romanization had little effect on the life of the average voter, showing up mainly as roman letters on street signs that locals read in Chinese. Given the large phonetic gap between Chinese (whether Mandarin or Taiwanese) and English and other major world languages, no system of Romanization could be ideal, and Taiwan had fallen into an uneasy combination of a virtually unknown official system and widespread adoption of a simplified version of the dated Wade-Giles system.

The blue side of the political spectrum supported official adoption of *hanyu pinyin* (漢語拼音—"Chinese phonetics"), a system devised in mainland China and adopted by the United Nations, the International Standards Organization, most libraries, other international and academic organizations, and the overwhelming majority of Chinese-language teaching programs outside of Taiwan. The objections of the green bloc to *hanyu pinyin* (usually just referred to as *pinyin*) boiled down to two general points: first, they claimed that Taiwan should not adopt a system that would confuse foreigners into believing that Taiwan was just another province of China. Second, they argued that a new system should be developed that would facilitate Romanization of Hoklo, Hakka, and aboriginal languages (though in reality any attempt to represent several languages with one system, or group of systems, would inevitably be more complex and subject to confusion). In the late 1990s, some green-inspired academics devised a system (or perhaps more accurately an approach, since the system was not entirely stable) called "*tongyong pinyin*" (通用拼音; general use phonetic system). Despite widespread confusion and opposition, including from many of its own advisors, in 2002 the Ministry of Education adopted *tongyong* pinyin as a standard, but it did not force local governments to adopt by it.

The foreign community in Taiwan–the people who actually had by far the most contact with Romanized Chinese–universally and vociferously opposed the idea of creating a half-baked "*tongyong*" system. Most of them had learned Chinese abroad via pinyin, and many had professional and business contacts with the mainland that were based on in whole or in part on pinyin. Even among the small group of foreigners who had settled in Taiwan permanently and supported the idea of Taiwanese independence, opposition to *tongyong* was absolute (for two of the more prominent discussions hosted by Westerners living in Taiwan, complete with extensive historical documentation of the debates over *tongyong pinyin*, see http://pinyin.info/links.html and http://www.jidanni.org/lang/pinyin/older_en.html). For those passing through Taiwan as part of a career in Chinese-speaking Asia, or the even more important group that interacted with Taiwan but did not live there, the incentives to use pinyin were even greater. From their perspective, rejection of pinyin was not an affirmation of Taiwan's separate identity, but a significant obstacle in the path of foreigners who might like to learn more about Taiwan, or interact with it more easily.

The result was a complete debacle. The DPP-controlled central government pushed the *tongyong* system, but without even a pretense of quality control, so variant spellings abounded. Taipei City, under KMT control, adopted *hanyu pinyin*. As a result, one street or subway stop would often be surrounded by a multitude of signs with variant spellings and orthographies that seemed designed to confuse and repel any foreigner brave and foolish enough to take to the streets of Taiwan without a thorough command of Chinese characters. Irregular and competing spellings became a favorite topic of jocular entertainment English-language newspapers and web sites in Taiwan.

After the *tongyong-pinyin* controversy decayed into a polarized mess, a more consequential issue arose that led, through quite a different route, to a similar failure to place any priority on increasing foreign support for Taiwan: the stalling of financial reform, and the failure to create an alignment of interest with foreign financial firms that would strengthen overseas support for Taiwan. Under the KMT, the financial system was relatively stable, but rigid and inefficient, dominated by state-owned banks. Taiwan withstood the Asian financial crisis better than did most other East Asian countries. Non-performing loans mostly remained restricted to farmers and fishers cooperatives and local banks, where political influence loomed larger than in the commercial banks (Noble and Ravenhill 2000). The KMT's approach to financial liberalization remained slow and cautious. The bursting of the information technology bubble in 2001 hit Taiwan's electronics-dependent economy harder, partly because the stock market had declined in the wake of partisan conflict between the DPP-dominated executive, which tried to halt the construction of Taiwan's fourth nuclear power plant, and the KMT-dominated legislature, whose claim that the executive lacked the authority to ban the plant eventually was upheld by the courts. Non-performing loans swelled, and the government was forced to step in clean up the banks.

Most observers gave the government fairly good marks for tackling bad loans, the ratio of which gradually declined without major effects on the real economy. In contrast, the government made relatively little progress in the "second stage" of financial reform—liberalization, privatization, and structural reforms. The government passed a financial holding companies act in 2001 in an attempt to follow the lead of the United States in lowering the barriers between banking, securities, and insurance, and the share of government holdings in state-owned banks declined, but in most cases government retained ultimate control, and it froze establishment of new bank branches in 2002. Banks continued to dominate the financial system far more than in advanced economies such as the United States and United Kingdom, or even Japan. In contrast to Korea, where consolidation following the financial crisis left the country with only 19 banks, dominated by just four bank holding companies (Korea, Financial Supervisory Commission 2005), Taiwan remained burdened with a large number of banks (over eight times as many as in Korea, which has an economy twice as large; 行政院金融監督管理委員會 2007). The domestic banks could only offer the same, undifferentiated loans. They lacked the management information systems and human resources to assess and price risk accurately and to provide innovative new financial products and asset management services. The government proclaimed its intention to cut the number of banks in half, but absent regulatory reforms to allow banks to engage in a higher degree of specialization, or penalties against weaker banks, the drive to consolidate only heightened defensiveness.

The sources of policy paralysis were numerous, and included the usual partisan conflicts, and opposition from labor unions in public (and even private) sector banks. Political obstacles also loomed large. Like the KMT before it, the DPP talked of liberalizing government-owned banks, but once it came into power it became reluctant to relinquish control of the commanding heights of the economy, and the many opportunities for patronage appointments (reminiscent of *amakudari* in Japan). Instability of leadership did not help, as the Chen administration changed the premier, finance minister and economics minister almost every year. Corruption was also a major problem: in February 2007 Lin Zhongzheng (林忠正), a former economics professor and DPP legislator, became the third high-level official of the Financial Supervisory Commission to be indicted since its establishment in 2004 (*Taipei Times*, February 15, 2007). Even observers who gave the DPP administration credit for handling the non-performing loan problem effectively argued that corruption was a major obstacle to systemic reform (author interview, Chi Schive 薛琦, President, Taiwan Academy of Banking and Finance, and former Vice-Chairman, Council on Economic Planning and Development, December 27, 2006).

In the absence of progress on the "second stage" of reform such as privatizing public banks and using neutral policy tools such as increases in deposit insurance rates to reflect real risks and encourage the takeover of weaker banks by stronger ones, market dynamics eventually led to an influx of foreign firms, but not on terms planned by the government or likely to increase its influence on major international financial companies. Huge losses on debit and credit cards undermined the profitability of domestic banks just as Taiwan's manufacturing sector increased its investments in mainland China and Southeast Asia, creating a demand for global (or at least regional) financial services that none of the domestic banks could meet, especially given the government's politically-inspired ban on establishing bank branches in mainland China. Starting in 2005, foreign financial giants such as the UK's Standard and Chartered, and Citigroup of the US began to acquire smaller local banks in Taiwan, linked them up with their rapidly increasing lineup of bank branches in China, Hong Kong and Southeast Asia, and began offering more sophisticated asset management services beyond the capabilities of local banks (Yang 2007)

Hemmed in by burdensome regulations, particularly the ban on establishing branches in the mainland, excess competition in Taiwan, and the influx of far more sophisticated foreign rivals, the larger domestic banks complained that the government was depriving patients in intensive care of their oxygen supply (Daniel Tsai, Chairman of Fubon [Fubang] Financial Holding, quoted in the *International Herald Tribune*, May 10, 2007). The government was left with a dangerously weakened cadre of domestic banks, both publicly-controlled and private, that still controlled the large bulk of the financial sector, while foreign financial giants that could have been valuable partners for Taiwan aligned with smaller banks to perform an end run on the government's increasingly unviable policies on restricting financial contacts with the mainland. The contrast with Korea, which was in far less need of diplomatic support, but thanks to the Asian financial crisis ended up with a small but powerful set of foreign financial investors and a greatly strengthened banking sector, could hardly be greater.

Conclusion

The division across the Taiwan Strait joins the standoff on the Korean peninsula as primary examples of the dangerous combination of incomplete democratization (or in the North Korean case, uninitiated democratization) and unreconciled rivalry over territorial boundaries and national identity. Incomplete democratization and unreconciled rivalry, in turn, complicate efforts at regional economic intercourse and cooperation. As the Taiwan case illustrates, however, they do not necessarily prevent large volumes of trade and investment, and the effects on regional cooperation are not necessarily uniformly malign. The ongoing struggle between China and Taiwan over Taiwan's "international space" often undermines, or at least complicates, regional cooperation, and it contributes to mutual suspicions (not least between Japan and China) but it can also provide an incentive to compete to see who can cooperate most eagerly.

Given the huge disparity in size, population, and, increasingly, economic power, it seems logical for Taiwan to adopt an especially aggressive policy toward all types of formal and informal cooperation with countries outside of China to ameliorate its strategic weakness. And in fact, all political figures in Taiwan claim to favor such a strategy. Yet as we have seen, the reality is that in a range of policy issues ranging from high profile to relatively obscure, the recurrent tendency, under the KMT of Lee Teng-hui and perhaps even more under the DPP, has been to privilege domestic politics over policies that might enhance multinational support, leaving Taiwan in a one-on-one competition with the mainland that it is gradually losing.

Many in Taiwan attribute this outcome to an unrelenting campaign by the mainland to isolate Taiwan and undermine multinational support. Yet many of the cases examined here, from self-defeating limitations on technology investments in China to incomplete banking reforms that privilege domestic politics over international connections (or economic dynamism and efficiency) to the half-hearted "Look South" policy, to abandonment of the Stanford Center and opposition to a form of Romanization uniformly supported by Taiwan's foreign residents and partners, turned primarily on domestic politics, not on the machinations of China.

Explanations for this dynamic vary. The Greens blame the Blues for recalcitrance and mindless opposition, if not a secret, treasonous plot to advance the cause of the mainland, while the Blues blame the Greens for incompetence, arrogance, and self-defeating ideological dogmatism. Political scientists often claim that policy paralysis stems from political deadlock imposed by a malfunctioning constitutional structure that diffuses power and responsibility among the president, premier and legislature, rather than checking and balancing it in a responsible way that provides accountability and encourages eventual cooperation (though partisan deadlock is not easy to define and measure, and the evidence from the experience of the United States with divided government is at best mixed; Howell et al. 2000). Domestic opinion also plays a role. Areas and sectors that gain from economic interaction with China, such as northern Taiwan and young professionals tend to look much more favorably on both cross-strait interaction and liberalization than do older and less well-educated workers in the south, with its base of agriculture and traditional, labor-intensive industry.

Behind domestic tensions lies the structural fact that Taiwan is far smaller than China and the United States, and in the end its fate will depend largely on relations between the superpowers. Moral hazard, whether in the form of refusing to purchase American arms or rashly challenging the PRC on the assumption that in the end the United States will have little choice but to support Taiwan's democracy and balance the power of China (or block its rise) remains powerful.

Given the clashes in interest, historical identity, and ideology, reconciliation and easing of tensions will not be easy. On the one hand, Chinese policy, both toward the East Asian region and toward Taiwan, has become more flexible, subtle and positive over the past few years, while the continued rapid growth on the mainland has made it an increasingly attractive, if not indispensable, market for businesses in Taiwan. Surveys clearly show that the more knowledge of and contact with the mainland people in Taiwan have, the less hostile is their attitude (see e.g. 天下雜誌 May 24, 2006). Strongly rejectionist attitudes toward economic interaction with China are also fading as even “deep green” supporters reluctantly acknowledge that the desire to invest in the mainland results not just from “Han chauvinist” brainwashing, but from the inescapable dominance of the Chinese economy in East Asia. On the other hand, the biggest sources of tension are the PRC’s unrelenting efforts to isolate and denigrate Taiwan and the equally persistent efforts of the deep greens to move toward a permanent and formal alienation from China, and those have not fundamentally changed.

If the tensions over the Taiwan Strait influence regional cooperation, regional cooperation may also influence cross-Strait relations. The current practice of taking ASEAN + 3 (with one or more optional additions, such as India, Australia and New Zealand) as the basis for the “East Asian summits” clearly alienates and isolates Taiwan from regional cooperation, and could increase xenophobic sentiments in the island. Striking a balance between basic principles and pragmatic adjustment in handling the problems of incomplete democratization and unreconciled rivalry over territory and identity will tax the wisdom and patience of all the parties involved, including the United States and Japan, but whichever direction the cross-Strait relation takes, it is likely to involve itself intimately with regional patterns of economic, political and security cooperation.

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