

# Introduction: The WTO and Cross-Strait Economic Relations

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On January 1, 2002, Taiwan joined the World Trade Organization (WTO) as its 144th member. Membership represented an important watershed in the evolution of an economy which, since the 1970s, had been recognized as one of the “miracles” of East Asia. Although its phenomenal growth had been driven by exports, the island was only selectively-integrated into the world economy. Its industrial policy was vigorously protectionist and its foreign trade, focused on the U.S. and Japan, was hardly multi-lateral.

Taiwan’s accession followed that of the People’s Republic of China (PRC) that became the 143rd member of the world organization the previous month. Like Taiwan, China’s membership in the WTO represented a dramatic reversal of past economic policies. Ambivalence about participation in the world economic system gave way to “deep integration,” while the demands of being a part of the global regime required a radical restructuring of the nation’s socialist economy.

It was clear that membership in the world organization might provide not only new opportunities for the economies on both sides

of the strait, but would also pose formidable challenges as Taiwan and China each sought to adjust to what was literally a new way of doing business. Their respective commitments to globalization under the WTO regime were universally expected to inaugurate periods of transformation and uncertainty.

What was less clear was the impact that common membership would have on the China–Taiwan relationship. Although Taiwan and the mainland shared memberships in non-governmental organizations and in regional governmental organizations such as the Asian Development Bank, their common membership in the WTO that sets the ground rules for world trade was an extraordinary event. Moreover, mutual accession was occurring against the backdrop of a decade characterized by growing cross-strait political and military tensions, and amidst a flourishing economic relationship. Speculation was rife concerning the impact that membership in the WTO might have on the shape and direction of economic ties, as well as concerning the increasing disconnect between these ties and the degenerating political relationship during the 1990s.

This volume draws from a project launched at Harvard University to examine the implications and results of the simultaneous accession of Taiwan and the mainland to the WTO. In the chapters that follow, we examine the commitments made on each side of the strait to secure membership in the organization; the extent to which these commitments have been applied by each side in its economic dealings with the other side; the implications for Taiwan's place in the economic architecture of the region; the impact of the cross-strait trade regime that has evolved since WTO membership on four major sectors of economic interaction (finance and banking, agriculture, automobile manufacturing, and electronics); and the degree to which common membership has contributed to an improvement in the cross-strait political and security relationship.

In this introduction, we endeavor to provide the background to, and context for, these individual analyses. We begin with an examination of the respective accession processes of the PRC and Taiwan; of the motivations behind their applications; and of the general nature of the commitments made by each side prior to accession. We then turn

to a description of the cross-strait economic relationship that had evolved during the 1990s. This, in turn, provides the basis for an analysis of the manner in which the commitments made to secure WTO membership interacted with the structure and rationale of the existing relationship to give shape to the specific cross-strait interactions described by the individual authors in the chapters that follow.

## THE PATTERN OF ACCESSION

*A Global Trade Regime.* The WTO emerged out of the General Agreement on Tariffs and Trade (GATT) created in 1947. The stated purpose of this agreement was to arrive at “mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce.”<sup>1</sup> Having agreed to begin the process of achieving major tariff reductions in the import of foreign goods, the signatories established two fundamental principles that would continue to guide its successor organization, the WTO: most-favored nation (MFN) and national treatment. The former assured that concessions granted to one member would be available to all, while the latter prevented discrimination (such as taxation) against imported goods in the home market.<sup>2</sup>

By 1986, the GATT had secured accession of additional members. Six more rounds of negotiation had been held, leading to a further reduction of tariffs; the expansion of the agreement to include such items as anti-dumping provisions and dispute resolution procedures; and the beginning of the process to consider the reduction of non-tariff restrictions on imports.<sup>3</sup> Also, in 1986, the so-called “Uruguay

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<sup>1</sup> “The General Agreement on Tariffs and Trade” [GATT, 1947], Preamble, [http://www.wto.org/english/docs\\_e/legal\\_e/gatt47\\_01\\_e.htm](http://www.wto.org/english/docs_e/legal_e/gatt47_01_e.htm), accessed August 1, 2005.

<sup>2</sup> “The General Agreement on Tariffs and Trade” [GATT, 1947], Articles II and III, [http://www.wto.org/english/docs\\_e/legal\\_e/gatt47\\_01\\_e.htm](http://www.wto.org/english/docs_e/legal_e/gatt47_01_e.htm), accessed August 1, 2005.

<sup>3</sup> Except where noted, the following three paragraphs are drawn from World Trade Organization, *Understanding the WTO*, 3<sup>rd</sup> ed. (Geneva: World Trade Organization, 2003).

Round” began, which would continue into 1993. With 123 nations eventually taking part, the seven years of meetings produced a new agreement that combined an amended and expanded GATT treaty (GATT 1994) with a General Agreement on Services (GATS) and an Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). These three agreements were to be administered by a newly-established organization, the World Trade Organization, headquartered in Geneva.<sup>4</sup>

The agreements created an international trade regime with far greater complexity and coverage than the GATT. In the first place, during the Uruguay Round, the original GATT agreement was expanded to regulate a wider range of trade instruments, now including subsidies, supports and local content requirements, and covering a broader range of goods — particularly textiles and agricultural products. The GATS extended the scope of the trade regime to include foreign participation in domestic service industries (ranging from finance to telecommunications) which, by the end of the twentieth century, had come to represent 60 percent of global output and 30 percent of global employment. The TRIPS agreement set the ground rules for the international protection of copyrights, patents, designs, and so forth. Finally, the agreements of the Uruguay Round established an enhanced dispute resolution mechanism and provided for periodic reviews of member nations’ compliance with the terms of the agreement.

In short, with the establishment of the WTO in 1995, a structure was created that provided a negotiation arena for participants in the global economy; a set of transparent rules for mutual interaction; and a mechanism to settle disputes regarding these rules.<sup>5</sup> Significantly, the expanded agreements reached during the Uruguay Round were guided by the same two basic principles that had been at the center of the GATT — most-favored nation and national

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<sup>4</sup> For a discussion of some of the issues that led to the transition from the GATT to the WTO, see Hugh Corbet, “Issues in the Accession of China to the WTO System,” *Journal of Northeast Asian Studies* 15, no. 3 (Fall 1996), pp. 14–33.

<sup>5</sup> *Ibid.*

treatment. It is thus no wonder that, for better or for worse, the WTO has become the symbol of globalization.

*Accession.* Neither the PRC nor Taiwan was a member of the GATT when the Uruguay Round began. Although the Republic of China (ROC) had been one of the founding members, after its defeat in the civil war on the mainland and its retreat to Taiwan, it resigned from the organization in 1950, only to rejoin as an observer in 1965. However, in 1971, when it was replaced by the PRC in the United Nations, it also lost its observer status. In 1990, it decided to re-apply to the GATT, and in 1995, it again became an observer.<sup>6</sup> The PRC became an observer in 1982 and, despite its claim for succession to the ROC's founder status, began the process of formal application in 1986.<sup>7</sup>

With separate applications submitted within a period of six years, it seemed as if the two sides would move on parallel tracks toward membership in the WTO. In fact, from the very beginning, the two applications became not only linked, but also enmeshed in the politics of cross-strait relations. However, due to the GATT's (and later the WTO's) distinctive nature as an inter-governmental organization, the either/or solution that had been reached at the United Nations in 1971 was avoided — much to the frustration of the PRC.

In order to accommodate the accession of colonies, Article XXXIII of the GATT agreement had stipulated that “a government acting on behalf of a separate customs territory possessing full autonomy in the conduct of its external commercial relations and of other matters provided for in this Agreement, may accede to this agreement.” Pursuant to this article that spoke of a “government” and not a “state,” the ROC applied under the designation of the “Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu” (TPKM), asserting that it met the requirement of being “fully autonomous in the conduct of the external commercial relations of

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<sup>6</sup> “The Republic of China [Taiwan] in 2003 APEC,” [http://www.gio.gov.tw/taiwan-website/5-gp/apec/ap3\\_03.htm](http://www.gio.gov.tw/taiwan-website/5-gp/apec/ap3_03.htm), accessed July 12, 2005.

<sup>7</sup> “Chronology of China's Bid for WTO Accession,” <http://www.china.org.cn/Beijing-Review/Beijing/BeijingReview/99Nov/bjr99-48e-8.html>, accessed July 16, 2005.

the territory.”<sup>8</sup> By the time a working party had been appointed to consider its application, the parenthetical expression “referred to as ‘Chinese Taipei’” was being used along with the more unwieldy title.<sup>9</sup> In short, the absence of statehood as a requirement made possible Taiwan’s initial application and then future membership in the inter-governmental GATT/WTO.<sup>10</sup>

For Beijing, of course, this was a difference without a distinction. When Taiwan applied in 1990, the PRC Foreign Ministry dismissed the application as “utterly illegal and absurd.”<sup>11</sup> Article XXVI:5 (c) of the GATT Agreement provided for colonies to gain membership with the sponsorship of the home country once full autonomy was certified by the contracting metropolitan country. Britain had provided such a certification for Hong Kong and the PRC maintained that it had given its consent in the 1984 agreement regarding the handover of the colony. Since Taiwan was a province of China, Beijing argued, it was not entitled to apply for membership on its own. If it were to join, it could only be in a similar manner, i.e., with sponsorship from the PRC.<sup>12</sup>

However, due to the lingering effects of the 1989 Tiananmen crackdown, Beijing was in a weak bargaining position.<sup>13</sup> Concerned that, given the mood of the time, Taiwan might be admitted before

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<sup>8</sup> For an excellent discussion of the nature of this clause, see Cho Hui-Wan, *Taiwan’s Application to GATT/WTO: Significance of Multilateralism for an Unrecognized State* (Westport, CT: Praeger, 2002), pp. 173–179.

<sup>9</sup> “Working Party on the Accession of the Separate Customs Territory of Taiwan,” General Agreement on Tariffs and Trade, Document L/7095/Rev. 1, November 6, 1992, www.GATT.Stanford.Edu, accessed July 26, 2005.

<sup>10</sup> For a defense of the appropriateness of Taiwan’s application under Article XXXIII, see Y. Qin, “GATT Membership for Taiwan: A Study in International Law,” *NYU Journal of International Law* 24 (1992), p. 1059.

<sup>11</sup> James V. Feinerman, “Taiwan and the GATT,” *Columbia Business Law Review* 39, no. 1 (1992), pp. 39–60.

<sup>12</sup> Cho Hui-Wan, *Taiwan’s Application to GATT/WTO: Significance of Multilateralism for an Unrecognized State* (Westport, CT: Praeger, 2002), p. 179; Tsai Ing-Wen “Taiwan’s WTO Accession: Meeting the Requirements,” *Journal of Northeast Asian Studies* 15, no. 3 (Fall 1996), pp. 34–44.

<sup>13</sup> This paragraph is based on the discussion in Wei Liang, “China’s WTO Negotiation Process and its Applications,” *Journal of Contemporary China* 11 (2002), pp. 693–694.

the PRC, the mainland relaxed its opposition. In a letter to the director-general of the GATT and all contracting parties, Premier Li Peng set three conditions for Taiwan's admission: that "the PRC is the only legitimate government of China and Taiwan is a part of China; Taiwan could join GATT as a separate customs territory only after the PRC joins GATT; and Taiwan's application must be consulted [sic] and agreed to by the PRC government." After consultations with both the mainland and Taiwan, as well as with the American and European Union representatives, a compromise was reached.

At a GATT Council meeting in late September 1992, Chairman B.K. Zuchi announced that after "extensive consultations" ... "all contracting parties" ... "acknowledged the view that there was only one China"; that "many ... had agreed with the view of the People's Republic of China ... that Chinese Taipei, as a separate customs territory, should not accede to the GATT before the PRC itself"; and that there was "a general desire" to set up a separate working party to consider the application from TPKM.<sup>14</sup>

This being the case, Zuchi "concluded that there was a consensus among the contracting parties" to establish a working party to consider the island's admission, but the GATT Council would adopt the protocol for the PRC accession before that of Taiwan. The minutes of the meeting note that the Council "agreed" to these conditions. Further, Zuchi informed the Council that:

...as a part of the understanding, the representation of Chinese Taipei in the GATT would be along the same lines as that of Hong Kong and Macau during the course of its status as an observer and subsequently as a contracting-party delegation, and that the titles carried by its representative would not have any implication on the issue of sovereignty.

The minutes report that "The Council *took note* [italics in the original]" of this statement (see footnote 14). The careful wording was clearly a result of the complex diplomatic minuet that had preceded the meeting; later on, this wording would become problematic.

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<sup>14</sup> "Minutes of Meeting Held in the Centre William Rappard on September 29-October 1, 1992," General Agreement on Tariffs and Trade, C/M/259, pp. 3-4, [www.GATT.Stanford.Edu](http://www.GATT.Stanford.Edu), accessed July 26, 2005.

The informal and somewhat ad hoc arrangement launched the process of what had become a parallel, but hardly separate, dual-accession process. This was an extremely fragile basis upon which to resolve the fundamental issue of sovereignty that divided the two sides. The content and the underlying logic of the compromise thus continued to be a contentious issue, despite the fact that in 1995, Taiwan transferred its application to the GATT to its successor, the WTO, in which Article XII of the founding agreement specifically used the wording “any state or separate customs territory” to define eligibility for membership (see footnote 12).

However, although neither side was completely satisfied with the apparent compromise, there were reasons, relating to cross-strait relations, not to belabor the issue. It should be recalled that relations were just beginning to thaw in the early 1990s. Each side had established semi-governmental organizations to manage policy toward the other, economic relations were growing apace, and, by the fall of 1992, preparatory negotiations were taking place for a meeting between representatives of each side for the first time since the end of the Chinese civil war. Here, as in the GATT, the issue of Taiwan’s status as a part of “one China” complicated the negotiations. However, both sides were anxious to get on with the meeting. The result was that in fall 1992, the GATT Council arrived at a shaky compromise, an even more tenuous arrangement defining the status of the two sides than the 1992 consensus which, as we shall see later, also became mired in controversy.

Still, the most compelling reason for the two sides to proceed with the process of accession related to the economic and political advantages that each believed would be gained from membership in the GATT/WTO. To be sure, motivations on each side of the strait evolved in the years that ensued from application to accession; after all, as we have seen, by the time they became members, the GATT had been transformed into the more-complex WTO.<sup>15</sup> Still, the underlying motivating factors — a mixture of politics and

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<sup>15</sup> Wei Liang, “China’s WTO Negotiation Process and its Implications,” *Journal of Contemporary China* 11, no. 33 (2002), pp. 683–719.

economics — remained constant on each side throughout the period pending accession.

For Taiwan, the application for membership was part of an initiative begun by Chiang Ching-kuo in the mid-1980s and aggressively continued by his successor Lee Teng-hui to reverse the steady diplomatic isolation of the island, which had followed the PRC's admission to the United Nations and Taiwan's expulsion from most inter-governmental organizations.<sup>16</sup> The combination of Taiwan's strong global economic position, the lack of a requirement of statehood for admission, and the fact that the PRC as a non-member could not effectively oppose Taiwan's application, presented a unique opportunity for Taiwan to enter a flagship inter-governmental organization. Moreover, in addition to the prestige — and the domestic political capital — to be gained from admission, membership in the GATT/WTO would provide opportunities for Taipei also to seek admission to related international organizations; to maintain quasi-diplomatic contacts with countries that recognize the PRC; and, most generally, to increase its international profile and reputation.

The economic motivation for membership was also rooted in developments that had taken place during the previous decade. As the island made the transition from labor-intensive consumer goods to higher value-added and more technologically-sophisticated products, there was a growing awareness that greater openness to international competition and increased access to foreign goods and services were necessary. Indeed, many in Taiwan argued that membership in the WTO would provide an external stimulus for the reform of an economic and industrial system that was becoming increasingly unsuitable for the changing international and domestic environment.

Finally, these domestic pressures and incentives for change were joined by calls emanating from the island's trading partners,

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<sup>16</sup> Government Information Office, Republic of Taiwan, "Taiwan's Accession to the World Trade Organization," pp. 1–3, <http://www.taipei.org/un2003/html/wto.htm>, accessed July 25, 2005; Paul Hsu, "Policy Brief on Taiwan in the WTO," [www.epoch.org.tw/pdf/knowledge\\_06.pdf](http://www.epoch.org.tw/pdf/knowledge_06.pdf), accessed July 28, 2005.

especially the U.S. During the 1980s, Taiwan had been forced to lower its barriers to international trade and investment and to improve its protection of intellectual property, largely as a result of pressures from Washington. As one author has noted, it began to appear that Taiwan was “following most GATT rules without being a party to the agreement” (see footnote 12). However, the island’s efforts were not fully reciprocated. Membership in a multi-lateral international organization based on the principle of MFN would assure such reciprocity. Moreover, contacts in a multi-lateral organization would presumably increase Taiwan’s leverage in settling economic disputes with those countries with which it had either no official relationship or only limited contact.

In the future, as Connie Guang-Hwa Yang notes in Chapter 2, with the protection of an international trade regime (in which it would have a voice) and of a system of dispute resolution, Taiwan could now defend itself against “the threat of unilateral sanctions and retaliations” that had been used to pry open its previously highly-protected economy.<sup>17</sup> Finally, of course, membership in the GATT/WTO would provide increased information about global economic opportunities and trends through contacts with delegations from other nations and the rich data provided by the organization itself.

Ironically, the efforts by the PRC to join the GATT/WTO were driven by similar factors.<sup>18</sup> Although the PRC did not suffer from the isolation that characterized Taiwan’s international position, the establishment of its nationalist credentials in the international trade

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<sup>17</sup> Paul Hsu, “Policy Brief on Taiwan in the WTO,” [www.epoch.org.tw/pdf/knowledge\\_06.pdf](http://www.epoch.org.tw/pdf/knowledge_06.pdf), accessed July 28, 2005.

<sup>18</sup> Icksoo Kim, “Accession to the WTO: External Pressure for Industrial Reform in China,” *Journal of Contemporary China* 11, no. 32 (2002), pp. 433–458; Joseph Fewsmith, “The Political and Social Implications of China’s Admission to the WTO,” *The China Quarterly*, no. 73 (2001), pp. 573–591; Leonard K. Cheng, “China’s Economic Benefits from WTO Membership,” *Economic Analysis and Commentary* [Hong Kong University of Science and Technology], [http://www.bm.ust.hk/~ced/nw\\_benefit.htm](http://www.bm.ust.hk/~ced/nw_benefit.htm), accessed July 23, 2005; Wei Liang, “China’s WTO Negotiation Process and its Implications,” *Journal of Contemporary China* 11, no. 33 (2002), pp. 683–719.

organization undoubtedly had great symbolic value for a Communist Party seeking to rebuild its image at home after a decade of the Cultural Revolution. Accession, like membership in the United Nations, was an indication of the nation's arrival as a recognized member of the international community. Moreover, after the suppression of the Tiananmen demonstrations in 1989, there was the additional incentive to refurbish its image abroad.

Equally important was the role that membership would play in assisting the development of the national economy. By the 1980s, it had become obvious that the architects of the post-Mao reform program planned to rely heavily on foreign investment and export-driven industrialization to promote economic development. Membership in the GATT/WTO would assure wider and more favorable access to markets abroad — especially those in the U.S. where the granting of most-favored-nation status had become a yearly drama. Moreover, with China committed by treaty to an international regime with binding dispute resolution mechanisms, international investor confidence would grow and bring with it an influx of capital, management techniques, international marketing experience, and technology.

Finally, it was realized by some of China's reformers that membership in the WTO could be an important factor to overcome domestic resistance to the reform of the formerly-planned economy. Although this objective had motivated Zhao Ziyang to sanction the original application in the 1980s, it became a much stronger factor during the mid-1990s when Zhu Rongji took over the premiership and the reform agenda became more complex. By that time, meeting the terms of the more-complicated WTO accession process and inviting the competition of foreign goods and services were seen by many leaders in Beijing as the key to speeding up the process of economic reform.<sup>19</sup>

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<sup>19</sup> Joseph Fewsmith, "The Political and Social Implications of China's Admission to the WTO," *The China Quarterly*, no. 167 (2001), pp. 573–591; Ji Chen and Steve Thomas, "WTO and China's Financial Services Sector," *Journal of Contemporary China* 11, no. 33 (2002), pp. 673–682; Wei Liang, "China's WTO Negotiation Process and its Implications," *Journal of Contemporary China* 11, no. 33 (2002), pp. 683–719.

With such strikingly similar motivations, both sides pursued accession. In the process, each side agreed to be bound by the general terms of the WTO trade regime, as well as by the accession agreements on specific issues that had been negotiated with existing members and that, for the most part, were thus extended to all members under the most-favored-nation principle. As the process progressed, the broad outlines of their future relationship to the world economy; of the structural reforms that each would have to implement; and of the impact that membership would have on various sectors of their respective economies, all became apparent.

This is not the place to review the specifics of the accession agreements of Taiwan and the mainland. Tian-jy Chen touches upon some of their highlights in his chapter in this volume. However, in order to pursue the theme of this introduction — the relationship between the commitments to the WTO and the cross-strait trade regime existing at the time of accession — it is necessary to identify the general classes of trade and investment that the organization sought to regulate.

In broad outline, the accession agreements negotiated by Taipei and Beijing had a common format.<sup>20</sup> Both sides agreed to the general rules of trade in goods included in the GATT treaty as supplemented/modified by the 1994 agreements. These included

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<sup>20</sup> The accession protocols for each side are lengthy documents that are available at [www.wto.org](http://www.wto.org). There are numerous summaries of the terms agreed upon by each side. Among the most useful for the People's Republic of China are: Office of the United States Trade Representative, "Background on China's Accession to the World Trade Organization," December 11, 2001, [http://www.ustr.gov/Document\\_Library/Fact\\_Sheets/2001/Background\\_Information\\_on\\_China's\\_Accession\\_to\\_the\\_World\\_Trade\\_Organization.html](http://www.ustr.gov/Document_Library/Fact_Sheets/2001/Background_Information_on_China's_Accession_to_the_World_Trade_Organization.html), accessed August 1, 2005 and "What Does China's WTO Accession Mean for Foreign Industry," [http://www.china-window.com/china\\_market/wto\\_and\\_china/what-does-chinas-wto-acce.shtml](http://www.china-window.com/china_market/wto_and_china/what-does-chinas-wto-acce.shtml), accessed July 22, 2005.

For Taiwan, see Republic of China, Board of Foreign Trade, "Trade and Investment Opportunities Presented by Taiwan's Accession to the World Trade Organization," <http://www.gio.gov.tw/taiwan-website/4-0a/wto/wto01.htm>, accessed August 2, 2005 and Robin J. Winkler, "Taiwan WTO Survey: Getting a Head Start on Reform," <http://www.winklerpartners.com/htmlfiles-english/Publications/articles/2001-12CLPWTO.PDF>, accessed August 1, 2005.

commitments to lower tariff barriers (itemized goods and the extent of tariff reductions were specified in the individual protocols); to reduce the number of non-tariff barriers (such as import licenses or quotas); and to adhere to the TRIMS agreement that disallowed the approval of investments conditional on adherence to regulations that favored domestic products, rules regarding dumping, and so forth.<sup>21</sup> In addition, Taiwan and the PRC agreed to the general terms of GATS, while, in a manner similar to the procedure followed in the GATT agreement, specifying in separate schedules what service industries would be opened and in what manner. Third, both sides agreed to the TRIPS agreement by pledging the protection of intellectual property rights and the punishment of violators. Finally, accession meant that both sides would be subject to dispute resolution proceedings brought by other members and to periodic reviews of their individual trade regimes by other members of the WTO.

As part of the accession process, Taiwan and China each negotiated separate agreements with some members of the organization, which were incorporated in their terms of accession and made available to all WTO members under the most-favored-nation principle. However, of particular significance was the fact that, since both parties were entering the organization at about the same time, they made no commitments to one another. This would later provide an important justification for the distinctive trade regime maintained by Taiwan vis-à-vis the mainland.

However, within the broad areas of the common commitments made by both Taipei and Beijing, there were significant differences. Most prominent among these were their very different tariff schedules and service schedules, and the fact that China entered as a developing economy, thus gaining greater flexibility in meeting the terms of accession, whereas Taiwan entered as a developed economy.

There were also differences that resulted from the special characteristics of each economy or the obstacles to trade perceived by the negotiating partners. Included in the mainland's terms were

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<sup>21</sup> For an explanation of TRIMS, see "WTO Related Investment Measures (TRIMS) Agreement," <http://www.dti.gov.uk/ewt/trims.pdf>, accessed August 3, 2005.

stipulations regarding state-owned enterprises, subsidies, trading rights, and intellectual property rights. For Taiwan, intellectual property rights, the service industries, the discriminatory nature of the government's alcohol and tobacco monopoly, and the agreement to join the Government Procurement Agreement (GPA) of the WTO after accession constituted the principal foci of the agreements.

As many of the chapters in this book suggest, when the terms of accession for each side became apparent, there was considerable speculation on such issues as the scope of the reform challenge faced by each economy; the identification of the winning and losing sectors within the economy; the social and political tensions that might result from these readjustments; and the opportunities presented to outside traders and investors. Generally, there was a consensus that due to previous reforms (for the most part made under pressure from the U.S.), Taiwan would have an easier task in conforming to the terms of accession. However, a common theme in the discussions of the post-accession economies of both sides was the warning about the severity of the short-term adjustments that would be required of certain sectors of the economy, complemented by an enumeration of the benefits that would be derived from greater global integration in the future.

In the end, it was obvious that it would no longer be business as usual with the rest of the world for either the PRC or Taiwan.<sup>22</sup> Policy

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<sup>22</sup> U.S. Department of Agriculture, "The U.S.—China Accession Deal: A Strong Deal in the Best Interests of U.S. Agriculture," <http://www.fas.usda.gov/info/factsheets/China/deal.html>, accessed July 18, 2005; Office of the United States Trade Representative, "Background on China's Accession to the World Trade Organization," December 11, 2001, [http://www.ustr.gov/Document\\_Library/Fact\\_Sheets/2001/Background\\_Information\\_on\\_China's\\_Accession\\_to\\_the\\_World\\_Trade\\_Organization.html](http://www.ustr.gov/Document_Library/Fact_Sheets/2001/Background_Information_on_China's_Accession_to_the_World_Trade_Organization.html), accessed August 1, 2005; Thomas Weishing Huang, "The Impact of the WTO Treaties on Investments in China," *Harvard Asia Quarterly*, <http://www.fas.harvard.edu/~asiactr/haq/200102/0102a002.htm>, accessed August 6, 2005; Robin J. Winkler, "Taiwan WTO Survey: Getting a Head Start on Reform," <http://www.winklerpartners.com/htmlfiles-english/Publications/articles/2001-12CLPWTO.PDF>, accessed August 1, 2005; I.-W. Tsai, "Taiwan's WTO Accession: Meeting the Requirements," *Journal of Northeast Asian Studies* 15, no. 3 (1996).

tools that had been essential to the industrial policies of these two very different economies either would not be permitted or would have to be reduced or phased out. Domestic industries and agriculture could not be protected by an array of high tariff barriers and non-tariff measures. Export subsidies would be eliminated and trade-distorting domestic subsidies reduced. Special trading or distribution privileges for domestic companies and domestic content requirements were no longer allowed. The most-favored-nation principle would end special privileges granted to one partner and requirements for transparency would limit official discretion in manipulating trade regulations. The service sector would undergo a revolution as foreign participation was to be permitted in areas such as telecommunications, insurance, and banking. Finally, accession to the WTO meant the periodic monitoring of the members' trade regimes and the possibility of the imposition of sanctions for violations of the agreement through the organization's dispute settlement proceedings.

What was not so apparent was the impact that common membership would have on the relationship between the two sides. Although the earlier wrangling over the terms of Taiwan's application gave important clues to the future, absent any accession negotiations between Taipei and Beijing, it was difficult to predict what opportunities and problems lay ahead in the relationship. However, there was little question that the complex history of the relationship between the two sides — both economic and political — would create a post-WTO relationship quite different from that which each was expected to maintain with the rest of the world.

## **BEFORE THE WTO: A FLOURISHING ECONOMIC RELATIONSHIP**

Cross-strait relations had their origins in the civil war. When the Republic of China moved to Taiwan in 1949, it declared Taipei to be the temporary capital of a mainland temporarily occupied by the Communist "rebels." The island was to be a staging area for a

counterattack that would restore the rule of the Kuomintang (KMT), or the Nationalist Party, to the mainland. Aside from some smuggling, economic contacts were non-existent and political negotiations were off-limits — to take any other posture would constitute a recognition of the illegal regime on the mainland. The fundamental policy of Chiang Kai-shek's government was founded on the principle of “recovering the mainland” (*guangfu dalu*).<sup>23</sup>

After the end of the civil war, the posture of the new government in Beijing was equally confrontational. On the mainland, the slogan was to “liberate Taiwan” (*jiefang Taiwan*). In the 1950s and 1960s, mainland leaders did offer some proposals for a new period of “Kuomintang-Communist cooperation” that would have Taiwan rejoining the mainland, while retaining some autonomy (an offer refused by Chiang). However, the main thrust of Beijing's policy was unyielding — as reflected in the crises of 1954–55 and 1958.<sup>24</sup> In these years, the only thing that both sides of the strait seemed able to agree upon was that Taiwan was a part of China; of course, who ruled that China was another question altogether.

The PRC identifies the January 1, 1979 “Letter to Taiwan Compatriots” as a watershed signaling the change from a policy of liberating Taiwan by force to one of seeking “peaceful reunification” (*heping tongyi*). Although Beijing continued to reserve the right to use force in certain circumstances, the tone and substance of mainland policy changed as it sought to engage both the government and the people of Taiwan. Drawing on the earlier offers for autonomy, in 1983, China's new leader, Deng Xiaoping, offered to negotiate the island's reunification under the terms of a “one country, two systems” (*yiguo liangzhi*) framework (see footnote 24).

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<sup>23</sup> Zhang Zhanhe, *Liang'an guanxi bianqian shi* [A Changing History of the Relations between the Two Shores] (Taipei: Shibao wenhua chuban qiye youxian gongsi, 1995), p. 193.

<sup>24</sup> Quanguo Taiwan yanjiuhui, *Taiwan wenti shilu* [Report on the Taiwan Issue] (Beijing: Jiuzhou chubanshe, 2002), pp. 993–1001.

Initially, there was little response from Taiwan. Chiang Ching-kuo, who succeeded his father after the latter's death in 1975, stuck to what had become known as the "three nos" policy — no contact, no compromise, and no negotiation with the mainland. However, in the period immediately preceding his own death in January 1988, in an effort to rebuild the eroding legitimacy of the KMT government, Chiang set into motion a series of policies that relaxed the single-party dictatorship and took a more pragmatic approach to foreign relations.

With regard to cross-strait policy, Chiang initiated three policies that, although they did little to change the politics of cross-strait relations, had an enormous impact on the economic relationship: travel to the mainland was approved for limited categories of citizens (with a humanitarian gloss regarding the need for aging veterans to visit relatives); a general regulation relaxing restrictions on the export of capital was promulgated; and a willingness to turn a blind eye to cross-strait trade through a third country (or colony, in the case of Hong Kong) was apparent in the statements of government officials who did little to discourage the beginnings of such economic contacts.<sup>25</sup> As the Director-General of the Board of Trade put it coyly, the policy was that there would be "no direct trade with the mainland, no direct contact with Communist Chinese representatives, and no interference with trans-shipment trade."<sup>26</sup>

During the decade of the 1990s that followed, cross-strait trade and investment took off dramatically, with an average growth rate of 30 percent per year.<sup>27</sup> In 1990, the total two-way trade was

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<sup>25</sup> This refers to the so-called "non-interference principle of indirect trade with the mainland" announced in 1985. See Tung Chen-yuan, *China's Economic Leverage and Taiwan's Security Concerns*, Ph.D. Dissertation, Johns Hopkins University, 2002, p.27.

<sup>26</sup> *Free China Journal*, September 21, 1987; The previous year, Chiang Ching-kuo had told an American reporter, "it is beyond our control to prevent indirect trade through a third country," *Free China Journal*, October 20, 1986.

<sup>27</sup> Luo Qi, "Economic Dynamism and Political Fragility: The Mainland China-Taiwan Relationship Revisited," [http://www.future-china.org.tw/csipf/activity/19990606/mt9906\\_08e.htm](http://www.future-china.org.tw/csipf/activity/19990606/mt9906_08e.htm), p. 7, accessed August 11, 2005.

US\$ 5.2 billion; in 1995, it was US\$ 22.5 billion; and in 2001 — the year before accession — it reached US\$ 27.9 billion. Moreover, during this same period, trade with China went from 3.31 percent of Taiwan's total trade in 1990 to 12.10 percent in 2001. For the mainland, growth was much lower, rising from 4.47 percent of overall trade in 1990 to 5.46 percent in 2001 — although it had been as high as 8.2 percent in 1996. By the time they entered the WTO the mainland was Taiwan's leading export destination and Taiwan ranked fourth among China's sources of imports.<sup>28</sup>

Looking at these figures, one author has noted three characteristics.<sup>29</sup> The first is their “increasing trade dependence” — especially in the case of Taiwan. During the years from 1990 to 2001, trade with Taiwan averaged 7 percent of the mainland's total trade, with imports from Taiwan at 12.8 percent and exports to Taiwan a mere 1.9 percent. For Taiwan, the average figures were 9.6 percent of total trade, 3 percent for imports from the mainland and 15.7 percent for exports to the mainland. Significantly, in the case of Taiwan, the overall and export figures grew by roughly 300 percent in those years.<sup>30</sup>

The second characteristic suggested by these figures is that in the 12 years between 1990 and 2001, Taiwan consistently ran a large surplus in its trade with the mainland. Indeed, in 2001, the PRC's trade deficit with Taiwan was more than twice that with next trading partner (South Korea).<sup>31</sup> Specifically, in 1990, the deficit was

<sup>28</sup> *Liang'an jingji tongji yuebao* [Cross-Strait Statistical Monthly], no. 112 (December 2001), Tables 6, 7, 8, and 9, <http://www.chinabiz.org.tw/chang/Eco/112-2001-12/menu.htm>, accessed August 10, 2005.

<sup>29</sup> Luo Qi, “Economic Dynamism and Political Fragility: The Mainland China-Taiwan Relationship Revisited,” [http://www.future-china.org.tw/csipf/activity/19990606/mt9906\\_08e.htm](http://www.future-china.org.tw/csipf/activity/19990606/mt9906_08e.htm), accessed August 11, 2005.

<sup>30</sup> *Liang'an jingji tongji yuebao* [Cross-Strait Statistical Monthly], no. 112 (December 2001), Tables 8 and 9, <http://www.chinabiz.org.tw/chang/Eco/112-2001-12/menu.htm>, accessed August 10, 2005. We have calculated these percentages from figures supplied by Taiwan's Mainland Affairs Council.

<sup>31</sup> U.S. Department of Commerce, International Trade Administration, Market Access and Compliance, “China Trade 1995–2002,” Table 3B, March 2003.

US\$ 3.6 billion; in 1995, US\$ 16.3 billion; and in 2001, US\$16 billion (down from nearly US\$ 19 billion in 2000). During this period, Taiwan's trade surplus with the mainland represented respectively 29 percent, 202 percent, and 103 percent of the island's total trade surplus (it had been as high as 266 percent in 1998).<sup>32</sup>

The final characteristic pertains to the composition of the trade. Studies by Tung Chen-yuan and Luo Qi, which examine the content of trade according to the standard international classification code (the "Harmonized System" numbers), tell largely the same story. By 1998, the principal exports from Taiwan to the mainland were machinery and electrical equipment, plastics and rubber, base metals, and textiles — representing 79 percent of total exports. Growth was particularly dramatic in the iron and steel and machinery sectors, which grew by 93 percent and 44 percent respectively in the 1995–98 period.<sup>33</sup> In the year before accession, three of the five top exports from Taiwan were classified as electrical machinery, with "parts and accessories of automatic data machines" and chips and integrated circuits topping the list.<sup>34</sup>

The pattern of mainland exports to Taiwan was strikingly similar. In 1998, machinery, electrical equipment, and base metals constituted approximately 57 percent of mainland exports. During the 1995–98 period, certain sub-categories of machinery and electrical equipment saw strong growth as their volume increased by

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<sup>32</sup> *Liang'an jingji tongji yuebao* [Cross-Strait Statistical Monthly], no. 112 (December 2001), Tables 8 and 9, <http://www.chinabiz.org.tw/chang/Eco/112-2001-12/menu.htm>, accessed August 10, 2005.

<sup>33</sup> Tung Chen-yuan, *China's Economic Leverage and Taiwan's Security Concerns*, Ph.D. Dissertation, Johns Hopkins University, 2002, p.30; Luo Qi, "Economic Dynamism and Political Fragility: The Mainland China-Taiwan Relationship Revisited," [http://www.future-china.org.tw/csipf/activity/19990606/mt9906\\_08e.htm](http://www.future-china.org.tw/csipf/activity/19990606/mt9906_08e.htm), accessed August 11, 2005. It should be noted that, although there is a slight difference in the way these two authors use the Harmonized System classification system, their results are roughly comparable.

<sup>34</sup> *Liang'an jingji tongji yuebao* [Cross-Strait Statistical Monthly], no. 112 (December 2001), Table 3, <http://www.chinabiz.org.tw/chang/Eco/112-2001-12/menu.htm>, accessed August 10, 2005.

147 percent and 243 percent respectively.<sup>35</sup> In 2001, they represented four of the five major mainland exports to Taiwan.<sup>36</sup>

The similarity in the composition of exports to the mainland and imports from the mainland provides a clue to the final characteristic of cross-strait trade — what Luo Qi has called “the investment induced effect.”<sup>37</sup> As Luo notes, in the late 1990s

... about two-thirds of Taiwan’s exports to mainland China were actually ordered by Taiwan-invested enterprises (TIEs) in the mainland, which have to import machinery and equipment, semi-products, parts and accessories, and raw materials from Taiwan for their operations on the mainland.<sup>38</sup>

In other words, although over time, upstream and mid-stream suppliers followed industry to the mainland, while local sourcing increased, it remained the case that in the pre-accession period, the bulk of Taiwan’s exports to the mainland consisted of machinery and raw materials that were processed by less expensive Chinese labor. The finished products were then exported directly from the mainland to customers abroad.<sup>39</sup> Indeed, by the year 2000, it was estimated that 39 percent of the output of information

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<sup>35</sup> Tung Chen-yuan, *China’s Economic Leverage and Taiwan’s Security Concerns*, Ph.D. Dissertation, Johns Hopkins University, 2002, p. 33; Luo Qi, “Economic Dynamism and Political Fragility: The Mainland China-Taiwan Relationship Revisited,” p. 14, [http://www.future-china.org.tw/csipf/activity/19990606/mt9906\\_08e.htm](http://www.future-china.org.tw/csipf/activity/19990606/mt9906_08e.htm), accessed August 11, 2005.

<sup>36</sup> *Liang’an jingji tongji yuebao* [Cross-Strait Statistical Monthly], no. 112 (December 2001), Table 4, <http://www.chinabiz.org.tw/chang/Eco/112-2001-12/menu.htm>, accessed August 10, 2005.

<sup>37</sup> Tung uses the term “FDI-driven trade,” in C.-Y. Tung, *China’s Economic Leverage and Taiwan’s Security Concerns*, Ph.D. Dissertation, Johns Hopkins University, 2002, p. 42.

<sup>38</sup> Luo Qi, “Economic Dynamism and Political Fragility: The Mainland China-Taiwan Relationship Revisited,” p. 14, at [http://www.future-china.org.tw/csipf/activity/19990606/mt9906\\_08e.htm](http://www.future-china.org.tw/csipf/activity/19990606/mt9906_08e.htm), accessed August 11, 2005.

<sup>39</sup> In addition to the sources cited above, see also M.S. Chase, K.L. Pollpeter, and J. Mulvenon, *Untying the Knot: Making Peace in the Taiwan Strait*, Chapter 3 (Santa Monica: Rand Corporation, 2004) and B. Naughton, ed., *The China Circle: Economics and Electronics in the PRC, Taiwan and Hong Kong*, (Washington, DC: Brookings Institution Press, 1997), Chapter 1.

products manufactured by Taiwan companies was from companies based in China and that these enterprises were producing about 72 percent of the mainland's total information technology hardware.<sup>40</sup>

Moreover, although the quantities were not the same, mainland imports to Taiwan reflected a somewhat similar pattern. In certain higher-value-added industries, components or semi-processed goods produced in China were returned to Taiwan for finishing and export.<sup>41</sup> Ironically, this kind of activity increased during times of Sino-American trade frictions as the government in Taiwan relaxed rules on the import of semi-finished goods from the mainland so that they could enter the American market with Taiwan as the country of origin.<sup>42</sup>

In short, cross-strait trade and investment were intimately linked. Underlying the dramatic growth of trade in the pre-accession period was a related, and equally significant, evolving cross-strait division of labor, which was driven by a parallel and similarly-rapid growth of investment by Taiwan companies on the mainland, which began in the late 1980s.

At that time, the original drivers of the Taiwan "economic miracle" — the small and medium enterprises producing labor-intensive goods for export — were facing severe challenges. At home, land and labor costs were increasing and a growing environmental movement was complicating production. The appreciation of the Taiwan dollar made Taiwan products more expensive and neo-protectionist sentiment in the island's traditional export markets was growing. When restrictions on investment abroad were reduced in the late 1980s, Taiwan's business people — primarily in

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<sup>40</sup> Tung Chen-yuan, *China's Economic Leverage and Taiwan's Security Concerns*, Ph.D. Dissertation, Johns Hopkins University, 2002, pp. 42–45.

<sup>41</sup> Sheng Lijun, *China and Taiwan: Cross-Strait Relations under Chen Shui-bian* (London: Zed Books, 2002), p. 78; Steven A. Y. Lin, "Roles of Foreign Direct Investment in Taiwan's Economic Growth," in *Taiwan in the Global Economy*, ed. Peter C. Y. Chow (Westport, CT: Praeger, 2002), pp. 85–88.

<sup>42</sup> Kelly Her, "Mainland Market Alliance a Risk to Economic Health," *Free China Journal*, June 28, 1996, p. 3.

the labor-intensive “sunset industries” — began to look abroad to areas with lower production costs, more flexible environmental regulations, and larger import quotas in the developed world.<sup>43</sup> Given the cultural affinity and geographic proximity, China was a natural choice.

Indeed, the move to the mainland was made even more attractive by the orientation of mainland foreign economic policy in the late 1980s. It was at this time that Beijing implemented its coastal development strategy that was specifically intended to make the east coast of China an attractive venue for labor-intensive manufacture. Given the “push” factors at work in Taiwan, the “pull” from the mainland dramatically accelerated the movement of the island’s firms to the mainland.<sup>44</sup>

Thus, the drivers during the initial period of Taiwan investment on the mainland were industries manufacturing shoes, umbrellas, textiles, and so forth.<sup>45</sup> As the 1990s progressed, the nature of investment changed. Investment in manufacturing remained dominant at more than 90 percent of the total, while agriculture and services represented less than 10 percent.<sup>46</sup> However, the size and technological sophistication of the investments increased over time and upstream suppliers (for example, Formosa Plastics) followed their customers to the mainland and companies producing for the mainland market (such as those in the food industry) established a presence across

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<sup>43</sup> Timothy Ka-ying Wong, *The Political Economy of Taiwan's Foreign Policy* (Hong Kong: Hong Kong Institute of Asia-Pacific Studies, Chinese University of Hong Kong, 1999), Occasional Paper No. 92, pp. 17–19.

<sup>44</sup> Chung Chin, “Division of Labor across the Taiwan Strait: Macro Overview and Analysis of the Electronics Industry,” in *The China Circle: Economics and Electronics in the PRC, Taiwan and Hong Kong*, ed. Barry Naughton (Washington, DC: Brookings Institution Press, 1997), p. 98; Barry Naughton, “Economic Policy and Reform in the PRC and Taiwan,” in *Ibid.*, p. 163.

<sup>45</sup> Yun-wing Sung, *The Emergence of Greater China: The Economic Integration of Mainland China, Taiwan and Hong Kong* (Basingstoke: Palgrave Macmillan, 2005), p. 139.

<sup>46</sup> This is typical for Taiwan’s outward investment where services dominate. Y.-W. Sung, *The Emergence of Greater China: The Economic Integration of Mainland China, Taiwan and Hong Kong* (Basingstoke: Palgrave Macmillan, 2005), p. 161.

the strait.<sup>47</sup> Within a decade, there had been a dramatic change in the profile of Taiwan-invested enterprises on the mainland.

Still, the most significant development was the migration of Taiwan's electronics industries to the mainland. On the eve of WTO accession, these industries were the dominant investors, constituting 45 percent of the island's FDI on the mainland, with metals and metal products in a distant second place at 7 percent — a figure that correlates with the dominance of these industries in Taiwan's foreign trade.<sup>48</sup> At that time, 37 percent of Taiwan's information technology hardware was being produced on the mainland.<sup>49</sup>

Measuring the precise amount of investment on the mainland during the pre-accession period is difficult, although its overall magnitude is unquestionable.<sup>50</sup> According to figures provided by Taiwan, between 1952 and 2001, the government approved 24,160 applications for investment on the mainland, worth nearly US\$ 20 billion. This made it the leading destination (at 39 percent) for the island's outward investment during that period.<sup>51</sup> The larger

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<sup>47</sup> In 1995, electronics and information technology took the place of food and labor-intensive goods as the major investments on the mainland. *Free China Journal*, January 6, 1996, p. 3.

<sup>48</sup> *Liang'an jingji tongji yuebao* [Cross-Strait Statistical Monthly], no. 112 (December 2001), Table 12, <http://www.chinabiz.org.tw/chang/Eco/112-2001-12/menu.htm>, accessed August 10, 2005.

<sup>49</sup> Michael S. Chase, Kevin L. Pollpeter, and James Mulvenon, *Shanghaied?: The Economic and Political Implications of the Flow of Information Technology Across the Taiwan Strait* (Santa Monica: Rand Corporation, 2004), p. 63.

<sup>50</sup> Due to restrictions by the Taiwan government to be discussed below, many potential investors funnel their money to the mainland from subsidiaries abroad, or from accounts in third countries (e.g., the British colonies in the Caribbean). Thus, although both China and Taiwan report figures that are usually quite different, with the mainland's estimates consistently higher, both are thought to under-estimate the true amount.

<sup>51</sup> The next largest approved destination was "British Central America" with 21.24 percent. A large proportion of these funds surely found their way to the mainland (*Liang'an jingji tongji yuebao* [Cross-Strait Statistical Monthly], no. 112 (December 2001), Table 13, <http://www.chinabiz.org.tw/chang/Eco/112-2001-12/menu.htm> accessed August 10, 2005).

mainland figures claim that, from 1979 to 2001, the mainland was the destination for nearly 50,000 projects from Taiwan, with a contracted value of about US\$ 55 billion and US\$ 29 billion already utilized. As a result, Taiwan was the fourth-ranked investor on the mainland after Hong Kong, the U.S., and Japan.<sup>52</sup>

In sum, during the 1990s, there was a dramatic change in the economic relationship between the two sides of the Taiwan Strait. The former enemies had become economic partners. The scope and the intensity of the rapid development of their relationship was remarkable. Yet, for many commentators, even more surprising was the contrast between the flourishing cross-strait economic ties and the almost simultaneous deterioration in the political/security relationship. As Richard Bush<sup>53</sup> writes in a recent study:

Since the late 1980s...the story line has taken two very different paths: economically and socially, what was a no man's land is now a superhighway of cross-Strait trade and travel, while politically and militarily the two sides are locked in a stalemate of mistrust and hostility.

As we shall see in the next section, the political-military tensions surely escalated during these years. However, they did not do so on a "path" apart from the economic developments. In fact, the difference between the two was more apparent than real.

## **BEFORE THE WTO: GROWING POLITICAL TENSIONS**

Despite the lingering impact of the civil war on cross-strait relations after 1949, the two sides always agreed that the conflict was a domestic matter between two political parties within the context of one

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<sup>52</sup> Once again, the importance of the British territories should be noted. The mainland reports that the Virgin Islands was the source of about US\$ 37 billion in contracted investment, with about half of that utilized (*Liang'an jingji tongji yuebao* [Cross-Strait Statistical Monthly], no. 112 (December 2001), Table 28, <http://www.chinabiz.org.tw/chang/Eco/112-2001-12/menu.htm>, accessed August 10, 2005).

<sup>53</sup> Richard Bush, *Untying the Knot: Making Peace in the Taiwan Strait* (Washington, DC: Brookings Institution Press, 2005), p. 7.

China. As Deng Xiaoping noted in 1983, the KMT and the Chinese Communist Party spoke “a common language” (see footnote 24).

As late as the 1980s, it seemed that Chiang Ching-kuo and his KMT were still speaking the same language. Chiang upheld the notion of Taiwan’s inclusion in “one China,” affirmed the domestic nature of the relationship with the mainland, and, as we have seen, initiated a process that enhanced the economic contacts between the two sides. However, he also began a reform process that had the effect of reshaping the “central government” in Taipei into a government of the island, rather than of all of China. By doing so, he eroded the island’s ties to the mainland, thus laying the basis for a radical change in the dynamics of cross-strait relations.<sup>54</sup>

Chiang initiated a process of political reform that brought large numbers of non-mainlanders into the KMT party and government, and permitted the creation of an opposition party — the Democratic Progressive Party (DPP) — that was committed to the further Taiwanization of the government, as well as independence from the mainland. Moreover, by abandoning the KMT’s insistence that other nations and international organizations had to choose between relations with either Taipei or Beijing, Chiang began the process of establishing a separate international identity for Taiwan.

After Chiang’s death, his successor, Lee Teng-hui, continued — and even accelerated — these somewhat contradictory trends. On the one hand, the new administration spoke the language of one China, and created political institutions and a legal framework for increased dealings with the mainland. Thus, from 1988 to 1993, the fundamental legislation governing cross-strait relations was promulgated; organizations (both official and semi-official) were created for the management of cross-strait relations; the National Unification Guidelines that laid out a process for Taiwan to rejoin the mainland were established; and the thick economic ties described above

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<sup>54</sup> Steven Goldstein, “Terms of Engagement: Taiwan’s Mainland Policy,” in *Engaging China: The Management of an Emerging Power*, ed. Alastair Iain Johnston and Robert Ross (London: Routledge, 1999), pp. 57–86.

began to develop in an environment of cautious rapprochement. Most dramatically, in 1993, talks were held in Singapore between “unofficial” representatives of both sides — the first such meeting since the end of the civil war.

However, in retrospect, it is clear that this meeting represented not only the high-tide of cross-strait relations during the 1990s, but also the beginning of the end of positive developments in both the economic and political realms.<sup>55</sup> As Taiwan and the mainland edged toward the 1993 talks, the opposition, the pro-independence DPP, accused the KMT of selling out Taiwan in party-to-party talks through a new “united front.” These voices challenged the traditional KMT-CCP consensus that Taiwan was a part of China. In the new democratizing Taiwan, these voices could be neither suppressed nor ignored.

Negotiations between the former enemies in the civil war thus no longer defined the nature of cross-strait talks. The KMT was a ruling party within a developing democracy in which the nature of the relationship with the mainland was now a bitterly-contested political issue. If political progress were to parallel the economic progress, it was now necessary to arrive at a new agreement regarding the nature of each side and its relation to the other side.

As the Singapore talks approached, it was evident that although the KMT government still adhered to the principle of “one China” in name, its definition conflicted with that held by Beijing. Even though Taipei noted the mainland’s claim that “one China” was the PRC, it maintained that “‘one China’... [meant] the Republic of China founded in 1911...with *de jure* sovereignty over all of China [but] jurisdiction only over Taiwan, Penghu, Kinmen, and Matsu.” On this basis, Taipei insisted that unification would be a multi-stage process to be negotiated by two equal, sovereign entities.

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<sup>55</sup> Steven Goldstein, “The Cross Straits Talks of 1993 — The Rest of the Story: Domestic Politics and Taiwan’s Relations with the Mainland,” *Journal of Contemporary China* 6, no. 15 (July 1997), pp. 259–286; Wang Mingyi, *Bu queding de baixia* [Uncertain Strait] (Taipei: Shibao wenhua chuban qiye youxian gongsi, 1993).

By the mid-1990s, Taiwan was routinely defining itself as an “independent sovereign state since its establishment in 1912.” Lee Teng-hui sought to substantiate this claim by increasing Taiwan’s international profile through “pragmatic diplomacy” and renewed efforts to enter the United Nations. In 1999, he appeared to erode his commitment to the idea of one China by speaking of the “special state-to-state relationship” (*teshu guo yu guo guanxi*) that existed between Taiwan and China.

The reaction of the leadership on the mainland to the evolution of Lee Teng-hui’s cross-strait policy was predictable. Follow-up talks to the Singapore meeting scheduled for the summer of 1995 failed to materialize as a result of Lee’s “unofficial” visit to the U.S. Rather, the mainland flexed its muscle with missile tests close to the island — a form of intimidation repeated on the eve of the first presidential election in Taiwan in 1996. From that point on, Lee was seen as an advocate of independence, and when he enunciated his “two-state theory” in 1999, the PRC ended the tenuous political links that had existed between cross-strait organizations and declared that their renewal would require recognition of the “one China principle.”

The election of Chen Shui-bian as President of Taiwan in March 2000 and the legislative gains of the DPP in December 2001 exacerbated the situation. Because Chen and his party were closely associated with the independence cause, on the eve of his election, the mainland adopted a threatening posture. Although Chen struck a moderate tone in his inaugural address, he co-opted the KMT view that the ROC was already an independent, sovereign state; continued to refuse to accept the “one China” principle, or the consensus of 1992, as a precondition for talks with the mainland; and accelerated efforts to enhance Taiwan’s international profile. Characterizing his approach to cross-strait relations as “insincere” and his efforts to secure a separate international identity for Taiwan as seeking independence, Beijing refused any dealings with Chen or his government and aggressively sought to limit the island’s “international space.”

In short, after the mid-1990s, the two sides simply ceased to speak “a common language.” As a result, negotiations stalled and the

political relationship reached a new low point even as economic relations lingered at their apex.

Yet, economic and political policies were not entirely as separate as is so commonly assumed. The spillover of the political conflict into the economic ties was manifest in the dispute over the negotiation of direct shipping links between the island and the mainland. Despite the growing economic presence on the mainland and the wishes of many Taiwan entrepreneurs, Taipei held to its demand that direct transportation links would have to be negotiated by government representatives from each side. Although Beijing was willing to hold such talks if Taiwan accepted the “one China principle” (which it would not), the mainland proposed unofficial talks that were unacceptable to Taipei. Meanwhile, Taiwan’s business people on the mainland incurred the extra indirect shipping and travel expenses as cross-strait economics were subordinated to politics.

This very public, and often bitterly-contested, spillover of political concerns (the one China issue) into economic relations seemed an exception in the trade and investment relationship that was developing from strength to strength during these years. In fact, this was more a symptom, rather than an exception. Although lacking the visibility of the dispute over negotiations of direct links, the deep political differences between the two sides were creating a distinctive trade regime that would have to be reconciled — or not — with the requirements of membership in the WTO.

## **BEFORE THE WTO: A VERY POLITICIZED TRADE REGIME**

Almost from the inception of renewed cross-strait economic contacts, Beijing was not shy about making it clear that these policies also had an important political purpose. As Yang Shangkun, then China’s President, put it in December of 1990:

We should make efforts to develop cross-strait relations. The emphasis should be placed on economic and other exchanges in order to *yi shang wei zheng* [exploit business to exploit politics] and *yi min bi guan* [utilize the public to urge

the official]. We should lead cross-Strait exchanges in the direction to facilitate unification of the motherland and the four modernizations.<sup>56</sup>

In other words, economic relations would create a constituency for unification within the Taiwan business community. Economics would create a united front from below, as China put its “hope in the Taiwan people” (*xiwang yu Taiwan renmin*), rather than in its government. Throughout the 1990s, as cross-strait political relations deteriorated, official dialogue ended, and the issue of direct transport links remained unresolved, mainland statements sought to mobilize this constituency by emphasizing the importance of improved cross-strait relations for Taiwan’s economic health. Indeed, this message intensified (especially in respect to the economic benefits of direct shipping) as the island’s economy braced for an unprecedented decline on the eve of accession to the WTO during the 2001–2002 period.<sup>57</sup>

In pursuit of these political goals, the mainland created a regulatory framework and political environment for Taiwan’s business people on the mainland, which was both exceptionally open and supportive. Paradoxically, at a time when China’s opening to the world was still somewhat circumscribed, the privileges granted to Taiwan companies were expansive. In July 1988, the “Regulations of the State Council of the PRC for Encouraging Taiwan Compatriots to Invest in the Mainland” extended regulations pertaining to foreign companies to those from Taiwan; stipulated the types of investment that would be permitted; pledged that Taiwan Invested Enterprises (TIEs) would not be nationalized; permitted remittances abroad, and so forth.

In addition, the compatriots (*tongbao*) of Taiwan also were granted special privileges. In 1994, the “PRC Law on the Protection of Investment by Taiwan Compatriots” that was further elaborated in 1999 in the “Detailed Implementation Rules,” according to mainland

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<sup>56</sup> Tung Chen-yuan, *China’s Economic Leverage and Taiwan’s Security Concerns*, Ph.D. Dissertation, Johns Hopkins University, 2002, p. 2.

<sup>57</sup> Steven Goldstein, “The Taiwan Strait: A Continuing *Status Quo* of Deadlock?” *Cambridge Review of International Affairs* 15, no. 1 (April 2002), pp. 89–90.

commentators, was intended to ease the concerns of Taiwan's investors. These regulations covered matters ranging from tax status to the schooling of children to the protection of property to the enjoyment of equal rights with Chinese firms with respect to the purchase of materials and utilities.<sup>58</sup>

Taiwan enterprises received special privileges as well. Preferential treatment was initially accorded to Taiwan enterprises investing in the province of Fujian. In the years that followed, other provinces and cities set aside special zones for investment by Taiwan enterprises and provided added incentives such as tax exemptions, duty free imports, land use rights, and so forth — some of which were granted without the approval of the central government.<sup>59</sup> Moreover, according to mainland commentators, special assistance was provided to these Taiwan companies in matters such as obtaining loans or resolving disputes and the local branches of the Taiwan Affairs Office of the State Council were required by law to provide assistance to the Taiwan compatriots.<sup>60</sup>

To be sure, there were occasional suggestions of Taiwan business people being subjected to political pressure and of their

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<sup>58</sup> Appendix 52—"Regulations of the State Council of the PRC for Encouraging Taiwan Compatriots to Invest in the Mainland," <http://cns.miis.edu/straittalk/Appendix%2052.htm>, August 9, 2005, accessed June 2, 2006.

<sup>59</sup> Barry Naughton, "Economic Policy and Reform in the PRC and Taiwan," in *The China Circle*, ed. Naughton, p. 101; Michael S. Chase, Kevin L. Pollpeter, and James Mulvenon, *Sbanghaied?: The Economic and Political Implications of the Flow of Information Technology Across the Taiwan Strait* (Santa Monica: Rand Corporation, 2004), p. 6; Tian Cheng, "The Political Economy of Taiwan's Investments in China," in *Inherited Rivalry: Conflict Across the Taiwan Straits*, ed. Tun-jen Cheng, Chi Huang, and Samuel S. G. Wu (Boulder, CO: Lynne Rienner, 1995); Wu Yu-shan, "Economic Reform, Cross-Straits Relations, and the Politics of Issue Linkage," in *Inherited Rivalry: Conflict Across the Taiwan Straits*, ed. Tun-jen Cheng, Chi Huang, and Samuel S. G. Wu (Boulder, CO: Lynne Rienner, 1995), pp. 67–96.

<sup>60</sup> Liu Zhengtao, "Cujin liang'an jingji jiaoliu, zaofu Zhonghua minzu" [Promote Economic Exchanges Across the Strait, Benefit the Chinese Nation], in *Cross-Strait Interactions in the New Era: Challenges and Opportunities*, ed. Phillippe Regnier and Wei-wei Zhang (Geneva: Modern Asia Research Center, Graduate School of International and Development Studies, 2003), pp. 2–3.

vulnerability to predatory local officials. However, in a detailed study of the interaction between Taiwan business people and the mainland government, Tung Chen-yuan also found considerable evidence of efforts by Chinese officials both at the center and in the localities to look after the interests of Taiwan investors, and to retain their confidence during times of political or military tension (such as during the 1996 cross-strait crisis).<sup>61</sup>

Finally, the mainland's trade regime for Taiwan was intended not only to favor and nurture investment from the island, but also to keep it quite distinct from the international trade regime. Taiwan businessmen were referred to as *tongbao* (fellow countrymen or compatriots), and although they were *granted* many of the privileges of foreign business people (and sometimes treated as foreign investors), they were clearly in a different category on the mainland.<sup>62</sup> For example, Beijing refused to discuss an investment protection treaty with Taipei because such a treaty would have suggested that relations were international in nature. Rather, investment protection was, as we have seen, legislated as if it were a domestic issue, with the implication that Taiwan companies were domestic in nature.

Taiwan's regulatory framework for trade with the mainland was also shaped by political factors — of both a domestic and international nature. However, here, the orientation was the mirror image of that prevailing on the mainland. At a time when Taiwan was progressively liberalizing its trade regime vis-à-vis the rest of the world, it was seeking to closely regulate interaction with the mainland.

From the inception of cross-strait economic relations in the 1990s, the government in Taiwan was torn between a policy of restricting interactions with the mainland in the interests of limiting perceived damage to the security and the economy of the island,

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<sup>61</sup> Tung Chen-yuan, *China's Economic Leverage and Taiwan's Security Concerns*, Ph.D. Dissertation, Johns Hopkins University, 2002, Chapters 10 and 11.

<sup>62</sup> Michael S. Chase, Kevin L. Pollpeter, and James Mulvenon, *Shanghaied?: The Economic and Political Implications of the Flow of Information Technology Across the Taiwan Strait* (Santa Monica: Rand Corporation, 2004), p. 87.

and the desire to lessen political pressures emanating from the business community for a more open trade regime.<sup>63</sup> What resulted was not only a fluctuating pattern of regulation, but also, more fundamentally, a paradoxical situation, whereby a highly restrictive trade regime for the management of cross-strait trade existed alongside an apparently flourishing economic relationship.

Although Chiang Ching-kuo had unleashed the forces for cross-strait trade and investment in the late 1980s, it did not take long before the government became alarmed over the potential impact on both the island's economy, as well as on its ability to resist mainland pressures. As early as 1990, there was official concern over what came to be known as "mainland fever," and frequent warnings of the dangers of what, at that time, was a relatively small amount of Taiwan trade and investment with the mainland.<sup>64</sup> Over the next decade, these warnings intensified, culminating in Lee Teng-hui's 1996 direct response to Yang Shangkun's pronouncement of 1990:

During this year's elections, the Communists ended the close communications channel that had been established. Until now they have practiced techniques of "cold dealings" [*leng chuli*], and methods of "using the people to pressure the officials" [*yi bian bi guan*] and [to] "use business to surround politics" [*yi shang wei zheng*]...to counter this situation we must adopt the great principle of "avoiding haste and being patient" [*jingji yongren*].<sup>65</sup>

Still, although there were occasional suggestions that a constituency sympathetic to mainland demands was indeed developing, and considerable concern that investment flight to the mainland would "hollow out" Taiwan's industry or cause the island to lose its technological edge, the major worry in Taipei, during the 1990s,

<sup>63</sup> Leng Tse-keng, *The Taiwan-China Connection: Democracy and Development Across the Taiwan Straits* (Boulder, CO: Westview Press, 1996); Steven Goldstein, "The Cross Straits Talks of 1993—The Rest of the Story: Domestic Politics and Taiwan's Relations with the Mainland," *Journal of Contemporary China* 6, no. 15 (July 1997), pp. 259–286.

<sup>64</sup> Lin Ching-wen, "Mainland Fever Concern Heating Up in Taiwan," *Free China Journal*, August 23, 1990; "Political Ties in M'Land Trade," *Free China Journal*, April 16, 1990.

<sup>65</sup> Zhou Yang-shan, ed., *Li Denghui zhizheng shi nian* [Lee Teng-hui's Ten Years in Power] (Taipei: Luntan chubanshe youxian gongsi, 1998), p. 233.

centered on the political leverage through economic sanctions that the mainland would gain from the island's growing economic dependence.<sup>66</sup> In order to prevent such an outcome, the government initiated several measures to regulate and restrict economic relations with the mainland.

In 1992, the Lee Teng-hui Administration promulgated the "Act Governing Relations between the People of the Taiwan Area and the Mainland Area" that established broad governmental powers for the purpose of "regulating dealings between the people of the Taiwan area and the mainland area." Under the umbrella of this legislation, more specific regulations to govern trade and investment, such as the "Regulations Governing Permission of Trade between Taiwan Area and Mainland Area," were put into effect in order "to implement due control or administration of the trading activities" across the strait.<sup>67</sup>

Four areas were subject to control by the government in Taipei. Incoming investment from the mainland was, by and large, forbidden, as was investment by Hong Kong companies in which mainland companies held more than a 20-percent share.<sup>68</sup> Second, there were regulations limiting the movement of persons across the strait, especially mainland technicians or managers employed by Taiwan or

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<sup>66</sup> Tung Chen-yuan, *China's Economic Leverage and Taiwan's Security Concerns*, Ph. D. Dissertation, Johns Hopkins University, 2002. For another consideration of the dependence issue, see T.-K. Cheng, "The Political Economy of Taiwan's Investments in China," in *Inherited Rivalry: Conflicts Across the Taiwan Straits*, ed. T.-J. Cheng, C. Huang, and S.S.G. Wu (Boulder, CO: Lynne Rienner, 1995), pp. 153–169. For a report from the mid-1990s, concerning over-reliance on the mainland, see K. Her, "Mainland Market Alliance: A Risk to Economic Health," *Free China Journal*, June 28, 1996, p. 3.

<sup>67</sup> <http://www.mac.gov.tw/english/english/law/law1.twm> and <http://www.mac.gov.tw/english/law/en09.htm>, accessed August 19, 2005.

<sup>68</sup> As the chairperson of Taiwan's Mainland Affairs Council noted in 2001, "Currently the [Taiwan] Government in general prohibits inward investment from mainland China and approvals are only granted as exceptions on a case by case basis" (Dr. Tsai Ing-wen, "Current Cross-strait Relationship," speech to the Taiwanese Chamber of Commerce, San Francisco Bay Area, <http://www.mac.gov.tw/english/english/foreign/2.htm>, accessed August 3, 2005).

foreign companies.<sup>69</sup> Third, imports from the mainland were strictly controlled. For example, in mid-1991, imports of 158 classes of items were designated as permissible (a three-fold increase over 1988); by 1995, the number had increased to roughly 3,900 industrial products and 200 agricultural products; and in the year before accession to the WTO, approximately 5,600 agricultural and industrial items were permitted, representing slightly less than 50 percent of China's classes of exports.<sup>70</sup>

For many in Taiwan, the final area of control was the most critical: the regulation of investment on the mainland. In a manner similar to the regulation of imports, the government sought to identify permissible areas of investment on the mainland. During the 1990s, a complicated regulatory framework for the approval of individual investments, which considered the sizes of the investment, the types of companies that could invest, and the classes of investments that would be permitted, was developed. By 1994, almost half of the 9,000 types of products produced by Taiwan companies could be manufactured on the mainland, with the government noting that approval would be granted only if the manufacture of the products in Taiwan could "no longer be competitive internationally." At the same time, some investment in the service industries on the mainland was also permitted.<sup>71</sup>

After Lee's 1996 exhortation to the business community to limit its investments on the mainland, regulations were tightened, accompanied by threats of more diligent enforcement and severe punishment for violations. Thus, in May 1996, a more stringent screening process went into effect; investments were capped at US\$ 50 million (although exceptions were possible), and investments in infrastructural projects on the mainland were banned. Still, despite Lee's rhetoric and encouragement for Taiwan's investors to "go south,"

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<sup>69</sup> Allen Pun, "Visits Open to Mainland Businessmen," *Free China Journal*, August 26, 1994, p. 3.

<sup>70</sup> "Government Eases Trade Restrictions with China," *Taipei Times*, February 18, 2002.

<sup>71</sup> Deborah Shen, "Investment Channels Increase," *Free China Journal*, September 2, 1994.

the government still classified over 6,600 classes of manufactured goods that could be manufactured on the mainland — only 342 were prohibited.<sup>72</sup> Persistent demands from the influential business community for a less restrictive trade regime, as well as simple evasion, remained at odds with the government policy.

In 2001, on the eve of accession to the WTO, the administration of Chen Shui-bian tried to seize the initiative in managing economic relations with the mainland. It abandoned the “no haste, be patient” policy and replaced it with a policy of “active opening and effective management” (*jiji kaifang, youxiao guanli*), which was both a recognition of the failure of earlier attempts to regulate and a political concession to business on the eve of the legislative elections. In essence, the rules that followed from the new approach retained the principle of government regulation of investments and imports, and enhanced the “security coefficient of the economy” (“effective management”), while simplifying administrative procedures and easing restrictions on the size of investments (for example, the US\$ 50 million cap on investment size was eliminated) and on the types of projects that could be initiated (“active opening”).<sup>73</sup>

In sum, although the active and often cooperative nature of economic relations between Taiwan and the mainland provided a sharp contrast to the stagnation and conflict of the political relationship, the two tracks were not mutually independent. Although neither side totally succeeded, each sought to shape the cross-strait trade regime in a manner that would serve its respective political ends. The complex intertwining and interaction of these two strands with politics as the dominant factor was the defining characteristic of cross-strait relations as both sides acceded to the WTO.

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<sup>72</sup> Tung Chen-yuan, *China's Economic Leverage and Taiwan's Security Concerns*, Ph.D. Dissertation, Johns Hopkins University, 2002, p. 36.

<sup>73</sup> David G. Brown, “China-Taiwan Relations: Economics is Still the Story,” *Comparative Connections* 3, no. 4 (2001), pp. 64–70. For an official presentation of the new regulations, see Mainland Affairs Council, “Trade and Economic Category,” <http://www.mac.gov.tw/english/english/macpolicy/qa03.pdf>, accessed August 22, 2002.

**BEFORE THE WTO: EXPECTATIONS AND OBSTACLES**

There was considerable optimism regarding the economic potential of dual WTO membership. During the preceding decade, a foundation had been built for a close and mutually-beneficial relationship between the mainland and Taiwan. This was not due simply to the magnitude of the economic links between the two sides — their quality was also important. A cross-strait division of labor tied to often-complex production chains had emerged, even as Taiwan enterprises on the mainland established roots in the mainland's cultural, legal, and economic systems. For the most part, the existing size and quality of the economic relationship seemed to provide precisely the kind of environment that, after an inevitable period of adjustment, could thrive in the trade regime mandated by the WTO agreements. As Barry Naughton noted, the years before had seen the “close integration of production networks without any institution for fostering overall economic integration and despite significant unresolved political differences.”<sup>74</sup> The world organization could provide the institutional framework that was lacking, but the political differences would remain.

While the economic relationship that developed during the 1990s held the promise of dramatic expansion under the new trade regime, the highly-politicized trade regime that had shaped it would have to be radically reformed, if it were to conform to WTO requirements. As we have seen, both Taiwan and the PRC, by seeking to achieve political/security ends through economic means, by parallel, unilateral actions had developed regulatory frameworks for cross-strait trade and investment, that were inconsistent with the WTO and the associated agreements that they had pledged to respect.

Thus, although the lingering ban on direct transportation links did not fall under WTO regulations, Taiwan's restrictions on imports from the mainland; regulations of movement of persons across the strait; and blocking of mainland investments in the island's service industries, which had been motivated by the perceived need to limit the island's vulnerability to political and economic pressures from

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<sup>74</sup> Barry Naughton, ed., *The China Circle: Economics and Electronics in the PRC, Taiwan and Hong Kong* (Washington, DC: Brookings Institution Press, 1997), p. 7.

the mainland, were clear violations of the core principles of the most-favored nation and national treatment. Although Taiwan might have invoked the non-application clause (Article XIII) in the WTO founding agreement or used the vaguer rationale of security concerns (Article XXI), it chose not to.<sup>75</sup> These non-conforming elements remained in place as Taiwan entered the WTO.

For the mainland, the areas of possible non-compliance did not revolve around restraints on incoming trade and investment. Expansion, rather than restriction, served the PRC's interests and political goals. However, the special privileges granted to Taiwan investors or favorable treatment on imports in order to increase political capital did run afoul of the WTO's core principles of most-favored nation and national treatment as blatantly as Taiwan's restrictions. Still, although important elements in the mainland's cross-strait policy, these issues were dwarfed by the much larger question of the implications for the PRC's "one China principle" were it to deal with Taiwan within the context of the WTO either by applying its rules to cross-strait trade, or by dealing directly with the island's representatives. To recognize that the WTO agreement applied in any way to cross-strait relations would contradict the claim that these relations were a domestic issue subject to no outside interference and, tacitly, sanction Taiwan's participation in a key international organization. Yet, like Taiwan, the mainland chose not to exercise the exclusion clause or to make claims based on national security.

Thus, the dual accession of Taiwan and the PRC to the WTO presented a paradox. As the result of historical conditions, both were entering the organization against a background of promising economic relations, while still steadfastly holding to fundamental policies vis-à-vis each other which, as a condition of membership, they had solemnly pledged to eliminate from their dealings with all other members.

In the chapters that follow, the contributors to this volume address this dilemma, but they do so within the broader context of

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<sup>75</sup> Kong Qingjiang, "Cross-Strait Relations: What are the Legitimate Expectations from the WTO?" *Harvard Asia Quarterly* (Spring 2004), pp. 1–2, <http://www.fas.harvard.edu/~asiactr/haq/200402/0402a003.htm>, accessed August 18, 2005.

the more general impact of accession to the WTO on the economies of Taiwan and China.

## **OVERVIEW OF THE CHAPTERS**

In the first chapter, Tain-Jy Chen provides a survey of the domestic consequences of WTO accession for both Taiwan and China. After reviewing the accession agreements of each party, he examines the concessions in industrial goods, agriculture, and services such as telecom, insurance, banking and securities on Taiwan. In China, he examines the concessions in tariffs, quotas and import controls, trading and distribution rights, and the service industry. He concludes that Taiwan experienced no “major dislocation” due to accession. In fact, Taiwan’s industrial sectors were able to make some inevitable adjustments that would have been difficult to make without the cover provided by the WTO accession demands. To some extent, a similar process occurred in China and the perceived fears of the impacts of WTO trade liberalization were cushioned by a variety of technical measures. As has become obvious over the past four years, post-WTO economic growth continued with no major disruptions.

Connie Huang-hwa Yang reviews the domestic legal and structural changes that Taiwan had to make in order to fulfill its commitments. Similar to Chen’s analysis, she finds that the long accession process enabled Taiwan to make gradual changes that, in any case, were desirable. Examining the legal history with the knowledge of an insider, Ms. Yang explores how approaches to amending its laws were expected to be used as a precedent for future trade pacts. She also reviews the domestic consultative process for accession; the internal tensions of the administration during the accession process; and the internationalization of different agencies after accession. The role of the foreign business communities was another factor that impacted the redesign of the legal infrastructure. Finally, the chapter presents two cases to illustrate the political difficulties Taiwan has confronted after accession — the stigma attached to WTO accession due to the public’s misconception of the merits of the WTO rules and China’s refusal to treat Taiwan in the same manner as other WTO members.

In a guardedly-pessimistic conclusion, Yang writes that, for the moment, China has no intention of interacting with Taiwan under the WTO framework, but hopes that China's domestic economic growth will bring China's political conditions closer to those of Taiwan.

In his discussion of Taiwan's accession requirements and their impact on economic policy, Chi Schive looks at the extent of Taiwan's deregulation in trade and investment policies toward the mainland, notably in the commodities area. After introducing a projection of the possible economic impact on both sides of the strait of the policy changes made in accordance with the WTO rules, Schive explores the reasoning guiding Taiwan's current policies to restrict the scope of cross-strait economic ties. He goes on to examine the unilateral import and investment restrictions by Taiwan with respect to the PRC, which resulted from this reasoning, and reviews existing Taiwan regulations regarding investments in and technological collaboration with the PRC. Schive notes that, if Taiwan continued its tight control policy, real GDP was predicted to increase by 0.17 and 0.15 percent in Taiwan and the PRC, respectively, whereas if Taiwan loosened its policy, real GDP was predicted to increase by 0.21 and 0.17 percent respectively. He concludes with a call for Taiwan to continue to liberalize its trade policy in all sectors, including agriculture, which he sees as Taiwan's weakest sector.

Peter Drysdale and Xinpeng Xu use a trade efficiency and intensity analysis to look at the relative benefits for Taiwan and China after WTO accession. They find that, due to political restrictions, Taiwan has not been able to take full advantage of China's economic liberalization and, thus, Taiwan's industrial upgrading has not progressed as quickly as it could have. In part, China's pursuit of Free Trade Agreements (FTAs) on sub-regional or bilateral bases has also pre-empted many of Taiwan's own interests in these arrangements. The authors recommend a strategy for Taiwan of going "loudly and actively globalist," and including China in its liberalization strategy. Taiwan should push for liberalization in goods and services and remove trade discrimination against the mainland.

In his chapter on the political economy of cross-strait relations, Joseph Fewsmith reviews the tight trade and economic links between

Taiwan and China. He asks how such links — the “centripetal forces” of integration — might interact with the “centrifugal pulls of identity and politics” on both sides of the strait. After reviewing the benefits of investment flows for both Taiwan and China, Fewsmith looks at the impact of the investment trends on cross-strait economic and political ties. He examines the case of the steel dispute in 2002 as an example of increased cooperative behavior within an international organization. Unfortunately, as Fewsmith notes, this was the only case of a dispute being adjudicated in such a manner. However, Fewsmith’s conclusion is relatively optimistic. He contends that WTO accession has been a “boon” to both Taiwan and China, and that, within a range of politically acceptable options, amelioration of tensions could occur.

In the first of the chapters on sectoral studies, Jih-chu Lee reviews the state of the financial sectors in Taiwan and China. She notes that this sector is commonly regarded as the weakest in both of the two economies. One difference is that Taiwan has allowed foreign financial institutions equal footing with local entities, thus bringing in competition at an earlier stage in Taiwan. Lee identifies the major weaknesses of Taiwan’s financial sector as the following: too many banks; increasingly poor quality of assets; lack of innovation in service offerings; and inadequate exit mechanisms. In a cautiously-optimistic prognosis for the long term, however, she notes that Taiwan’s reform initiatives in the financial sector, such as the establishment of asset management companies, will create greater efficiency over the next few years. In a similar review of China’s financial sector, Lee finds greater cause for concern. Poor supervision, distortions of loan portfolios, higher levels of NPLs, an underdeveloped money and bond market, as well as an undisciplined stock market, remain highly problematic. She predicts an outflow of deposits, human resource problems, and increased competition from new financial instruments. All this may be ameliorated by an acceleration of financial reforms as the WTO regulations kick in. Lee also reviews cross-strait cooperation in the financial sector and offers suggestions for further integration.

Robert Ash notes that the agricultural sectors in both Taiwan and China are vulnerable to foreign competition. However, the potential costs of WTO accession are not the same for each side. In China, the

possible dislocation of millions of farmers was seen as a real threat to regime stability, whereas in Taiwan, the “age structure of its farm population, its more comprehensive social security provisions and the greater cohesiveness of its social fabric promised to cushion the impact of more intense foreign competition.” After a review of the accession requirements and negotiated settlements, Ash analyzes the implications of the accession agreements for China and Taiwan. His wide-ranging discussion of crop distribution, employment, and regional implications concludes that the significance for agricultural restructuring and intensified economic reform may be the most important results of accession. In terms of cross-strait consequences, although Taiwan’s economy has generally become more integrated with the Chinese economy, in the agricultural sector, the data are not conclusive.

Charles Trappey presents an optimistic scenario for the future of the electronics and the ICT sector. After reviewing the histories of the electronic industries in both Taiwan and China, he compares the WTO accession terms for each side. He notes that China had a longer way to go than Taiwan to meet the terms of accession, but still has made great progress. Trappey is confident that WTO accession will continue to be the primary driving force for positive trade policy changes in both China and Taiwan during the next few years.

Chwo-Ming Joseph Yu looks at the WTO’s impact on the auto sector in Taiwan and China, and examines the types of cross-strait cooperation, as well as the future prospects. Automakers on both sides of the strait have increased their links with foreign companies, but cross-strait trade has been limited due to political tensions. After reviewing the world automobile industry and the many joint ventures formed by major automakers in China, Yu proceeds to describe the market characteristics in Taiwan and China. He assesses the impact of WTO accession, examines joint ventures between automakers from Taiwan and China, and summarizes the development of cross-strait cooperation for firms in the automobile industry. Yu finds that Taiwan and China automakers have become integrated into the global automobile industry over the past few years. But, with the exception of parts trade, they have not achieved the kind of cross-strait integration once thought possible due to political conflicts.