

George Washington University  
The Sigur Center for Asian Studies  
The Elliott School of International Affairs  
Taiwan, Asia and the Global Economic Crisis  
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**Panel I: The Economic Crisis and Taiwan's Political Strategies in Asia and Beyond**

Shawn McHale: Well, I want to welcome you all to this event. My name is Shawn McHale, I'm the Director of the Sigur Center for Asian Studies and now it seems as if I've been director forever, but that's not actually true. We are proud to co-sponsor this event with the Institute for International Economic Policies. Some of you actually may have been at an event over a week ago co-sponsored with us but it's a particular pleasure to do so as, I think, many of us realized that if politics was much of the time a driver in the past, economics is a major driver both in East Asian relations as well as U.S.-East Asian relations.

One of the reasons though, even before the crisis caught our attention, one of the reasons why, I in particular was interested in focusing on some more economic issues was simply the issue of trying to situate Taiwan in a larger space. And I say this because politically and in terms of population, I mean, Taiwan is around 23 million people and then East Asia of nearly 1.5 billion and if you think of it in such terms, it does seem like a tiny island in a very large area.

If we think about Taiwan and its place in East Asia, in fact, in East Asia as a whole in economic terms, it seems rather clear that Taiwan, one might say punches way above its weight. To use the buzzword, perhaps of the recent times, has much greater footprint than many other countries. It is ranked 20th in the world, an economy of 714 billion in purchasing power parity. Its economic impact obviously is significant on the island of Taiwan but extends

far beyond that. I think anyone who, for example, has been to Shanghai, Vietnam and many other parts of Asia, realizes the significance of Taiwanese investments outside of Taiwan.

For that reason alone, actually Taiwan commands attention but particularly in these times when so much talk has been made about the global economic crisis and in particular the issue of last week we were talking about whether or not there should a G2 with other countries as well which, obviously, are in a sense a part of any economic equation, part of any resolution of such issues then Taiwan quite clearly is one of them. More specifically, what exactly is the place of Taiwan in a sense of this larger economic crisis?

We are going to have two panels this afternoon. The first one is going to have more of sort of political orientation but not always but have some economic as well, for Sigur perhaps more economic but nonetheless, they both complement each other and they both are fixed squarely on the issue of the economy whether we approach it from a political-economy point of view or an economic point of view or financial.

Without further ado, let me turn the turn the microphone over to Ed McCord, he is going to introduce the speakers for this panel. Take it away.

Edward McCord: I'm Ed McCord, I'm the Director of the Taiwan Education and Research Program in the Sigur Center and I'm very happy to be here. I'm actually very interested in this because my weakest point is actually on the economy and also political economy in particular. So I hope we're going to learn something today in coming to this.

Our first panel is really looking at the political economy of the economic crisis and Taiwan's relations with Asia -- strategies with Asia. And we have three panels. We are going to run this like a roundtable panel and just let one speaker follow after the other. We have one person, Vincent Wang is showing up, he is on his way in a car somewhere so hopefully he

shows up before too long. But our first speaker is going to be Terry Cooke who is founder of GC3 Strategy and senior fellow at the Foreign Policy Institute and that will be followed in by Kerry Dumbaugh who is a specialist in Asian Affairs and from the Congressional Research Service and then finally we'll have Vincent Wang who is associate professor of Political Science at the University of Richmond. And there is a full biography of all these people in the back. I just feel like we can save a little time for me not to read off what you can read on these longer bios. So at that point I'll turn it over to Terry.

M. Terry Cooke: Good afternoon. I hope everybody is comfortable visually and in other ways with me just staying here. Kerry and I compared notes and we thought it would promote the informality of the event. I also wanted just to commend Shawn and Ed for putting together this event because whether the topic we are looking at is Taiwan's adjustment and positioning to meet the global economic environment or as Shawn just said, situating Taiwan in a larger space, I personally believe that that is exactly the right perspective to understand both Taiwan's importance and to help define the challenges facing the U.S. administration and the Taiwan administration for moving forward.

Let me sketch out the three things that I hope to accomplish in my 15 or 20 minutes. I'm going to take a small portion of time right at the outset to broad-brush, just review with all of you what crisis we're talking about and what the regional perspective of the global economic crisis means. And so we are really adopting a timeframe of about one year looking back to September 15th 2008 when Lehman Brothers folded and taking us up pretty much to now, both globally and regionally.

The middle part of my remarks, rather than jumping right into Taiwan, I would actually like to first zoom-in to three things that are happening exactly right now which I think are key

events for understanding Taiwan's situation in a larger space, and then zoom-out quickly to a historical perspective. And then in the third and final part of my remarks, I do want to look in a granular way at what all of these means for Taiwan and its positioning and its emergence.

So first question, what crisis are we talking about? Well, we're obviously talking about a crisis that was brewing for sometime before September 15th 2008 and which manifested itself in really unprecedented imbalances that showed up in food prices during 2007 and early 2008, in unprecedented accumulations of money manifested in the emergence of sovereign wealth funds that the oil-producing countries and which the export-oriented countries of East Asia both accumulated to a startling degree. And then what happened with the Lehman Brothers' harbinger for the global economic crisis was a crisis in confidence that manifested itself in credit markets. So suddenly the ability to borrow money to buy all these things absolutely evaporated overnight.

This really represented globalization in reverse. One of the interesting byproducts of the crisis is that economies such as Bangladesh which were somewhat off the global grid, they were backwaters. They actually got through the past year of turmoil relatively unscathed. The more integrated an economy was, the more badly it was hit. And the most deeply hit economies were the oil producers, the newly emergent economies from East Europe, and the export-dependent economies of East Asia.

Now, just last week, Dubai had its own mini-crisis, and I think the takeaway lesson from the Dubai crisis is that we are emerging from phase one of the global economic crisis in reasonably good shape, better shaped than anyone really expected six months ago, because there is not a ripple effect from the localized crisis of confidence in Dubai that is ricocheting

and amplifying through other markets. And what that probably means from a global and U.S. standpoint is that we're moving into phase two of managing the crisis.

For us in the U.S., phase two probably means now that the situation has been more or less stabilized and the life-and-death crisis is probably passed, what is the fallout of this crisis? In the U.S. the fallout is jobs fallout, very high unemployment and I think as we look forward over the next year in the U.S., that preoccupation will tend to dominate things.

Now let's pivot to looking at what all these means in the East Asia Region. The Hu-Obama Summit a few weeks ago is a nice lens that crystallizes these issues and fundamentally there is a major structural mismatch that has been around ever since World War II involving the U.S. and China. And the tensions that emanate from that mismatch are some of what underlay the Hu-Obama Summit. I mean, in a nutshell to help Asia emerge from the difficulties of the postwar period, an Asian model evolved which was export-led. Taiwan has been a great beneficiary of this system. Currently, 70 percent of Taiwan's economy is export-oriented.

Japan as described in the 1980s and 1990s literature was the lead nation in the Asian formation of these export-oriented economies and this was encouraged by the West both in the '60s and '70s as a way of boosting the prosperity of an important region of the world that was coming out of a difficult period. And then from 1972 on, it was encouraged because trade was just booming globally. If one looks back at international trade performance from the period of 1972 to 2008, it is just an uninterrupted boom. And so there was enough money going around that people can afford to absorb all of these exports coming from East Asia.

That is no longer the case. I'm not a macroeconomist but I think there is good evidence that buying patterns in the U.S. market have changed and are likely to stay changed following the global economic crisis. China, however, was already causing discomfort in the global

system with its rapid rise since Deng Xiaoping's economic reforms in 1982 just because it's so big and it was essentially off the global grid entirely from 1950 until 1982. So China, once the Comecon system folded and China was rejoining the Western system, just the entry into the system of that degree of productive power and that energy, given its scale, was clearly going to be difficult to absorb. And when the U.S. consumer stops reaching into their pockets to buy goods that have been produced by a governmental system that is designed to sell to the West, it's going to aggravate what was already an irritant.

People talk about the need for China to readjust its system exports more towards domestic consumption, building a domestic safety net so that people will take their money out of their mattresses and actually kind of spend it and let it flow and get organized for productive investment. But that undertaking for China to build out a greater investment in its educational system, its healthcare system, and a social safety net of pensions, I think, really is at best a five to 10-year undertaking.

And so we're going through a short-term period where the structural pressure and friction that has been designed into the system ever since World War II is going to go through a period that's a bit aggravated. This is all manifested most clearly in the currency exchange rate discussions and it goes hand in glove with an export-oriented structure to keep exchange rates at a place that they make your exporters globally competitive. That is largely what has happened.

I will not get into pretending that I'm in the head of any decision maker in Zhongnanhai, but you can predict what the structural system requires and you can look at what happened and the two match, except for roughly a year-and-a-half long period that ended in September 2008 when the economy tanked. There was a year-and-a-half period that ended in

September 2008 where the Chinese did allow the renminbi to adjust its evaluation by about 21 percent, something significant but not enough to deal with the inherent tensions in the system. And since the global crisis, that movement has absolutely stopped, the renminbi stayed pegged to the dollar, and it has made some of these pressures more difficult.

I want to make sure that I manage time properly. One more important point is the great, kind of office pool that is going on among economists trying to figure out what China's stimulus package really means and what kind of China is going to emerge from the global crisis that we've all been through. Since there are not channels for them to push their money into healthcare, education and pensions, the stimulus from China has largely gone to making even more powerful the infrastructure of highways, factories, ports and industrial parks that has produced all these exports.

China does appear to be coming out of the global recession faster and with its engines at even higher rpm than any other nation, but the cost of them doing it in this way is that their exporters are going to be generating even more political tension because they are exaggerating this structural tension. And we're moving into a period where jobs in the U.S. are going to become the real political focus. So I'm not in any way suggesting there is a train wreck coming but I am suggesting that there are serious and as yet unaddressed structural tensions that are just getting more and more tense.

Okay. Last comment on the regional picture is -- of course, before going to Beijing, President Obama was in both Singapore where he got an earful from Singapore's Senior Statesman Lee Kuan Yew, about the United States being distracted, not focusing on the economic game going on in Asia and possibly missing the boat on economic growth, not championing the free trade system, and then he went on to Korea and made encouraging verbal

noises about completing the free trade agreement with Korea which like the free trade agreement for Colombia has been negotiated and approved but not yet ratified by the Congress.

The difficulty with making those noises is that it's not in the president's control to ratify it and it's in the Congress. And given the pressures on the U.S. auto industry, the role of some key states like Michigan, pressures on the Democratic Party base that have to do with healthcare and Afghanistan, the chances of getting Congress to move when the job situation is deteriorating are pretty remote. So that will play back on the third part of my remarks.

I need to pick up the pace but the three key events that I'd like to draw people's attention to are last week's devaluation of the Vietnamese dong by 5 percent. What this indicates is that countries are starting to take a hard-nosed approach to keeping their industries vibrant because one country devaluating their currency tends to push other countries to doing the same thing. Thailand has been quite reactive to what the Vietnamese did. Now the U.S. and the EU are not going to be likely and they're not in a good position to be playing games with their currencies but that creates a space for other countries to get a short-term advantage by devaluing their currencies. And I'll stop there.

The second recent event that I'd like to just highlight is kind of a tiny little subtext of President Obama's remarks last night about Afghanistan. China is going to be a very interested listener and parser of that speech because from China's point of view, they have an Eastern Coast which is First World and it's supported by three major axes of economic development, the Pearl River in the South, the Yangtze River in the middle part of the country and then the Bohai area to the north.

The other major axis of China's planned growth is Chongqing in the west but the only way to move the energy resources to fuel that growth are not by transporting it in 6,000 miles



from the east. There have to be links from the interior of the country down to places like Afghanistan and their deep water port, Gwadar, in Pakistan to get the resources to fuel the growth in the west. And with some degree of balanced growth in the west, China is looking at unbalanced economic development nationally and potentially social unrest. So there are important stakes that China has in what's going on in Afghanistan. China has the largest copper mine, I think, I may not be right on this but it may be one of the largest copper mines in the world in Afghanistan.

All right, then the third and last event that I wanted just to reference briefly is on January 1st 2010, a China Free Trade Agreement with the ASEAN countries comes into effect. That is kind of a game changer for Asia in the context of a stalled Doha Round of the World Trade Organization. And for reasons that I just kind of ticked off politically, there is not a lot of reason to expect in the short term that the U.S. and the Obama Administration are going to seize the leadership mantle in getting things going with Doha. It has to do with the Democratic base and a new young administration and preoccupations with healthcare and Afghanistan. But the ASEAN-China Free Trade Agreement covers a lot of economic strength but it's a regional quasi-bilateral trade agreement that leaves a lot of people out. And it's the type of thing that happens in the absence of a broad WTO-sponsored multilateral arrangement.

So with that, I will pivot to the third and its last and accelerated portion of my remarks which is just looking at given all of these dynamics in the larger space, globally and regionally, where is Taiwan right now? Well, Taiwan is in a very interesting place. Taiwan, as mentioned, was hurt badly by the global economic crisis and to the extent that Taiwan has been emerging from that crisis, it has largely been on the back of higher growth rates in Asia than elsewhere in the world and closening [sounds like] economic and commercial links with China.

The specific path forward for Taiwan has been through the ECFA negotiations - the Economic Cooperation Framework Agreement - which I somehow find myself writing about a lot, so if anybody is interested I can bury you in detail on that process but it's essentially an FTA-like bilateral agreement proposal between Taiwan and China that is adjusted to take into account the sovereignty concerns that Taiwan has vis-à-vis China and which China has vis-à-vis Taiwan.

Now a word of background to make sense of the ECFA, at least my individual interpretation of ECFA, is you have to look back to the 1990s when Taiwan's economy boomed through its participation in the IT boom. The global strength of Taiwan's industry, developed through light industry, bicycles, footwear, but the sweet spot of Taiwan's economy has been, ever since the 1990s, it is fighting above its weight in global IT. And being a partner to the U.S. and Japanese advanced technology and being the manufacturer of choice that protects intellectual property rights and can help with the production of IT on the Chinese Mainland.

That has been the part of the economy that, to some degree, has been forcing political normalization between Taiwan and China. The global supply chain, you know, runs from Silicon Valley and the Austin, Texas Corridor and all of these places, really through Taiwan and then across the Strait of Taiwan and into Suzhou and Kunshan and all of these production centers. It is a single supply chain that represents a huge amount of industrial value. And it has really been that way and it has grown ever since the early 1990s with Taiwan's golden years.

The current moment, if we look back to September 15th 2008, is that Taiwan and China had both gotten into the WTO as of, I think it was January 2001, and that was good as a confidence building measure for both countries but they had learned over the following six

years that the WTO was not a forum where they could address their own issues with each other. And so their interests have become very deeply meshed commercially and economically because of the global IT supply chain and then with the downturn in September 2008 they needed to do something to respond. The circumstances were okay politically because the Ma Ying-jeou KMT government that came into power was less problematic from Beijing's point of view than the previous Chen Shui-bian DPP administration. And so the ECFA has become the way for Taiwan and China to expand the normalization of their commercial relationship beyond just IT.

The ECFA does not hold out much improvement in terms for the IT industry. Tariffs are already incredibly low. I think for most IT goods it is like 0.58 percent tariffs. You cannot lower that too much. But in more traditional areas of the economy that have been kept apart because of political antagonism, the ECFA does represent something quite important.

And so my final point and I will conclude with this, it's really a question that I expect other panelists will address and perhaps we can explore it in Q&A. There have been some limited political dividends out of this economic and commercial process already for Taipei. It's not just buying missions from China that have spent several billions of dollars, it's also admittance of Taiwan into the World Health Assembly, the fact that the tug-of-war and checkbook diplomacy wars in this political space have kind of ended. The question is what other political dividends can be yielded by this economic normalization process and how will the U.S. respond?

There is an opportunity for the U.S. to reward both Taiwan and China for what have been, in my estimation, economically necessary and economically astute moves to broaden the normalization of their relationship. Where will that lead? Can Singapore follow the conclusion

of the ECFA between Taiwan and China with a free trade agreement with Taiwan so that Taiwan is not marginalized by these bilateral trade agreements, and can the U.S. recognize and support this process or will the U.S. be distracted by nuclear proliferation in North Korea and problems in our own backyard? Thank you very much.

Kerry Dumbaugh: I'm Kerry Dumbaugh and before I start maybe I should lean back and give Vincent and Terry a chance to say hello to one another. I also want to thank Shawn and Ed for inviting me to speak at this panel and I want to thank Deepa and Erin also for chasing me down with emails and everything that they've done for me.

I was told what panel I was going to be on and I was given the topic and then I was told that really I could kind of talk about anything I wanted. That's always dangerous when it comes to a panelist especially since I'm not an economist and I do work for the Congressional Research Service which is a non-partisan, objective, think-tank for Congress so I don't speak for any member of Congress. But I'm also sitting in a room filled with Taiwan experts some of whom have forgotten more about Taiwan than I will ever know, so it's always a daunting task. So I've decided to really talk about three areas just for some food for thought for discussion later.

First, just the Obama Administration's approach to Taiwan policy, I'll just briefly sketch out what that is. Second are kind of the potential consequences for Taiwan's political strategies in Asia and around the world, the potential consequences that the global financial crisis has given us, things to kind of watch for, to take the temperature of how things are going. And finally, what some of the policy consequences are for the United States.

First, we all know in this room what the fundamental framework for U.S.-Taiwan policy is. It's the three communiqués. It's the Taiwan Relations Act. We've had policy continuity

for 30 years now, but anybody who has been watching Taiwan and watching U.S. relations with Taiwan over the last 38 years knows that even in the midst of this policy continuity there can be nuance.

In fact, I was just listening to a conversation a few minutes before the panel started where there was a vigorous discussion going on about what word Hu Jintao used in his statement and whether the Chinese word and the English word, you know, how it was translated, so these are the kinds of minutiae of U.S. policy toward Taiwan and there has been nuance in this. We've had movement and nuance during the George W. Bush administration, a move away from strategic ambiguity toward what some people thought was a little more clarity. We've had various minute changes and adjustments and -- please don't write that, Walter, because one formulation of the U.S. One-China Policy, a different word is used to different emphasis. The formulation has changed a little bit.

We've had dramatic political and economic changes in both China and Taiwan and these have had very substantial consequences for policy and we've had substantial improvements in cross-strait relations, improvements that ultimately could change the entire character of U.S.-China-Taiwan relations. And we're still at the beginning of these changes but you can kind of look out and see what some of the potential consequences are.

Given all of this policy continuity, even in the midst of these shaded nuances, it's nearly inconceivable to anybody who knows anything about U.S.-China-Taiwan Policy that the Obama Administration would do anything other than tread the well trodden path of U.S. policy on Taiwan.

Still, there are some potential changes that the Obama Administration could be facing. We saw in the Obama-Hu Summit that Terry alluded to that the focus really is, "it's the

economy stupid.” It's that focus that the administration has on China and on Taiwan and the global financial crisis really, its causes and its consequences really could change the entire global debate in substantial ways.

The challenges that Obama faces with respect to Taiwan, just a series of questions and from my vantage point it's not only easier but certainly appropriate just to raise questions and not to answer them so we can perhaps try to answer them in the question-and-answer section: what U.S. policy should be toward Taiwan if Taiwan continues to move closer to the PRC economically and the political implications for that that Terry also alluded to; what economic policies the United States should pursue toward Taiwan in the aftermath of the global financial crisis? The financial crisis showed us some real vulnerability in the global economic system and there may be policy choices that the United States would want to make in light of that. What should be the administration's policy on new arms sales to Taiwan and on defense assurances to Taiwan given this greater economic interconnectedness that Taiwan is having with the PRC? And what role, if any, the United States should play in cross-strait relations? There is a debate on that. Should the United States become involved? In the past, the United States resolutely wanted to remain uninvolved but with the 30 years that have passed since our Taiwan policy was really initiated, is it time to kind of rethink that and play some kind of more active role?

I want to talk about the potential consequences that are worth keeping in mind, I think, consequences of the global financial crisis for Taiwan's policies and maybe its view of itself even. And consequence number one, I think that in the aftermath of the crisis, now this is my opinion only, I'll lay this out for discussion later, but the crisis has the potential for helping to

foster a new appreciation in Taiwan and perhaps even a new humility about its - Taiwan's - global interconnectedness and thus its global economic vulnerability.

In the past, Taiwan's economy was steaming along, the global financial crisis, as Terry said, hit Taiwan very hard and I think we have to watch out for the extent to which this might cause Taiwan to reassess what is in its own vital interests. Taiwan's elected administrations up through the Chen administration were able to focus a lot on political, ideological issues on diplomatic recognition around the world, keeping and holding, trying to expand Taiwan's diplomatic relationships on World Health Organization and UN membership. That was in an era when -- in the past. And what I think we should watch out for is the extent to which this new vulnerability of Taiwan in the global economic system might change and be changing those political calculations.

Second, the global financial crisis imposed, as Terry said, again imposed really a huge cost on Taiwan, moved economic issues up front and center, really have taken a new pragmatization, if that's a word, Taiwan leaders are being called upon to make. So we have to look and see what consequences, potential consequences for Taiwan's choices that fall out of those issues from the global economic crisis have. The analogy I would bring up is not quite similar but Hong Kong in 1997.

As we watched Hong Kong, the clock ticked up toward 1997, Hong Kong's economy was booming. It was in an economically strong place. We thought that any changes, any difficulties that Taiwan faced would come from political disruptions after the 1997 handover. I remember writing a paper saying that and then what happened? It was the Asian financial crisis. It was bird flu, chicken flu. Suddenly we were talking about economic difficulties and economic problems as a consequence partly of globalization.

So that's the first consequence that I think we should keep in mind as we look at Taiwan's choices in the future. The second consequence, and Terry also alluded to this, I think you can argue that the global financial crisis provided an additional incentive. Maybe you might call it an additional argument for Taiwan's leaders for closer and more formalized economic relations with the PRC and with the region. Obviously this was a goal of the Ma administration coming in before -- even when he was a candidate, before the global economic crisis really hit but I think the crisis has emphasized the degree to which Taiwan's economic interests are vulnerable to these global trends and resulting cross-strait tensions or improvements have lowered tensions and they're seen as having brought a new stability to the region. U.S. government officials have had very positive things to say about these cross-strait ties.

But you can see also a self-serving -- self-interest, no, I don't use self-serving in a bad way. Every country acts in its own interests. But I would argue that Taiwan can now see the need for or has a renewed appreciation perhaps for maintaining its competitive advantages where those exist and for regaining economic momentum that it has lost as a result of the global financial crisis. And one way to do this is to harness itself more closely to the PRC economy, the economy that is still a driving engine certainly in the region.

From a regional standpoint in the global economic dance party, if we could call it that, the prom of the global economy in the region where there are bilateral and regional free trade arrangements and agreements being signed, Taiwan's dance card has remained relatively empty through all of this. They're sitting on the sidelines of these arrangements and I think, again, the global financial crisis and these trends are moving or likely to move. We should watch to see if they move Taiwan more in this direction especially on the first of next month as Taiwan sitting



on the sidelines watches the PRC and ASEAN whirl off on the dance floor to another piece of music. I'm overusing this analogy, but you know what I mean, that there are benefits to be had from global economic integration and for perhaps downplaying or they have political consequences but not focusing purely on politics.

I think it's also possible to suggest that the global financial crisis, and I wouldn't put too much of an emphasis on that, I think it's just one piece of the puzzle, these trends toward regional and bilateral free trade arrangements, the global financial crisis, globalization itself, the growing awareness that we're all in this together. These have set the stage for perhaps altering the definition and the traditional perception of what is sovereignty and what is in a country's sovereign interest. It doesn't end at the water's edge anymore. It's a global interconnected world and so to watch again a longer term trend, watch the extent to which this might create a consequence like that.

The third consequence is the extent of the global financial crisis to be another in a series of events that are influencing and perhaps changing how Taiwan relates to the United States and how Taiwan-U.S. relations play out. Clearly, Taiwan is seeing its economic interests more in line with PRC economic interests but also the United States plays a key part in this, Taiwan's view of its international role in the world. Terry mentioned intellectual property rights. Taiwan in fact was taken off the Special 301 list because of its incredible improvements in protecting intellectual property. On January 16th, USTR announced that Taiwan was being removed from the list so Taiwan has already been moving into this global economic identity. Taiwan is also seeking to get into the U.S. visa waiver program and seeking a free trade agreement itself with the United States to revitalize TIFA talks at the very least and to move toward an FTA at some point in the future.

The fourth consequence and it's one, again I'm not speaking for Congress, but I would look at the role of Congress. I was having a discussion with Gareth [phonetic] about this earlier this afternoon. We know what U.S. policy continuity is for the executive branch and for the White House. It's really fairly seamless and just plodding along with very much the same kind of continuity. But events are changing. Events in Taiwan have changed, global events are changing and there are times when the U.S. Congress has acted more forcefully when it sees or feels the administration is out of step somehow with the events that are motivating Taiwan.

The U.S. Congress has become more active in acting both on behalf of Taiwan and in some cases being critical of Taiwan. So I would look at the role of Congress if the administration and the executive branch do not seem to be -- if the perception is that the global financial crisis and these world events require some kind of a different policy response or some kind of a more assertive action by the United States then you can possibly find that out by watching what Congress is doing and what hearings Congress is holding, what bills Congress is introducing.

All of these things that I mentioned have policy implications and political implications. It's not just an economic phenomenon and these things raise crucial questions for U.S. policymakers in both the near and longer term future. One of those is that given the global interconnectedness and the difficulties that developed economies have suffered from it, should the United States reassess its economic policies toward Taiwan? Is there a sense that the United States should act as some counterweight perhaps to growing Chinese economic influence or should the United States really look more carefully at a free trade agreement with Taiwan?

Should the United States take into account in its economic policy planning Taiwan's growing interconnectedness with the PRC? What impact for instance would and ECFA have on U.S. economic interest with Taiwan? What kind of consequences would there be and policy implications of such an agreement? How close - this is a question some are asking - can Taiwan and PRC relations get before there's some suggestion in the United States or a move that we really need to fundamentally reassess our policy?

Does global interconnectedness make it easier for The United States to argue that Taiwan needs to participate in international organizations? If the global economy is so interconnected, really shouldn't Taiwan be more of a player and has that strengthened the U.S. hand in making those kinds of arguments? And finally, the implications that closer Taiwan-China interactions would have for U.S. arms sales policies under the Taiwan Relations Act, is it feasible or appropriate for the United States to maintain a policy to sell arms to Taiwan when Taiwan's own perception of its own interests may have changed?

Those are the kinds of difficult questions there are that are lurking out there in the post-global financial crisis world and we can discuss that in the Q&A because if anybody has answers to those I have several members of Congress that would be delighted to get a phone call from you. Thank you.

Vincent Wei-cheng Wang: Good afternoon. It's a pleasure to be at George Washington University and I apologize for the Beltway traffic in the ring. But anyway, I feel very honored to follow Terry and Kerry. They both are experts and I learned a whole lot and I'm also glad that our talks actually complement one another.

What I would try to do is to talk about Taiwan's international strategy amidst economic crisis, particularly the economic imperatives and the security concerns of ECFA which Kerry

already started talking about. But before I do that, I just want to sort of set the stage by arguing that political scientists and economists have often described Taiwan's overall development strategies as export-led growth or ELG.

This ELG I would say has always been very important to Taiwan's prosperity and security. The prosperity side is very obvious because people know that Taiwan was one of the so-called four dragons. Its economy grew very fast in the 1960s and the '70s, '80s because of the demand in the international markets and it seems that China is also emulating this export-led strategy.

But on the security side the importance of the ELG has not been mentioned very much. That is to say that for Taiwan which was small and diplomatically isolated the ELG strategy provided Taiwan with the external links to its major markets and the technology sources and this has what economists would call the security externalities.

Let me explain. Of course, the most important external economic links for Taiwan were in the past with the United States, Japan and now we are debating about China. So these three countries are most important. What do I mean by the security externalities of Taiwan's export-led growth strategy?

Because Taiwan is a very important player as a world manufacturer/exporter particularly in certain commodities, the international community might intervene in the event of an armed conflict. A few years ago Craig Addison published a book called the *Silicon Shield*, that's the same idea that in 1999 there was a devastating earthquake in Taiwan which caused disruption of the Hsinchu Science-based Industrial Park. The global semiconductor industry felt the pain for several weeks so the logic was that because of Taiwan's importance in

certain key commodities in our daily life that if there's an armed conflict involving Taiwan that the international community might intervene out of self-interest.

The second aspect of this externality of Taiwan's export-led strategy, particularly with respect to China is actually it presents a kind of economic mutual assured destruction. Pardon me for using the jargon, mutual assured destruction, MAD, was often used in the discussion about nuclear weapons but I would argue that in this case there's an economic MAD. It's the following. Before that the relationship between China and Taiwan was purely conflictual but right now there is economic interdependence so China cannot hurt Taiwan without hurting itself.

This is why in 1996 even when China launched a missile test against Taiwan, the Chinese leaders went in great pains to "assure" the Taiwanese investors that your investment in China are safe so they're trying to decouple the two. And also previously, there was no constituency in China in favor of better relationship or continue a stable, normalized relationship between China and Taiwan. They want to liberate Taiwan and so on but today I think that there are actually plural forces in Taiwan. Some forces can be said to favor the continuation of normal, stable relations with Taiwan, talking about the governors of coastal provinces and so on. So there is a divide between Guangdong and Shanghai on the one hand and say the hawks in Beijing on the other and this also will probably restrain China's military options.

A third aspect of this externality is what the scholar Steven Chan of University of Colorado, Boulder called credible signals. He argued that despite all the noises in Taiwan, in the cross-strait economic relations in the past eight years during the Chen Shui-bian administration that the fact that the cross-strait trade and investment continued to expand was a

reassuring credible signal to China that Taiwanese actually wanted to have good and stable relationship with China so basically money can speak.

So the export-led strategy was very important to Taiwan's security but I would also say that the export-led strategy has condemned Taiwan's economy to the world economy. Basically it follows the cyclical patterns. In one sense, it is very vulnerable to the fluctuation in the demand of major markets. Recession in the major markets caused the weak demand on important exports from Taiwan such as semiconductors, information technology and the petrochemicals and so on.

So you can see from this chart that -- this is by the way, of course we know that President Ma Ying-jeou assumed power in May 2008 and the economic story of that had been pretty bad for the Ma administration. I mean it's hard to blame Ma but there's obviously an international factor in there but the point is that Taiwan's economy for instance last quarter of 2008 dropped about nine percent and the first quarter of 2009 dropped about 10 percent and the second quarter of this year dropped about 7.4 percent. In fact Taiwan's economic performance has been affected the most compared to Singapore and South Korea, the other two tigers and so on.

So in this context we need to understand why the Ma administration wants to promote ECFA and I will comment on the pros and the cons of ECFA. However, although Taiwan's economy is very vulnerable to the cyclical patterns in international markets, Taiwan suffers another problem which is its exchange rate policy. Taiwan dollar is essentially pegged to the U.S. dollar and as you know the U.S. dollar for the last couple of years has been weak vis-à-vis other currencies such as the euro and so on. So as a companion to the U.S. dollar, Taiwan did not benefit from the export competitiveness that will come with devaluation.

And furthermore, China's currency was also pegged to the dollar so it's kind of a double whammy, if you will. However, Taiwan is still very strong in manufacturing and Taiwan has a very conservative monetary policy, that is why I think Taiwan will not suffer the kind of fate that happened to the Celtic tiger Ireland which at one moment all the money came in and then all the hot money left and left the Irish picking up their bags. That will not happen to Taiwan. In other words, manufacturing is still very important. What the difference is that what used to be made in Taiwan is today made by Taiwan because a lot of the manufacturers, thanks to globalization, have actually moved to China and Taiwan has also tried with some success moving up the global value chain.

As I said, one of the Ma Ying-jeou administration's rationales for promoting ECFA is to provide the economic stimulus needed, much needed by Taiwan's troubled economy. However, that's only half of the story because as you can see China is actually Taiwan's number one export destination accounting for about 26 percent of Taiwan's exports or if you also include Hong Kong, that percentage is up to 31 percent. And China is the workshop of the world so when the major markets such as the United States slow down, the demand for Chinese goods will slow down which in turn will cause weaker demand for Taiwanese exports to China. And this is why the exports to China actually have not helped Taiwan in the last couple of years.

The domestic gross product, I already mentioned earlier, is the same story there. Taiwan's unemployment rate which used to be sort of the envy of most countries sort of growth with equity but the economic hard time has also caused unemployment to go higher. The overall story is not a pretty one and therefore the crucial question is what are the solutions and in particular is ECFA the solution or the most important solution.

When we talk about ECFA we need to basically talk about the rising regionalism which Terry talked about. And this chart basically shows you that the emergence of the regional trade agreements or RTAs was essentially a post-Cold War phenomenon. There were basically two cold wars, not only there's a military diplomatic confrontation but in fact there was an economic confrontation as well. So of all the RTAs reported to the WTO, about over 80 percent were actually signed after 1990.

So basically it's a catch up phenomenon. And as you can see from this chart, the data from WTO, and this will give you 2000 and 2005. In 2005, 67 percent of all the trade in Western Europe, among western European countries, happened under the RTA framework, basically preferential trade agreements. This is obviously the most integrated region and from here to Asia, it's only 16.2 percent and barely five years ago, Asia's RTA trade was only 5.6 percent of all intra-Asian trade.

So even though there is a 300 percent jump, I think comparatively speaking, Asia is still a latecomer. And of course as Terry mentioned that the new story now is China and China has been very active in this regard. So I already alluded to this, everybody is doing that. China is doing that and Taiwan cannot afford not doing that. This is a reason my Ma Ying-jeou is pushing for this. And in fact a lot of people talk about sort of the regional trade, it's like a spaghetti bowl and the concern is that if Taiwan does not join the spaghetti bowl it might be marginalized.

And this chart shows you the progress of trade agreements of major Asian countries. The left-most column is the number of agreements in force, not only signed but also implemented and then signed, in negotiation, evaluation stage and so on. As you can see, the



most active tend to be small countries like Singapore, Thailand and so on but the two giants - the elephant and the dragon - are also pretty active. India and China are also pretty active.

And Taiwan is here. Taiwan has only four RTAs in force. You might wonder who they are and they turned out to be Guatemala, Panama, El Salvador and several -- basically four countries, four of Taiwan's diplomatic allies in Central America. And the two that are being negotiated are the Dominican Republic and Paraguay. I think I already sort of alluded to the story about Taiwan's FTA endeavor here. And Taiwan is not a leader in RTA. In fact, we know that this is precisely the concern that if Taiwan does not join the train, the train might be leaving without Taiwan.

Now, Hong Kong, interestingly enough has only one RTA and everybody knows what that is. That is the CEPA, the Closer Economic Partnership Agreement with China. And this is another reason why some people in Taiwan are very concerned because they know that China is interested in the CEPA-like agreement with Taiwan and therefore downgrading Taiwan's sovereignty and Taiwan may be relegated to the fate like Hong Kong. And interesting enough, Hong Kong is also negotiating the free trade agreement with one country, and I will let you guess which one that is. Any guess?

Male Voice: [Inaudible]

Vincent Wei-cheng Wang: No.

Male Voice: Taiwan?

Vincent Wei-cheng Wang: No. Hong Kong cannot sign an FTA with Taiwan without the approval from Beijing.

Male Voice: [Inaudible]

Vincent Wei-cheng Wang: It's New Zealand. So as you can see, the point is that Hong Kong did that with Beijing's blessing, so that's a key point to remember. And China is very active, South Korea is active, Japan is kind of catching up. Japan also signed an FTA with ASEAN countries and so on. So the first reason is that everybody is doing that and in Taiwan's case, the argument for and against ECFA are the following -- there are basically two kinds of reasons for ECFA. One is defensive, the other is more proactive.

On the defensive side, Taiwanese policymakers argue that ECFA is needed because even though Taiwan joined the WTO, the kind of economic United Nation if you will in 2002, but the kind of trade breakthrough or diplomatic breakthrough did not actually quite happen. So signing ECFA is like a plan B. As a matter of fact, in the world today, there is a prevailing gloom, pessimism about the future of the multilateral trade because of the impasse of the Doha Round. If multilateralism cannot proceed so let's have a second best which is bilateral or regional.

A second defensive reason is actually to prevent Taiwan's marginalization. Of course in the region everybody understands why but I would also argue the argument for preventing Taiwan's marginalization also includes Taiwan's substantial economic stake in the Chinese domestic market. Actually Taiwan is China's third largest import sources and everybody have already mentioned that on any given day there's about five percent of Taiwan's population living and working in China and Taiwan's trade with China now exceeds \$100 billion and who knows, perhaps over \$100 billion in cumulative investment had been sunk in China. So in other words for the Taiwanese working in China, if they cannot benefit from the most-favored-nation treatment that other Chinese trade partners enjoy, they will be at a disadvantage.

And thirdly - this is actually a very important point - Taiwanese to sign ECFA with China to offset the negative impact that ASEAN Plus One or ASEAN Plus Three might bring to Taiwan. ASEAN Plus One refers to the free trade agreement between ASEAN and China which as Terry mentioned will go into effect January 1st, maybe a few days from today.

ASEAN Plus Three refers to the free trade agreement that is currently being negotiated or evaluated among ASEAN and China, Korea and Japan. I want to show you a chart, some economists in Taiwan have used this model to estimate the impact of ASEAN Plus One and ASEAN Plus Three on Taiwan's economy and the upshot is that it will have a negative impact on Taiwan's economy ranging from GDP, export, import, terms of trade, trade surplus and social welfare and so on.

But also compare these two tables, the real challenge for Taiwan is not ASEAN Plus One although some proponents in Taiwan have argued we need to do this because otherwise ASEAN Plus One will put us in a very disadvantageous position. The real challenge is actually ASEAN Plus Three. As you can see the negative impact of all columns in the bottom table are greater than the corresponding figures in the top table. The reason is very simple because ASEAN Plus Three includes South Korea. South Korea's economic structure and export structures overlap that of Taiwan very much. So ASEAN Plus Three or a China-Korea free trade agreement will actually put Taiwan at a severe disadvantage. So my point is that the Ma administration's argument about ASEAN Plus One is not entirely the story but we should really worry about the ASEAN Plus Three particularly the impact of Korea's signing free trade agreement with China.

And so this is sort of a defensive standpoint. There's a very good argument for Taiwan to sign ECFA with China but there are also positive reasons. One is that as I've mentioned

China now is Taiwan's largest export market. Well, obviously the economic benefits for signing a free trade agreement with your largest export market is very obvious because your exports will face less tariff and so on. And also the PRC is Taiwan's most important source of trade surplus. Overall, Taiwan still enjoys trade surplus worldwide but that derives primarily from its trade with China. Without the trade with China, Taiwan will actually run a severe trade deficit.

A third reason, sort of a good reason for Taiwan's ECFA with China is actually to expand Taiwan's international economic and trade space because this might alleviate some countries' concern particularly if they are worrying that China may react negatively to their negotiation of free trade agreement with Taiwan and then this country can say that cross-strait relations have now improved and even China, you, are signing a free trade agreement like the agreement with Taiwan, why can't we. And the most exemplary country in this regard is actually Singapore. I think Singapore is actually itching now.

And finally, with the improvement of cross-strait relations, the direct air links and so on and the improved trade relations and lower trade barriers and so on, maybe Taiwan will be closer than ever to become a so-called Asia-Pacific regional operation center. Remember a few years ago Taiwan talked about this and everybody thought that was a pie in the sky because without direct air links, it's not possible and that kind of a plan actually died silently. But I think that with the cross-strait trade, the air links and so on, this might be revived again and that will actually give Taiwan a renewed economic vitality.

However, not everything is free. Of course there are security concerns, sovereignty concerns. As people said the devils are in the details. Right now we don't know a whole lot about the details and as people also point out that it's a framework agreement. It's very

different from earlier generation of free trade agreement which is that we have dotted every line and then we sign an agreement. A framework agreement is that we will talk and we will gradually add into that so like accretion.

And also I think that it's very important to know that some people in Taiwan and outside Taiwan are really concerned that ECFA may start to roll toward economic unification and economic unification may start to roll to political unification or at least will reduce Taiwan's political options. And in Taiwan because it's a young democracy, there's a lot of partisan feuding that this aspect is particularly causing a lot of concerns and some people also charge that the negotiation so far has not been transparent enough.

Well, as anybody who has done trade agreement, you know that you have to kind of strike a balance between the democratic accountability which favors transparency and expediency which favors secrecy, but in this case I think too much expediency and secrecy given to the Ma administration in fact will exacerbate all the problems I just mentioned in Taiwan. In sum, Taiwan cannot put all the eggs in one basket.

ECFA cannot save Taiwan's imminent fire with distant water [speaks in Mandarin] but I will say, ECFA is not the magic bullet for Taiwan but I think it will help somewhat but at what price. One could argue that, as I mentioned before, Taiwan's economy is so cyclical, according to the world market, maybe economic rebounds will naturally occur without ECFA. In fact most of the -- [audio abruptly ends]

**[End of file - GWU Sigur CD 2 12-2-09 Taiwan]**

**[Start of file - GWU Sigur CD 3 12-2-09 Taiwan]**

[Note: One of the panelists has a thick foreign accent which makes it difficult to understand some of their words or comments.]

Vincent Wei-cheng Wang: -- to sign free trade agreements with Taiwan even if the United States find it politically impossible at this moment to sign FTA with Taiwan, but at least should encourage these other countries or at least not stand in the way to prevent, to basically side with China on this issue. So as I said, there's no magic bullet. ECFA has a lot of potential but also caused a lot of concerns. Thank you very much.

Edward McCord: Each of the speakers have covered so much territory today that I really was very reluctant to step on them when they went over their time limit. And as a result, we have like three minutes left for questions and we have to get the other panel set up. You just want to skip the questions and --?

Male Voice: No.

Edward McCord: Okay, so but quick questions, right? Identify yourself and a quick question, we'll do a couple. Yes?

Shih-chung Liu: My name is Shih-chung Liu from Brookings. I have a quick question for Dr. Wang. It seems the project of more relatively positive view that once the FY is signed and the Chinese may allow Taiwan to inaugurate or at least some country from Asia might talk Chinese into accepting Taiwan signing some sort of a free-trade agreement with them, first, how do you get the impression that Chinese might allow Taiwan to do that? And second, even if Chinese allows Taiwan to do that or allows some country to do that kind of business with Taiwan, is there other option like Chinese may allow Taiwan to sign some sort of an ECFA-like or TIFA-like agreement as an intermediate step? Thank you.

Vincent Wei-cheng Wang: Okay. I didn't make myself quite clear. I was analyzing the pros and cons. I did not take that position. I think if I have to sort of follow their logic, basically, those in favor of ECFA with China will say that this is a good barometer, a good

indicator of testing China's good will toward this government. And we know that China will not want to sign an FTA like between sovereign states. So the net result will be somewhere between a traditional FTA and the CFA, right? As I said, we don't know the details.

Male Voice: [Inaudible]

Vincent Wei-cheng Wang: The pros and cons, yeah.

Deepa Ollapally: Deepa Ollapally, Sigur Center. My question is also for Vincent. It is a quick question on one of the slides that you put up which is the regional trade agreement slide, and it was interesting to see that Asia had the lowest figure for that, yet it has been the most dynamic economic region in the world. And so I thought my economics friends told me that it's supposed to be the other way around. And I'm wondering have you explained that phenomena?

Vincent Wei-cheng Wang: Very simple, they used to trade with partners outside of Asia so the story there since the 1990s is the rise of the intra-Asian trade. That's also the reason why the United States is not as important to Taiwan as before.

Mike Fonte: Mike Fonte, DPP liaison here. For Mr. Cooke, the projection that China is investing now in production capacity and more manufacturing, more infrastructure so that it can be a better export platform seems to me to be that we're running into a real crisis mode. I wonder what your projections for it are. Others that I've talked to say we want to see rebalancing that the Chinese spend more on their own domestic consumption, but that the way the Chinese are structuring their stimulus package it's really more for export, not for household consumption and not for household income. So there seems to be a growing train wreck coming and I wonder what you thought about that?

M. Terry Cooke: Well, at the risk of sounding like I'm going to make a cop out because I am not a macro-economist so I can't measure and calibrate those things, and so I'm not really able to predict. But I do look at dynamics and I agree with you that is what I tried to get across. But there is a worrying dynamic that the Chinese stimulus and the Chinese policy response to the economic crisis has accelerated the export orientation rather than throttling it back.

Now, we've seen through years of the strategic, economic dialogue process that the George W. Bush administration led under Hank Paulson and the Treasury Department in the negotiations with China that there was a lot of mutual finger pointing. The U.S. would say the problem is that you, China, don't get enough money into the pockets of your citizenry and you don't encourage domestic consumption and you don't have a social safety net. And then the Chinese would point back to us and say, well, you over-consume and you are profligate and you're always borrowing money. And it really went nowhere.

The bottom line though once you get beyond the political rhetoric is that the Chinese system was designed for the U.S. consumer pocket. And when people stop spending, it doesn't matter what the political rhetoric is, it just can't continue. And so there is a reckoning coming that has to do with the global rebalancing that has to take place. Some of that global rebalancing is just to recognize the dynamism and economic growth of Asia but some of it has to do with better understanding what the political dynamics are and it's not sustainable.

Edward McCord: So I do think you need to call it. I want to thank everybody on the panel. You really [indiscernible].

[Off topic chatter until 0:08:46]

## **Panel II: The Economic Crisis and Taiwan-China Relations**



Shawn McHale: If the participants could make their way to the front and the others take their seats in a minute, I would be quite pleased, thank you. If individuals could take their seats then we can start. Thanks.

Well, I'm glad all of you had a chance to at least stretch your legs and at least ask a few questions. We'll be turning to the second panel. The title is The Economic Crisis and Taiwan-China Relations. Perhaps we could say that the first panel was actually about a very similar topic, just different perspectives. This one has two economists and a political scientist who will then give their insights into the issues. Actually, one of the faculty members, Jiawen Yang, is a faculty member of the School of Business. I stand corrected. I'm going to introduce the panelists in order. Some brief bios, you have the bios that are at that table so I will just hit some of the high points.

Peter Chow who will actually present first is a professor of economics at the City College and Graduate Center in New York, City University of New York and he's been there since 1986. He's been a visiting professor and researcher and professor at Stanford, UC Berkeley, National Taiwan University in Taiwan as well as Nagoya National University. Among other accomplishments, he has actually published 40 articles and 8 books. I'm feeling actually inadequate as I say this. And his main interest is international trade and economic development, particularly on East Asia.

The second speaker will be Jiawen Yang of the School of Business. Jiawen is a professor who received a PhD in international business from NYU and an MA in international economics from University of International Business and Economics in Beijing. And he joined GW 15 years ago and he's been teaching courses on international trade and finance, emerging markets and China's business environment.

And in fact he's led courses to both, I think, Korea and as well as China in recent years for students. And his research has appeared in a wide range of periodicals and also he's the author of two books. His current research focuses on exchange rate pass through, international capital flows and their impact on emerging markets, international business strategies for small and medium-sized firms and the Chinese economy.

And our final speaker comes from very far away, one state away, Maryland. Scott Kastner is associate professor in the Department of Government and Politics at the University of Maryland College Park. And his research in teaching is on international relations, international political economy and international politics in East Asia. And he's actually written on this, the Taiwan-China issue in particular. His book, *Political Conflict and Economic Interdependence Across the Taiwan Strait and Beyond* was recently published by Stanford University Press. So we're going to follow the same format as the last time. Three different presentations and then time for Q&A.

Peter Chow: Good afternoon. Thank you Shawn and Ed for giving this opportunity to meet these distinguished panelists and the audience. Also thank you Erin for making all this arrangement.

When I contact was approached by Shawn about this topic, I asked what should I talk? And at that time, we didn't put that financial crisis as my focus, my major focus. So you can -- this was very, very generous that I can simply want to say. But anyway, the story starts with the trade investment issues across the Taiwan Strait. And then I'd probably take a little bit longer-term perspective and also talk about what's the implication of the emergent trade block across in the Taiwan Strait to the U.S. All right, so the presentation including in the three part actually. The first part, of course, I'm talking about what is the story and some of it may be old

with [indiscernible] and the ones in the top so which I can skip. And then I will specifically deal with the global separation and the regional stability. And then number three is talking about the development of the emerging [indiscernible] and what is the implication for the U.S. economic and the strategical interest in the region.

Taiwan is a trade-dependent country, no doubt. Export accounts for 70 percent of GDP, and by the statistic of even DP, the output foreign trade investment stock as a percentage of GDP counts for more than 25 percent for Taiwan, outward foreign direct investment as a percentage of GDP. This is from UNDP statistical data. And this ratio is much, much higher than Korea, right? And also higher than Japan and the U.S. And the story was that the trade growth across the Taiwan Strait since the mid-1980s was mainly induced by the investment. So I call the investment and the trade nexus. And this trend has been accelerated in the 1990s for 1992 [indiscernible] the south to the economic zone and then the Asian financial crisis. As a matter of fact, I shall say after the 1997, 1998 Asia financial crisis, many of the Taiwanese investment in Southeast Asia relocated from Southeast Asia to China, all right?

How much is the foreign trade investment in China? Actually, I cannot give you any specific figure but it was an estimate that more than 60 percent of Taiwan's foreign trade investment were destined to China, okay? Okay, this ratio shows that the percentage of the output [indiscernible] stock China account 55 percent, and this is only the official statistic. It does not include in those investments through [indiscernible] no, so as the Cayman Island or U.S. Virgin Islands.

What is the investment? What sector did Taiwan investment in China? The bottom is the electronic IT industry which consistently account for more than 30 percent. The last current is this year, the first six months of this year. But previously, you can learn that the consistent

there is the IT industry. This chart shows you because of these changes of trade and investment direction, you have found that the U.S. trade as once pointed out, the U.S. trade as a percentage of GDP, substantial decline in Taiwan. And Taiwan's trade with China and Hong Kong combined put all together has been increasing. As a matter of fact, they are different estimate or different statistical source of how much is a trade to Taiwan. And I used both sources, one is from Hong Kong custom statistics and the other is the MAC. We adjust, that is a lot of the trade prior to 2001 goes through Hong Kong and others and get through China, all right?

In the U.S., U.S. import from East Asia, among the merchandiser, 40 percent are in electronic and electric-electronic product, 40 percent of the U.S. import from Asian country. And Taiwan is a small, open economy. In order to generate the economics of scale, Taiwanese high tech industry has to concentrate in a narrow selected sector and ITC is one of them. As a matter of fact, there is some legacy which I can talk but I want to talk more on the implication for the U.S. But Taiwan's ITC highly rely on the so-called OEM, the original equipment manufacture from the world-class company from the U.S., all right?

Now, for these reasons, so Taiwan becomes an important player on the global supply chain as Terry pointed out. This diagram showed that the six stages of the production of the ITC. The first stage is the design of the semi-conductor. The second stage is the production of the silicon roll. The third stage is the wafer production. The fourth stage is approving, testing for individual chip, and number five is assembly and the packaging. Number six is final testing. So from Silicon Valley as Terry pointed out, go to Hsinchu, go to Taiwan's science industrial park, all right? So the first or the second stage in the U.S. and Taiwan [indiscernible] down on number two and number three. And because of the cost of the one page, number four,

number five switched to Yangtze River Theatre or the Pearl River Theatre and some other part like the Bo Hai area. So this is the formation of the global supply chain of the IT industry.

This is the percentage of the production in China. In 2007, it's the 89 percent; in 2008, the most recent data is nearly 92 percent what was produced in China. Now, first advantage, where is Taiwan's comparative advantage? Somebody calls it the smiling curve from the president of Acer, Stan Shih. Now, the different stage of the production has a different value. The mode of access is the value added and Taiwan predominant on the middle part. Unfortunately, that is a low value added section of the IT. That's the development, design and the production assembly and gradually, you know?

Next diagram, I'll show you that one. From OEM, Taiwan developed ODM and to OBM, owner brand manufacturers. And so at the different stages, for example at the OEM, Taiwan of course is the second mover but at the ODM, Taiwan becomes an advanced the second mover. And move to the OBM, Taiwan becomes a driver to the fourth drivers. And also Taiwan began to outsource and also develop its own brand. Acer is one of the few brands which carry Taiwan's name.

So this is the situation of the structure shift in the ITC industry. And this from the IIT shows that Taiwan is imposed on the OEM and the OBM. And in a different account it shows the different company. Some of you may own some of the share or the stock of this company. The next one is the interrelated between OEM, ODM and OBM. That is, to what extent Taiwan can develop his own technology by innovate and to accept the challenge of the globalization. And then this, just for your information, what's the percentage of those product Taiwan on the world market share on the notebook and the PC? About 99 percent in the world

market, motherboard 93 percent and so on and so forth. So just give to you some information about it.

Now, here, so far, nothing belonged to my own research. Now, my own research is not [sounds like] here. Say where is the Taiwanese go on the global economy? Basically, the answer is a vertical specialization. Taiwan import intermediate goods and the technological know-how from U.S., Japan and some other countries, mainly in the U.S. and Japan. Taiwan never be -- as the intermediate country [indiscernible] is the domestic capital, domestic intermediate product, domestic skilled labor and then put some final goods or advanced intermediate product and then export to other countries.

Now, this is what I calculate from the Taiwan's input-output table that is each industry and show to what extent, what is the ratio of the vertical share in the export. That red line is the vertical share and the blue line is the inter-industry trade. That's the trade within the same industry. And this has a very important implication in terms of stability and the security which I will carry out.

But what is the vertical share? It takes a long time to talk about that. The calculation shows that -- and I'll give you an idea. The ratio of the vertical specialization in Taiwan is much, much higher than the OECD country. Many of the OECD country with equivalent size of the economy, that is the share of the VS in Taiwan is much higher than those economy with a similar size as Taiwan such as Netherlands and Ireland.

So then I start to talk about inter-industry trade. In the [indiscernible] economy, trade with each other within the same industry. They're on the same boat. This is the so-called vertical division of labor, and in any event, if there's any dispute, it's much easier to settle it peacefully because their export and import are within the same industry. And I found out

what? I found out that the early paper in 2002, I found out that more than 75 percent of Taiwan's trade with China is at the intra-industry trade. That's what somebody pointed out that China and Taiwan are interdependent now than it was before. Moreover, in my colleague at the Chung Hua, Ms. Lin [phonetic], calculated that in terms of intermediate product, Taiwan's export to China has increased in the decade of 1990s, all right? And among those intermediate product is a higher end, more sophisticated, more important strategical component increased from say two percent in the 1990s to 26 percent. Whereas, the ordinary intermediate product, the percentage decreased. So this increased Taiwan's strategical stability, a strategical dividend.

Now, those are positive but then what was the result of the next legacy? Legacy was that for Taiwanese company in China, the foreign trade investment induced the trade at first couple of years. But gradually, when those Taiwanese company in Taiwan settled in China, they purchased locally instead of imported from Taiwan. And when the regression several times and then when I used a T minus, one [indiscernible] T minus two, that's two years, three years become insignificant, which means that as the Taiwanese subsidiary in China become more and more localized, they rely on the local supply rather than to import from Taiwan, so that is the other aspect. And also the following one is the survey from Chung Hua Institution for Economical Research. They found that the percentage of the local purchase increased.

And then here, really, where is Taiwan's real compared advantage in the U.S. market? And I used the methodology statistic to calculate that break down the commodity into a high tech and low tech, medium tech and I found out what? The high tech compared advantage is much, much higher and increasing. And the classification of the high tech, low tech and

medium tech is according to Professor Long [phonetic] at the University of Oxford. And this is the percentage of Taiwan's total export by the classification of technological product.

Now, the next section I'll talk about the dynamic or the compare the international [indiscernible] and the challenge to the second movers. Taiwan has to grow -- am I time out? No. Okay, Taiwan has to engage in larger scale economy, but on the other hand is that what? It's that Taiwan too much concentrate on the ITC. ITC account for 60 percent or more of Taiwan's total export. So Taiwan becomes more vulnerable to the global economical recession. I told you over at lunch, in fact if people ask me what is impact of the financial crisis on Taiwan's economy, my answer to that is financial exposure for Taiwan to the U.S. was very limited. Taiwan has purchased only about 40 billion of the so-called toxic asset from Lehman Brothers which is less than 0.1 percent of the asset in Taiwan's banking system.

What hurt Taiwan severely was not the financial crisis per se but rather the economic slowdown. The global economical slowdown triggered by the financial crisis. Taiwan is an export-dependent economy, 70 percent of GDP in the export, export that concentrates on ITC by 60 percent and then Taiwan's ITC market rely on the U.S. So, therefore, when people in Wall Street sneeze, people in Taiwan have to suffer from pneumonia. I hesitate to say that but that was a generalization.

All right, and the other is that Korea become a very, very strong competitor and Korea does not have the problem as Taiwan face in terms of international isolation. Korean standard FTA with the U.S. pending to the signature of the Congress approval. Korean successful negotiate with the European Union and so on and so forth. And Korean passport can now get into ASEAN country too. So Taiwan, can we say in a dancing party, you only operate the



[indiscernible] but you don't have the dancing part also. Wang point out that the spaghetti ball or the marginalizations.

What I want to say is that, okay, given these factors, if Taiwan can continue to develop as a high tech industry, by focus on innovations, Taiwan still has a very, very strong potential to break through the international isolation. This is the chart I get from U.S. trade market office. In terms of the pendant [sounds like] in the right granted to Taiwan as a per capita, Taiwan ranked as number three only next to U.S. and Japan and much higher than Germany and then Israel. So Taiwan enjoys substantial compared advantage in innovation. But I have a footnote here is that in spite of fact, in spite of that, in terms of the trade and technology, Taiwan still suffering from deficit. So some problem in terms of the future direction of the research and development but rather than focus on the research and development by itself.

And then I want to talk about the recent liberization of the development in trade and investment with Taiwan and even liberization of China's investment in Taiwan and to what extent that affect the U.S. economic and the strategical interest. So far, I said that Taiwan get too this high tech but recent movement talked about the OMU and the liberization of the financial sector and so forth. My personal opinion is that Taiwan has not had the comparative advantage in the financial sector in Asia-Pacific. Look at the foreign exchange transactions, right? Less than .01 percent of what took place in Singapore and Hong Kong so I'm not so naïve to anticipate to have a magical solution to develop Taiwan's financial sector or even Asia single financial center. Taiwan has to rely more on the manufacture and I do too much argument on this one that the conclusion is that Taiwan could not be a second Hong Kong.

Now, we are in Washington D.C. so I want to talk about the emergent trade block and it's implication for the U.S. economic and strategical interest. Nobody like to have war and

nobody want to get mad with China, that's true. So it's good that the Ma administration is leaning towards China which will reduce the tension. That's good.

However, it's one thing that you reduce the tension, but it's the other thing that you're moving towards a formalized economic integration as once pointed out, the ECFA may eventually get into FTA and which become the so-called greater China economic zone. Growth of economic trade and reduce the tension, that's true but the formal economic integration between Taiwan and China may generally under concern for some people in a bad way. Why? Because the proposed ECFA according to the WTO framework has to become an FTA between Taiwan and China within 10 years and this will generate emerging trade zones and as I said, somebody called it a greater China economic zone, which possibly affect the U.S. economic and strategic interest and this is why.

With the time constraint, I will put that 60 percent of the world foreign exchange reserve were held in the central bank in Asia. The total reserve here by China, Taiwan and Hong Kong exceeded \$3 trillion - US\$3 trillion. Everybody know that, right? Although there is no significant tendency that any of those economy were loosely attached in the position of the U.S. Treasury bonds but one has to be cautious about the scenario. If all three of them have more consensus or more common actions in disposing the treasury bond, I think that will be disastrous on the U.S. financial market. And those of young people want to buy the house with mortgage, your mortgage has to be several percentage higher than what you're paying now.

The other is that is to say this is only on the financial aspect, okay? The other is what I say about the global strategic -- global separation, all right? The economic integration could generate more harmony or more common political actions which means that with a role model of the market economy and the democracy, Taiwan is going to become - what - more closer or

closer to an authoritarian China. No doubt that economical reform in China has generated more prosperity, more urbanization, and improving the living. But in terms of political system, China has been and still is an authoritarian regime, right?

So my argument here is that if the United States abandon a role model of the market economy and the democracy, U.S. fast [sounds like] will lose his trust and the confidence of all his ally in Asia and all over the world. I don't mean that the economic integration will necessarily [sounds like] generate political integration or unification. But possibly, the formal economic integration could generate the so-called China sphere of influence which will severely [sounds like] affect the U.S. economic interest.

So that's why concern and share with you some of my [indiscernible]. This diagram shows that the percentage of the trade deficit of those East Asia country with the U.S. And you see that Japan's -- the line economic is Japan. Japan's trade deficit with the United States declined.

All the East Asia countries with trade deficit with the U.S. have declined. Only the U.S. trade deficit with China increased. So this kind of economic integration is very interesting in terms of some of the policy measures. So what I'm going to argue is that U.S. homogenous economic and trade policy is better to pursue the principle of the open regionalism. Open regionalism in East Asia, even though the multilateral free trade agreement is so remote and the Doha and the so on and so forth, the United States needs to revitalize its law in the regions by engaging in multiple free trade agreement with Asia Pacific countries.

I can understand that President Obama is preoccupied with Afghanistan, he's preoccupied with healthcare, he's preoccupied with the financial crisis and I didn't see much of the proactive actions on the economic policy in Asia. No action taken by the current

administration on East Asia could pass for a [indiscernible] to some other potential crisis.

Why? My reason is here. This is a diagram by Richard Baldwin at the University of Wisconsin. He found out that eventually, Asia will have two major trading blocks. One is China-centric block, right? As the empress [sounds like], China with an FTA with Thailand, FTA with Pakistan and CPA with Macau, CPA with Hong Kong and FTA with [indiscernible] and China has induced Taiwan to sign the ECFA and plus others like Shanghai cooperation. That's one half.

The other half is Japan. Japan has ASEAN Plus One, that is the other one, okay. And Japan has a free trade with Singapore, with the Philippines, with Thailand, with the Burmese, with Indonesia, with Malaysia, with Chile. Comparing in other paper, if I had the time I can elaborate the difference of those two halves. One is Japan is an industrial democracy but China is a developing or emerging market economy with authoritarian regime, number one.

Number two, in terms of the market, China's market so far are all intermediate product. For China to become the market of the world economy, China will have to restructure its economical structure completely, right? Therefore, it's not going to overcome -- that's not going to materialize overnight. Theoretically speaking, China could emphasize more on domestic economy, domestic consumption and rely on less export. And somebody pointed out that possibly the coastal area with the per capita income of the US\$6,000 could be a promising domestic market. But by comparison to Japan, that kind of purchasing power is very weak, that's number two.

Number three is that Japan's foreign trade investment generally very significant impact in terms of technological transfer and the industrialization for Taiwan and Korea and some other Southeast Asia country. Other people will say yes, China also make a foreign trade

investment. Yes, but to the best of my knowledge, most of China's foreign trade investment are for extracting the control of the natural resources, particularly energy, rather than spread over the technology into the hosting country. So there's a choice. If there's a choice, people will make a good decision in terms of the two half and then I want to -- it's the time constraint. I want to propose there is another half which is emerging. If people impact with is willing to do it.

There is a super half, U.S.-centered half because U.S. has a free trade with Singapore. U.S. has free trade agreement signed with Korea. U.S. has signed or negotiated FTA with Thailand and U.S. has a TFA with 9 Asian countries, right? And also U.S. has TFA with Taiwan, not the treaty but in terms of negotiation. If the administration, Obama's administration is willing to take a more proactive trade policy, we should have the third half and this will secure the U.S. economic and strategic interest.

So the conclusion would be very simple. Taiwan has been playing a very important role, yes, in the global separation of the IT product. And yes, the peace and the stability on the Taiwanese Strait is crucial to the global production of the IT and the intel [sounds like] industry. This, U.S. has a very strong economic and strategic interest. As I said, 40 percent of the U.S. import from Asia are in this category. And therefore, United States should take an active role in the East Asia economic integration to speed up the U.S.-centric half by signing the multiple FTA with Asian countries including Taiwan. Thank you very much.

Jiawen Yang: Good afternoon. Thank you, thank you Shawn for inviting me to join this panel for the discussion of Taiwan economic crisis and the rest of the world. Actually, when Shawn contacted me about the topic, I realized that most people have the speakers talk about trade, talk about investment. I think maybe the financial linkages between mainland

China and Taiwan will be a good interest but if not, then any very in-depth research on this topic. I'll just share with you some information that I've just collected and maybe this is an area of interest for all of us.

Just as a background, I did some research on the Taiwanese investment in mainland China in the early years, so my conclusion at the time was that Taiwan's investment in mainland China was collectively very large but individually very small. That means Taiwan, together as the investor in mainland China, ranked number one or number two. But if you look at the individual sizes of the Taiwanese investment in mainland China, they were on average very small. That's due to many reasons, one is political restrictions on both sides and then more importantly, many small- and medium-sized firms from Taiwan invested in mainland China due to the cultural and language similarities.

So now I'm going to share with you some of my findings on the financial linkages between mainland China and Taiwan. So currently, there are eight commercial banks, 14 securities companies and more than 10 insurance companies that Taiwan has already established representative offices in mainland China. We all know in the financial sector, financial markets, there are three major industries: banking, securities and insurance. So in that perspective, Taiwan has a very good presence in mainland China in terms of financial institutions. One joint venture, a life insurance company, has already been established in mainland China and 9 Taiwanese enterprises have listed in the Asian market in mainland China as well. So this is another indication of presence of Taiwanese firms in mainland China. And commercial banks across the Taiwanese Straits have established direct business links. So this is the current situation.

In terms of their specific practices, that's an indication of how deeply integrated the two sides have become. In terms of insurance, this gives indication. So Taiwanese insurance companies entered mainland China market gradually and mainland insurance companies conducted high end insurance recruitment for Taiwan talents and some major insurance companies actually recruit top executives and talents from insurance companies from Taiwan. And Taiwan insurance executives organized marketing training for mainland insurance companies, particularly for China Life.

So mainland-based insurance operations have not yet invested in the Taiwan market or branched out yet so there is kind of asymmetry between the two sides so there is a lot more presence from Taiwan in mainland China, not otherwise. And mainland put in place policies and deregulations, an open door to mainland investors as of June 30th 2009.

Actually, there is a lot going on this year in the financial sector between the two sides. If you look at investment, if you look at trade, the two sides have a significant linkage. But in terms of financial cooperation, they have just started and there is a lot of emphasis in recent meetings between the two sides on the financial sector, on financial cooperation.

Let's look at another example in banking. When you look at insurance and let's look at banking. Lending from mainland Chinese banks to investors from Taiwan presently accounted for only about 30 percent of loans. This is because banks restricted capacity for credit investigations. So that actually provides a business opportunity for Taiwanese commercial banks to provide business services to the Taiwanese investors in mainland China. So another indication of the new development is that on August the 10th 2009, China Union Pay, this is a credit service, and Taiwan's national card center officially announced that China Union Pay

card would be acceptable in Taiwan. So this, of course, has been deemed as an icebreaker in cross-Strait financial cooperation by the financial industry.

So what's new? Well, we all know that ATFA [phonetic] has -- I believe the two speakers I heard talked about ATFA, so the economic corporation framework. But there is another aspect of recent development which is a financial service MOU that has already been signed. We announced, so signed on November 16th, a little over two weeks ago and to take effect in 60 days. This MOU -- I was trying to find the official version of this MOU but have not. But from the news reports, I've learned that this MOU covers the following areas: cross-strait financial supervision; exchange of financial information; opening financial markets to each other and currency-clearing between RMB and the Taiwanese dollar; allowing financial firms to invest in each other; and upgrading Taiwan's financial representative offices to branches and subsidiaries. So, so far, the representative offices do not have the full status of branches or subsidiaries but they are going to be upgraded according to this MOU. And more specific to be included in ATFA expected to be signed in 2010. People expect that when ATFA is signed next year, a lot more specific areas will be included for the financial set. So you all know what ATFA is so I'm going to skip that.

So future prospects. So let me talk a little bit about what's to happen or what I think would be happening in the future. Now, one is the coordination in monetary policy and financial regulation. And Professor Chow just mentioned that both mainland China and Taiwan have a lot of foreign exchange reserves. Including Hong Kong, the three had more than \$3 trillion in foreign exchange reserves. Well, that's become a world concern. We talked about the balances or imbalances across countries, particularly the United States and China and this has become a major issue. Maybe the coordination between Taiwan and mainland China



can help limit some of these problems. So eventually, to rebalance the balances in the world and the Asian countries, the Asian economies would have to reduce their foreign exchange holdings particularly in mainland China, Taiwan and Hong Kong, Japan and Korea. They all will have to do that.

One way to do that is the currency clearing or currency supplement among these economies particularly China with the neighboring countries. So we all know that RMB has been gradually though slowly been used as a settlement currency for trade between limited enterprises in China and their trade partners.

So I think from July this year, China had signed some agreements with neighboring countries particularly with ASEAN and other economies to pilot the use of RMB as a settlement or clearing currency for trade. At this moment, only for trade but in the future maybe is going to be used for capital investment, for international capital flows as well. Actually, Taiwan has proposed according to my reading that they may include the RMB in their foreign exchange reserves but that's only a proposal. There are pros and cons of course but if that's the case and then that's going to diversify the foreign exchange reserves of Taiwan.

And correspondingly, mainland China would be doing the same. Actually, mainland China has signed the swap agreements with some countries in the world to swap currencies. So that's just the first step for the RMB to become internationalized. Of course, at this moment, there are larger restrictions and China's capital economy is not open so the RMB is not tradable, is not internationally acceptable but China is taking steps to gradually allowing the RMB to be used outside the border.

So to do that, to involve the capital flows, not just trade and then Taiwan and mainland China would have to coordinate their policies and regulations because if one economy is open

in terms of capital flows and the other is not and you can realize that Taiwan and mainland China has a free capital flow, has a free conversion but China has capital control in place and Taiwan has a free flow, then you're going to see the inconsistency. So China's restriction on capital flow will not be effective so that means eventually have to take some cooperative measures in dealing with those capital flow and currency issues.

In terms of banking and investment or securities together so the three type of firms, banking firms, insurance firms or securities firms. At this moment, Taiwanese firms seem to be lagging behind in comparison with international financial institutions. I just looked at the list of QFII that is qualified foreign institutional investors in China. By the end of October 2009, there are altogether 88 QFIIs and all these 88 QFIIs are from the United States, from the European countries, from Hong Kong, from Japan, from Korea but none of this is actually from Taiwan. So Taiwanese financial institutions are latecomers to the mainland market but they do enjoy some advantages if the two sides are opened to each other in terms of financial investments. As I said earlier, insurance companies have already shown that they have an advantage in mainland China. The banking firms, they can serve the Taiwanese investors better and they know the language, they know the culture and definitely they can do relatively better job in serving the retail customers in mainland China.

So these are the areas that in the future you're going to see a lot of progress. And also cross-listing. There are a number of Taiwanese firms being listed in mainland China in the stock market but I'm not aware of any Chinese firms, mainland Chinese firms being listed in the Taiwanese stock market. I know from my talks with my friends and colleagues in Korea that the Korean stock market would like to have Chinese firms listed in their stock market. I'm not sure if there is a similar wish in the Taiwanese stock market but as the financial cooperation

between the two sides continues, I'm sure there is going to be some new potential in this as well.

So these are my points. I just heard from the previous speakers that it seems that the cooperation and integration between mainland China and Taiwan has posed some challenges or threat to the United States so let me share with you my view on this. I believe, yes, there are some challenges from a historical and traditional perspective but looking ahead, I believe this also become opportunities for the United States in this cross-strait relationship.

We talked about trade. If you look at the trade issues and I heard one of the speakers saying that the trade balance of Taiwan with mainland China has been a surplus. With the United States -- so this significance is being reduced. I think that this is just by looking at the surface. And then at the bottom of the issue is that not only Taiwanese firm but also firms from Japan, firms from Korea, from other countries including firms from the United States actually relocated their production capacities in mainland China and they will reroute their exports to the United States.

If you look at the big picture, actually, Taiwanese relationship with the United States is just through a different venue. It's not that changed. For example, like shoe manufacturing. Taiwan used to be the major shoe exporter to the United States but over the last two decades or so, all this shoe manufacturing has been relocated to mainland China then exported through mainland China to the United States. But I think the statistics do not really show all this interconnectedness in the relationships in trade. So I believe that the fundamental nature has not been changed but there is a change in form. So if we change the mentality, if we look at the cooperative opportunities, I think this is a positive. Okay, thank you.

Scott Kastner: Okay, so I just wanted to say a few words about the sort of security consequences of China-Taiwan economic integration. I again want to thank Shawn for inviting me to talk here. The presentation that I want to kind of present here is kind of based on a paper that I'm working on so it's kind of preliminary and maybe that's a nice way of saying it's kind of half-baked.

Okay so I don't think I need to say a lot given what the speakers already said about in terms of background in a cross-strait economic and political relationship. I think the phrase old politics economics pretty succinctly summarizes the relationship. Of course, tensions especially prior to the current Ma Ying-jeou administration were quite tense relations across the Taiwan Strait.

And despite this, we saw a verging economic relationship which the other speakers have already talked about. China became Taiwan's number one trading partner earlier this decade and for some time has been by far Taiwan's primary destination for outward foreign directed investment. And you could just kind of see in the charts this kind of a dramatic nature of increasing cross-strait economic integration. This is trade statistics based on Mainland Affairs Council statistics.

Okay, now the implications of deepening cross-strait economic integration have been a somewhat controversial in Taiwan. And in particular, many have worried deeply about some of the security implications of cross-strait economic integration. For instance, many worry that Taiwan's deepening economic dependence on the PRC makes Taiwan potentially more vulnerable to economic coercion such as threats of economic sanctions. I think the current leadership of the Democratic Progressive Party has articulated some of these sorts of concerns as have former presidents Chen Shui-bian and especially Lee Teng-hui.

On the other hand, many in Taiwan see economic integration as being something that is potentially helpful to Taiwan's security and something that potentially helps to stabilize the cross-strait relationship. For instance, current president Ma Ying-jeou has emphasized that he believes that growing cross-strait economic integration is something that fosters greater people-to-people contact which in turn can foster greater understanding and trust. And as Vincent was kind of emphasizing in his presentation, many also believe that kind of failure to continue liberalizing and normalizing the cross-strait economic relationship is something that can also kind of lead to increased marginalization for Taiwan. For instance, failure to pursue an ECFA with China is something that might make other countries even more reluctant to pursue free trade with Taiwan.

Okay, so I want to kind of present my take on this issue by putting forth kind of three expectations about what I see as being some of the security consequences of cross-strait economic integration. Again, the first expectation is that if we kind of talk about short-term effects on prospects for cross-strait stability, I suspect that in the short term whether or not economic integration helps to reduce tensions and stabilize cross-strait relations depends in part on the political party and particularly, the preferences of the political party in power in Taiwan. I'll come back to that in a second.

My second expectation is that over the longer term, cross-strait economic ties make formal Taiwan independence less likely and harder to achieve. But third, over the longer term, I also think that cross-strait economic ties have at best ambiguous effects on the likelihood of cross-strait unification and I suspect are relatively insignificant when it comes to thinking about the prospects for cross-strait unification. And so I want to come back to each of these in turn.

Okay, so why do I suspect that the short-term effects of cross-strait economic integration on the prospects for cross-strait stability are partially dependent in the preferences of the Taiwanese governing party? To see my reasoning here, let me give kind of a really stylized portrayal of the cross-strait relationship. In relations between China and Taiwan, in its simplest form the core area of contention is concerned with Taiwan sovereign status, the extent to which Taiwan is or should be an independent sovereign nation state.

Now, in practice, it's often the case that Taiwanese leaders are in a position to make unilateral decisions on sovereignty-related issues. That is, the PRC can't influence directly a whole host of sovereignty-related issues or policies that Taiwan might chose to adopt such as whether or not to adopt a new constitutions, changes to Taiwan's educational curriculum to highlight Taiwan's sovereignty from China and so forth. In these sorts of cases, the PRC can only influence Taiwan's decisions indirectly through threats of sanctions or promises of rewards.

Okay, so in this sort of environment, one scenario, perhaps the most likely scenario that could lead to military conflict is one in which Taiwan pushes beyond what Beijing is essentially willing to tolerate on sovereignty-related issues. For simplicity and in line with coming practice, I'll just kind of refer to this point as Beijing's redline. In simplest terms, Beijing's redline should be defined by the level of Taiwan sovereignty that would result from military action minus the expected cost of military action to Beijing. In a nutshell, Beijing should be less tolerant of Taiwanese efforts to enhance its sovereign status to the extent that Beijing expects military action to be inexpensive and effective in changing Taiwan's behavior.

In practice moreover, some uncertainty will always exist over the precise location of Beijing's redlines. Such uncertainty arises in part because it's hard to estimate the likely

effectiveness of military action and also because Beijing has obvious incentives to overstate its willingness to use force so as to deter Taiwanese policies that it doesn't like. Very few people in Taiwan, of course, would welcome military conflict with China but such a conflict could nonetheless occur if Taiwan were to misjudge the location of Beijing's redline; that is, to cross Beijing's redline unintentionally, a possibility that exists given uncertainty over the precise location of the line.

Okay, now growing economic ties across the Taiwanese Strait can potentially change the location of Beijing's redline to the extent that growing economic ties with Taiwan raise the cause of military conflict for the PRC. That is it may take more to provoke Beijing to military conflict to the extent that economic integration raises Beijing's cost of war. And I don't want to unnecessarily exaggerate the magnitude of this effect and obviously, it's unobservable since leaders in China would never admit to the possibility that growing economic ties with Taiwan might influence their willingness to consider military effort over sovereignty issues, but I do think that there is at least some marginal effect.

Okay, so to get back to my first expectation, I suspect that if cross-strait economic ties do indeed raise Beijing's cost of initiating military conflict in the Taiwan Strait, the broader short-term implications for stability in the Taiwan Strait are conditional in part on the preferences of the governing party in Taiwan.

Specifically, if Taiwan's governing party is happy, is basically happy with the status quo in cross-strait relations and does not aim to kind of try to establish or move Taiwan in the direction of the formally independent Taiwan state, and this is kind of clearly the case with the current Ma Ying-jeou administration, then growing economic ties across the Taiwan Strait should reinforce cross-strait stability. A pro status quo government, of course, would not be

inclined to pursue policies that might lead to a military response from Beijing in the first place. So you would naturally expect a relatively stable cross-strait atmosphere which is in fact what you see with the Ma Ying-jeou administration. But economic ties should help to reinforce the stability in cross-strait relations by giving greater confidence to Taiwanese leaders that the PRC is unlikely to attack because the costs are increasing.

On the other hand, if Taiwan's governing party is one some have turned revisionist meaning it's unhappy with the status quo and wants to further strengthen Taiwan's sovereign status, then the effects of economic ties are less clear cut. Indeed, it's possible to imagine that growing economic ties can actually contribute to a more tense relationship with China in that a revisionist Taiwan government would naturally want to push Taiwan's status closer to Beijing's redline.

If Taiwan suspects that Beijing's redline is shifting to be more accommodating of Taiwan's sovereignty, then a revisionist Taiwan government presumably will capitalize on Beijing's increased cost of war by moving closer toward independence. Beijing would undoubtedly respond to any policies that it might view as steps towards independence with harsh rhetoric and the cross-strait relationship will become tenser as a result. Okay, so on the margins at least, economic integration when you have a revisionist government in Taiwan, could potentially contribute to a more tense relationship though I suspect that the effect on the actual likelihood of military conflict would not necessarily be there. So in the short-term at least, I suspect that economic integration has marginally stabilizing effects on cross-strait relations when a pro status quo party is in power in Taiwan as is the case with today's KMT and more ambiguous effects if a revisionist party is in power.



Okay, over the longer term, my hunch is that cross-strait economic ties make formal Taiwan independence somewhat less likely and there's nothing too surprising here. Indeed, I think that this is basically the conventional wisdom. Economic integration in a nutshell creates a growing constituency in Taiwan with a stake in a able cross-strait relationship. This constituency includes of course those with a direct stake in cross-strait economic ties such as for instance the million Taiwanese who live in China or the Taiwan businesses who have investments in the PRC. But the constituency is also broader. For instance, individuals with investments in Taiwan's stocks may suspect that cross-strait instability could lead to a fall in the market as has happened in the past.

People may worry that the economy will suffer more broadly in the event of a confrontation with China affecting as individuals even if they have no individual stake in the relationship that's direct.

In short, deepening cross-strait economic exchange means that more and more people in Taiwan will feel uneasy about the consequences of cross-strait military confrontation. And this in turn means that they may be reluctant to support politicians who might want to test Beijing's redlines in the first place. Okay, so kind of what might be termed revisionist or pro independence politicians in other words will likely find it harder to get elected to the extent of Taiwan's economy is highly intertwined with the PRCs.

Okay, now whether cross-strait economic integration makes unification any more likely I think is far less clear cut. I think there are basically two possible mechanisms through which growing cross-strait economic ties could influence the likelihood of China and Taiwan political unification. First, kind of to return to an earlier point, economic integration might enhance China's coercive capacity over Taiwan; that is, by opening the possibility to threaten or use

economic sanctions it may become more feasible for Beijing to coerce Taiwan into some sort of unification party.

Second, economic integration could conceivably lead to changed preferences among societal actors in Taiwan and who would then demand unification. Economic integration for instance could conceivably lead individuals in Taiwan to identify more with China or alternatively, individuals could conceivably come to view unification as essential to stability in the cross-strait relationship. Okay, my hunch is that economic integration is pretty unlikely to lead to either of these effects.

In line with the work of Scot Tanner and others, I suspect that the PRC will remain quite reluctant to use economic coercion as a means to maneuver Taiwan into some sort of unification deal. And the reason is that economic sanctions against Taiwan are potentially very costly for the PRC. They are costly because actually carrying out sanctions would cause direct economic damage to China but perhaps more importantly, economic sanctions against Taiwan could be damaging to China's reputation as being a good place in which to invest. Actors from other countries that at times have testy relations with China such as the United States or Japan may also become alarmed at China's willingness to utilize economic sanctions to kind of politicize that relationship with Taiwan.

Furthermore, economic sanctions would most seriously hurt actors in Taiwan that already have a stake in the cross-strait relationship and as such, tend to be more skeptical of Taiwan policies that could be destabilizing in the first place. Punishing these sorts of actors could be especially damaging to Beijing's long-term goals in Taiwan as it would in essence alienate the very constituency in Taiwan that is least supportive of an independent Taiwan in

the first place. Beijing, I suspect, will continue to focus its attention primarily on cultivating this constituency rather than threatening it.

As for changing societal preferences in Taiwan, at least at the aggregate level, there just isn't a lot of evidence to support the proposition that growing economic ties across the Taiwan Strait are leading to kind of increased demands in Taiwan for unification. I'll just put a couple of probably familiar charts.

Here's a chart from a poll done by the Mainland Affairs Council over time looking at kind of where people stand on independence versus unification issues. The redline at the bottom is the percentage of respondents who suggested that they would prefer unification ASAP and that has kind of remained consistently trivial. But the yellow line, for instance, is the percentage of respondents suggesting that while they support the status quo now, they would like to see unification eventually. And even there, you kind of see a general decline just over the last decade. I can't read the dates but this goes back to 2001 and now stands at 8 and 7 percent. So it's again pretty trivial.

Here's a second chart from MAC. I think that the MAC has kind of stopped doing this survey - correct me if I'm wrong - so this only extends up through August of 2008. But this is a question that's been asked, in one country-two systems formula applicable to solving the problem across the Taiwan Strait. And, again, this is no trend here. It's just been done one country-two systems is consistently a non-starter in Taiwan.

And if you look at kind of these Taiwan identity trend lines and this is the one that the Election Study Center at National Chengchi University conducts. Again, the percentage of respondents who when asked do you consider yourself Chinese, Taiwanese or both, the percentage saying that they self-identify as Chinese has become kind of trivial; whereas, the

percentage self-identifying as Taiwanese is actually now represents the majority of the respondents.

Okay, so to conclude, my expectations about the security-related consequences of the cross-strait economic integration are three-fold. First, I think that economic integration short-term stabilizing effects are contingent on the preferences of Taiwan's governing party. Economic ties have a stabilizing effect on the margins at least when a pro status quo party is in power in Taiwan but the effects of economic ties and cross-strait stability are less clear when a revisionist party is in power in Taiwan.

Second, over the long term economic integration probably makes Taiwan independence less likely for more Taiwanese. But third, the long term effects of economic integration and the likelihood of formal unification are less clear cut and probably negligible. Thanks.

Shawn McHale: We have about 15 minutes or a little bit more for questions so by all means, come up for questions and remember --

**[End of file - GWU Sigur CD 2 12-2-09 Taiwan]**

**[Start of file - GWU Sigur CD 3 12-2-09 Taiwan]**

Scott Kastner: -- and again, you can't see with the tourist incident in Southern Taiwan earlier this year. So yeah, I mean clearly there's a willingness to put us but I guess I don't know like I don't feel confident in the answering like specifically like the extent to which there's an effort to kind of cultivate particular factions within the KMT. I just don't know.

Peter Chow: Perhaps I can repeat from the economic expert. Okay, for example in terms of China's liberalization of agriculture import from Taiwan for example which will be a very important leverage in terms of Taiwan's domestic politics, right? But there is no proof interest that those liberalization of the agriculture import from Taiwan has generated too much

substantial benefit to the Taiwanese farmers at all. Taiwanese farmers in the south are more than likely to support the DDP rather than KMT. And so far, in terms of the efficacy, I don't know. The European election or the local election this weekend, that's why I hesitate to answer that question, all right?

Number two, in terms of tourists, okay. China sends some tourists to Taiwan which may affect some of the hotel tourist industry. But again, the statistics varies. For one [indiscernible] is that there is a cardinal effect from those hotel and those spot which accommodate the Chinese tourists that squeeze out the Japanese tourists. In fact that in all the hotel now tend to T [sounds like] a system. One can accommodate Chinese tourists which Japanese tourists won't check in.

So there's a cost benefit and I didn't see the scientific assessments so as a scholar, I don't want to say, okay, that's no good. But there's some of this [indiscernible] expert. And then, yes, China can make some investment in Taiwan's real estate or some other sectors - even manufacture sector or say the infrastructure. Again, so far, there is no statistical report I can assess to. The real estate of course in Taiwan of course possibly if I have a home in Taiwan for example a house in Taiwan, I would welcome, you know, Chinese investor but then you need to understand that because of the outsourcing and globalization, Taiwan is a society leading to bipolarizations that is those extremely wealthy people, they don't care much about the estate boom. But those in the middle class and the low middle class, they can never afford to buy a house and which -- I don't know that if that impact is really right. Even say a college professor all right can hardly purchase a piece of let's say a suite bedroom apartment all their life. And so if the speculation on all those kind of real estate increases their burden, I don't know whether

that will generate a positive or negative impact. So I said, this is a very interesting question but it has to do more concrete study. Thanks.

Male Voice: Thank you very much for all three panelists' very concise lectures [sounds like]. So I have questions. So China was [indiscernible] to adjust its economical structure, its strategic adjustment of Chinese economic structure that is to expand domestic demands. So maybe you know that President Obama visited China last month so China and the United States signed an agreement. Both countries will have an educational exchange program. China will send 100,000 students to United States. United States will also -- I'm not sure, it's correct but according to the document, the United States also will send 100,000 to China.

So I think China is a huge potential market for Taiwan. I don't think you know, but maybe you know South Korea, Japan, even Hong Kong, EU, they will compete, you know, Chinese potential market because of China's economic structure adjustment. But I wonder, do you think you know, all three panelists, Taiwan has advantage for these potential competition. Do you think you know the IT products, electrical products or fruits - Taiwanese fruits are very popular in the mainland markets - and security service, insurance business, real estate business, or you know, the tour service and even as I know, today, Taiwanese students can study at the mainland, but the mainland students were not permitted to study at the Taiwanese university. So that's the issue. Taiwan has the advantage in the competition for the markets of the mainland. Okay, thank you very much.

Peter Chow: Well, the last question which I can answer first. I was a visiting professor in National Taiwan University when I was on sabbatical. And actually, the Taiwanese government, the Ministry of Education, provides the scholarship for the student from China. Free room and board, free tuition plus, you know, stipend so your information was wrong. I

met two young girls from Beijing. They stayed in a dormitory on National Taiwan University under the sponsorship of the Ministry of Education. They may not be large-scale but what you said, Taiwan --

Male Voice: The government exchange programs, you mean or the [cross-talking]

Peter Chow: I don't know what kind of program it is but the two female students were very smart and were charming. It was under this scholarship from the Ministry of Education. And they stay in a dormitory -- I mean the free room and board, free tuition plus the stipend. So the [indiscernible] you mentioned was not correct.

In terms of the advantage, compared to the advantage of ITC or the household appliance, you know, maybe Taiwan has the advantage, comparative advantage, but China's local market, you know, require substantial marketing channel in order to penetrate into the local market. The experience from the so-called house - what is that - household appliance, go to the Lulu area. There was a program and though in [indiscernible]. Taiwanese company only get less than one percent. They get one percent of the share on those [indiscernible] because they don't know how to market.

You need to have a very -- and this is also a lesson for the [indiscernible] because you don't have the local channels to get into that and then you dedicate those retail store, you never get those be collected. I mean you can put the product there for sale but you'll never get your money. So there's a substantial social network. I don't mean to be negative but I'm saying that substantial social network will be necessary for the Taiwanese company to penetrate in the local market given that they have the culture and the language advantage. The program this year shows that less than one percent of the household appliance was from Taiwan. So maybe the Taiwanese businesses need to learn more about the retail channel and this kind of system.

In terms of the education policy, I think the incumbent administration is much more liberal in the sense -- of course, this is also a pro and a con all right but I'm just making a factual report that the Ministry of Education is already proposed to recognize the credential of [indiscernible] university from China. And then once you recognize the [indiscernible] one, it will be [indiscernible] 100, once the doors opened, it's open forever, right, in spite of possible power shift.

But of course, this is not to confirm it but always has a pro and con. And the critical question is that the license, the professional licensure, yeah. Because right now, the unemployment rate in Taiwan, ones [sounds like] important are really high. And the wage rate has never adjusted for 10 to 12 years. Salary of employees, civil service, their salary had been freeze in the last 15 years and the inflation is not zero. Inflation, you know, how they advocate say the prices to be at least two percent a year and the college professor salary never raised. I mean it hasn't raised in the last 10 to 12 years. And so let's say, okay, liberal policy in terms of this kind of situation. It could adversely affect the labor market.

However, I understand the National Science Council takes a much more liberal policy attitude to recruit the talent of science and technological talent. That is to say National Science Council is willing to recruit and to invite the Chinese professional, science and the technological professionals to work and stay in Taiwan for a certain period of time. That's what -- I make it a factual report, okay? I don't make a comment whether I support or I like those policies. Thanks.

Jiawen Yang: Yeah, may I add just one more comment on your question. The joint announcement by President Obama and President Hu did include a section on the educational exchange between the two countries. And President Obama said in that report that the United



States would provide further support and help in terms of visa applications by the Chinese students. In the meantime, in the next four years, the United States will provide help for 100,000 U.S. students to study in China. So the number is not balanced. It's the United States is preparing to send 100,000 U.S. students to China in four years. I think this is a very good thing for students in both countries to study in each other's countries.

In terms of Taiwan, I know a lot of Taiwanese students are studying in China. I visited quite a few universities in Beijing. I saw a lot of Taiwanese students over there and also met a lot of Taiwanese executives in the businesses, a lot of professionals like in insurance companies. And even Taiwanese -- one of my students in Beijing University operates a restaurant and taking an MBA at Beijing University. So I think on Taiwan side, they are going to recognize -- up to now we have not recognized the diploma from Chinese universities but they are going to. I think this is a good progress so that more Chinese students from mainland can go to Taiwan and study there.

Garrett Trendau: My name is Garrett Trendau [phonetic]. I have a question for us Scott Kastner. I think your analysis reminds me a bit of the discussions we had in the mid-80s about Eastern Europe and the USSR. USSR had red lines which could not be crossed and they would never accept the Baltic States as independent neighbors. Of course, we all know what happened, the Berlin Wall fell and stuff like that. But shouldn't we perhaps have more - if I may - some out of the box analysis and try to look at the situation with a perspective in mind that China itself could change and hopefully, in a positive direction. And a changed China could accept Taiwan as a friendly and independent neighbor.

Now, that option is kind of shoved off the table and its tension and stuff like that but I think what DPP has advocated for is to have peaceful coexistence as two friendly neighbors

and forget about this historic past of animosity that was between the Kuomintang and the CCP. DPP was never any part of that.

Scott Kastner: Yeah, I mean clearly I'm just going to simplify and the idea I had in mind there was kind of basically focusing on kind of short term effects, kind of assuming, you know, given Beijing's preferences today like what should we kind of think about the marginal effects of increased economic ties to the extent that they affect Beijing's cost of war, right?

So you see, of course it's possible to imagine kind of a transformed China that ends up with different preferences with regard to Taiwan. I don't really know what the likelihood of kind of the scenario that you're imagining is. I mean my hunch is kind of low at least for the foreseeable future. You know, just kind of thinking of some of the literature on, you know, democratizing countries and kind of the role that nationalism sometimes plays. You can imagine the Taiwan issue continuing to be a very salient political issue even in a democratizing China, so I guess I'm kind of skeptical that we're going to see it, in the near-term anyway, kind of a China that's willing to accept an independent Taiwan. But that's just --

Garrett Trendau: The same thing with the USSR back in '87, '88 and [indiscernible].

Scott Trendau: Yeah, fair enough. I mean it's certainly good to -- you know, and I certainly don't want to suggest that it's inconceivable.

Shawn McHale: One more question and [indiscernible].

Male Voice: So now Chinese government -- I mean you know, that ministry of Chinese education each year, you know, support, provide the scholarship, different levels of the scholarship to the Chinese scholars. You know, different level of scholars. For instance, professors and graduate -- even, you know, master degree student about 10,000 people who can get the scholarship to go to the other countries. For example, I'm a scholar for Long Tongji

University. This year, I received the scholarship which would call, you know, the senior research fellow program. This is highest, it's a Chinese scholarship council.

So now, each year, the Chinese government provide more than 10,000 scholarships to support the Chinese scholars to go abroad. I think maybe Taiwan would take relative response to mainland because mainland education is very important sector for the exchange of views and ideas because we had a common culture, traditional culture that we can -- okay, just my comment but this is not a question. Okay, thank you.

Shawn McHale: On that note, let me just make a few very, very brief comments in closing. I'd like to remind listening to the two panels today of actually a conference, a mini-conference we had a few years ago on the occasion of the publication of *remapping East Asia*. *Remapping Asia*, I think the title of it is. Ms. T.J. Pempel was here and talking about, in a sense, integration from below and integration on high, integration that was driven by essentially economic drivers and integration that was driven by political, in a sense, political reasons. And one of the arguments that was being made at that time was economics was the driver.

What I found very interesting about this is very often, we've had the discussions here whether it's on integration or other issues in which essentially, very often, scholars [indiscernible] and scholars of economics seem to speak different languages, focus on different topics and so on. This is a different conference than what we often have had when we've talked about cross-strait relations. I don't think -- precisely one of the reasons why is that we've been zeroing in on this extensive network of connections across the strait whether they're financial, economic, global supply change, whatever. But it's rather - I must say - it's intriguing to me. I guess one of the questions I have is in essence to what extent is actually the economy going to

drive, in a sense, this process? Regardless of what actually political leads want but the answer to that question will be obvious in perhaps years and decades to come.

In any event, I want to thank all of the panelists who presented much food for thought and I'd like to ask you all to give them another round of applause.

**[End of file - GWU Sigur CD 3 12-2-09 Taiwan]**

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