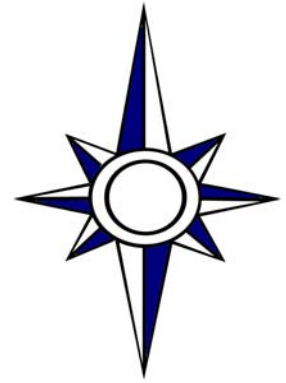


Comparative Connections

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China-Taiwan Relations: Continuing to Inch Forward

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As the year ends, cross-Strait tensions remain remarkably low. This is so despite President Chen Shui-bian's continuing efforts to promote his Taiwanese nationalist agenda in ways that could threaten cross-Strait stability. However, as Chen is a seriously wounded lame duck, his influence is declining and his initiatives are often just rhetorical flourishes. Despite President Chen's restrictive approach to cross-Strait economic ties, his administration finally approved some long-pending proposals for high-tech investments in China. Beijing continues to pursue President Hu Jintao's policy of positive outreach to Taiwan. Discreet talks between designated associations have reportedly neared agreement on arrangements for Chinese tourism to Taiwan. Progress was made toward breaking the deadlock over arms procurement, with hope that some initial appropriations may be approved by the Legislative Yuan early in the new year. If any progress is to be made on functional issues next year, it will have to occur early before the sides become engaged in preparations for the 17th Chinese Communist Party (CCP) Congress and Taiwan's elections.

DPP postpones releasing draft constitution

As the last quarter ended, President Chen was pressing the Democratic Progressive Party (DPP) to issue a draft of a new constitution that would include a redefinition of Taiwan's territory. Even though there was no consensus in society on such sovereignty-related issues, Chen argued that the party should use the draft to lay out its long-term vision for the future as a means of mobilizing support for a new constitution. DPP Secretary General Yu Shyi-kun told the press that three drafts reflecting different approaches on the sovereignty related issues were under discussion.

However, when the DPP Central Executive Committee met Oct. 4 to approve a draft for a new constitution, the committee decided to postpone issuing its draft and to refer the sovereignty issues for further study. Reportedly, Premier Su Tseng-chang and former Premier Hsieh Chang-ting were among those who supported this more cautious approach. After the meeting, Su told the press that it would be important to take into account the views of allies and the past commitments made by the president, presumably a reference to President Chen's statement in his second inaugural address that sovereignty issues would not be addressed in the process of constitutional re-engineering. Hsieh pointed out that as the threshold for constitutional amendments was high; a wide range of opinions

would have to be taken into account. After the October meeting, the party's attention shifted to the mayoral election campaign and no further action has been taken on constitutional reform.

Chen's inability to get his way on the draft constitution is a sign of his waning influence as a lame duck leader plagued by scandals among his family and close political associates. While his influence is reduced, Chen's desire to promote constitutional change and a stronger Taiwan identity remains. At a birthday celebration for long-time independence advocate Koo Kuan-min, Chen said that the idea of freezing the current constitution and writing a new constitution for a "second republic" was something that should be considered. Some observers believed this was only Chen being polite to Koo who had long advocated this idea. Then in a Nov. 2 *Financial Times* interview, Chen Shui-bian endorsed the idea again, arguing that freezing the current constitution would maintain the link to China so that redefining the territory of a second republic would not be so provocative to Beijing. In his campaign appearances in Kaohsiung, Chen repeated his earlier advocacy of applying for UN membership as "Taiwan," expressed support for the idea of moving the capital to southern Taiwan and promised to move his residence to Kaohsiung if the DPP won the election. While Chen has less ability to implement policies, his Taiwanese nationalistic rhetoric appeals to the DPP's base and continues to raise concerns in Beijing and Washington.

Functional issues

Despite President Chen's political difficulties, talks on arrangements for Chinese tourism to Taiwan took place during the fall between China's Cross-Strait Travel Exchange Association and Taipei's Taiwan Strait Travel and Tourism Association. In November, the vice director of the Tourism Administration of China led a delegation of 500 persons from China, including a dozen officials, to the Taiwan Tourism Fair in Taipei. Sources on both sides have indicated that by late November agreement had been reached on the technical aspects. In November, Beijing announced the list of Chinese travel agencies that would handle tours to Taiwan. After the Taiwan mayoral elections, the Mainland Affairs Council (MAC) again expressed the hope that arrangements could be finalized by the end of the year. While the year ended without any announcements being made, it still appears that Chinese tourism to Taiwan could begin early in the new year.

In December, both Taipei and Beijing made announcements concerning arrangements that had been worked out for Spring Festival/Chinese New Year's charter flights in 2007. This indicates that the New Year's charters have now become routine. Also in December, Perng Fai-nan, the governor of the Bank of China, told the Legislative Yuan (LY) that, in light of the expansion of cross-Strait contacts, the time had come to legalize the exchange of renminbi (RMB) throughout Taiwan. Subsequently, Premier Su instructed the MAC to coordinate arrangements for RMB exchange.

Beijing outreach to Taiwan continues

While working of these functional issues indirectly with Taipei, Beijing continued its outreach programs and its party-to-party cooperation with the opposition KMT. In mid-October, the KMT and Chinese Communist Party (CCP) co-sponsored an Agricultural Forum in Hainan to promote cross-Strait agricultural cooperation. To underline the importance Beijing placed on such cooperation, both Politburo Standing Committee Member Jia Qinglin and State Counselor Wu Yi attended. The forum produced a list of measures that would be taken to facilitate agricultural trade and investment. Shortly after the forum at a time when a glut of bananas had driven down market prices in Taiwan, Beijing announced that it would buy a significant quantity of bananas from Taiwan.

In November, Beijing unveiled a new program to provide scholarships to students from Taiwan, Hong Kong, and Macau beginning in 2007. In December, Beijing announced that entry procedures for people from Taiwan would be simplified in the new year and relaxed the rules on Taiwanese journalists reporting on the 2008 Olympics.

Taipei approves some China investments

Taiwan ministries dealing with economic affairs have been working quietly to ease restrictions on Taiwanese investments in China. In November, Vice Minister of Economic Affairs (MOEA) Shih Yen-hsiang indicated that the government was considering easing existing restrictions. The Nov. 24 announcement by the Carlyle Group of its intention to buy out Advanced Semiconductor Engineering (ASE) caught many by surprise and gave this review process a needed jolt. Many interpreted the buy-out offer as a way for ASE to turn itself into a U.S. company in order to avoid Taiwan government restrictions on investing in the PRC. The following Monday a group of legislators including at least one from the DPP introduced a bill to raise the ceiling on the percent of capital that Taiwan firms can invest in China. The next day, MOEA Minister Chen Ruey-long said the government supported some easing of the ceiling.

On Dec. 14, the government finally announced new policy approval procedures for major investments in China which were designed to implement President Chen's "active management, effective opening" policy announced in January. On Dec. 18, an inter-ministerial meeting chaired by Minister Chen gave approval to three long-pending high-tech investments in China. The meeting brought together officials from MOEA, the National Science Council, the Financial Supervisory Commission, the Council for Economic Planning and Development, and the MAC – all organizations that favor facilitating well-conceived investments in China. Two of the projects involved the transfer of eight-inch wafer fabrication plants using 0.25 micron technology to China by Powerchip Semiconductor Corporation and ProMOS Technology, both of which had filed their applications two years earlier. Not surprisingly, the third approval was for ASE to purchase GAPT Inc, a PRC chip packaging and testing firm. On May 27, Taipei had said investments by chip packaging and testing firms could be approved. However, none of the pending applications for such investments had been acted upon. The Carlyle Groups buyout plans jarred loose approval for an investment by ASE.

On Dec. 29, Taipei gave policy approval for Taiwan firms to transfer 0.18 micron chip making technology to their fab plants in China. In making the announcement, MOEA Minister Chen noted that transfer of 0.18 micron technology to China has been approved under the Wassenaar Arrangement in 2004 and that plants in Taiwan were now using 0.09 and 0.065 micron technology.

Taiwan's defense procurement

The more than two-year struggle over the special arms procurement budget appears to be coming to a partial conclusion. In October, a tacit agreement was worked out between Defense Minister Lee Jye and pan-Blue legislators. Under this agreement, the administration would withdraw the modified special procurement budget. In return, the legislators agreed that they would then approve a package of initial spending for procurement submitted in a supplemental 2006 defense budget and in the regular 2007 defense budget. This package would include funds for a study on the need for submarines, for purchase of *P-3* maritime patrol aircraft, for upgrading existing *PAC-II* anti-missile systems and for first steps toward procurement of *F-16C/D* aircraft. The administration did withdraw the special budget, but the Peoples First Party (PFP) legislators balked saying they would not act until the public prosecutor had issued indictments in the case involving the presidential office's special fund for state affairs. Once again, partisan politics had prevented action on a national security issue.

Nevertheless, KMT Chairman Ma Ying-jeou said the party was committed to passing the package by the end of this legislative session on Jan. 19. In November, the LY's Defense Committee did act on parts of the package contained in the 2007 defense budget. Despite this hopeful sign, pan-Blue legislators continued to block consideration of the 2006 supplemental defense budget. The withdrawal of PFP Chairman Soong Chu-yu from politics and the near collapse of the PFP have helped ease the way for action on arms procurement. On Dec. 29, the LY voted to refer the 2006 Defense Supplemental to the Defense Committee for consideration – an important step toward possible LY action on the package. KMT, DPP, and TSU legislators combined to support the referral over PFP opposition. However, under the LY's complex procedural rules, there is no certainty the package will be passed by the end of the LY session.

Implications of the mayoral elections

The KMT went into the December mayoral elections expecting to win in both Taipei and Kaohsiung. When the results were tabulated, the DPP won the Kaohsiung mayoral race by the narrowest of margins despite scandals that had damaged the party's image. As a wide variety of factors contributed to the DPP win, it would be wrong to read specific policy implications from the results. Nevertheless, the KMT's failure to live up to expectations has further complicated Chairman Ma Ying-jeou's efforts to consolidate control of the party. After the election, KMT members in the LY urged Ma to develop a more "nativist" profile in order to appeal to voters in southern and central Taiwan. KMT legislators, most of whom are native Taiwanese, have not been comfortable with Ma's views about eventual reunification. Some have advocated the party adopt a more neutral

position on Taiwan's future based on the idea that all options are open and that anything democratically accepted by Taiwan's people would be acceptable to the KMT.

The win in Kaohsiung has put new wind in DPP sails. Hsieh Chang-ting, the party's candidate in Taipei, made a very acceptable showing. This has boosted his opinion poll ratings. As such the DPP has two attractive potential candidates for the 2008 presidential election – Hsieh and Premier Su Tseng-chang. Although the presidential election is still 15 months away, the maneuvering for advantage is underway. With KMT Chairman Ma's poll numbers declining and new hope in the DPP camp, it would be a mistake for Beijing or others not to see that the outcome is wide open.

Looking ahead

Despite the absence of a basis for political talks between Beijing and Taipei, the small steps taken by both sides during 2006 have helped stabilize cross-Strait relations and contributed to the current environment of reduced tensions. The early part of 2007 presents a window of opportunity for some further progress on cross-Strait functional and investment-related issues. Thereafter, Beijing will be pre-occupied with preparations for the 17th CCP Congress and Taipei will be in the midst of primaries preceding the December LY elections and the March 2008 presidential election.

It seems likely that arrangements for Chinese tourism to Taiwan will be announced early in the new year. Further agreements on expanding cargo and passenger charter flights would benefit both sides. An agreement on bank regulatory cooperation is needed as a basis for approval of Taiwan bank operations in China and much further in the future for Chinese Banks in Taiwan. However, as bank regulation is a government function, an agreement on regulation presents additional procedural problems. Taiwan might approve adjustments in the ceiling on investments in China or the transfer of 0.18 micron technology. There are continuing hints that Beijing may soon approve the establishment of a Taiwan Businessman's Association in China – a step that would give the network of local Taiwan Invested Enterprise (TIE) Associations an organizational voice in Beijing. It is in such limited areas where some progress may be possible early in the new year

Chronology of China-Taiwan Relations October-December 2006

Oct. 4, 2006: DPP postpones issuing draft of new constitution.

Oct. 5, 2006: Premier Su Tseng-chang meets Taiwan investors in mainland.

Oct. 10, 2006: Taipei's Cross-Strait Tourism Association begins operation.

Oct. 13, 2006: President Chen survives second recall vote.

Oct. 15, 2006: President Chen says "second republic" deserves to be considered.

Oct. 16, 2006: *United Daily News* reports MND to establish “strategic force” with *Hsiungfeng 2E* cruise missiles on an off-shore island.

Oct. 16, 2006: KMT-CCP Agricultural Forum opens on Hainan.

Oct. 17, 2006: In LY, Premier Su discusses constitutional reform and “second republic.”

Oct. 17, 2006: At Agricultural Forum, TAO’s Chen Yunlin outlines 20 measures.

Oct. 19, 2006: Press reports preliminary LY agreement on small defense supplemental.

Oct. 21, 2006: China offers to buy Taiwan bananas to reduce glut on market.

Oct. 23, 2006: Premier Su expresses hope for progress on cross-Strait economic issues.

Oct. 23, 2006: PFP says it will block arms supplemental until prosecutor closes investigation into Fund for State Affairs; Ma regrets decision.

Oct. 23, 2006: DPP Secretary General Yu Shyi-kun leads delegation to Japan.

Oct. 26, 2006: EU Chamber “blue paper” predicts more EU firms will leave Taiwan if cross-Strait economic policies are not eased.

Oct. 27, 2006: MAC defends repatriation to Hong Kong of tourist who claimed asylum.

Oct. 30, 2006: Ma says KMT has policy of passing supplemental budget during this LY session.

Oct. 31, 2006: Pan-Blue legislators block arms supplemental for 62nd time.

Nov. 1, 2006: President Chen commissions last two *Kidd* destroyers.

Nov. 2, 2006: President Chen’s *Financial Times* interview.

Nov. 3, 2006: Vice Director Zhang Siqin of China National Tourism Administration and 500 others arrive for Taiwan Tourism Fair.

Nov. 3, 2006: Forum for China-Africa Cooperation opens in Beijing.

Nov. 3, 2006: Prosecutor indicts First lady Wu Shu-chen on corruption and forgery.

Nov. 5, 2006: In press conference, President Chen proclaims his innocence.

Nov. 7, 2006: China announces new scholarship program for Taiwan students in 2007.

Nov. 8, 2006: High-level Chinese airline delegation arrives in Taiwan.

Nov. 10, 2006: MND Minister Lee says naval group in U.S. to discuss submarines.

Nov. 13, 2006: Vice Economics Minister Shih Yen-hsiang tells LY government is considering easing rules on chip investment in PRC; stocks rise.

Nov. 14, 2006: Chinese tourism official says tourism contacts taking place in Hong Kong.

Nov. 15, 2006: At APEC, Beijing says only states can sign FTAs.

Nov. 15, 2006: MAC Chairman Wu hints at approval for 0.18 micron technology.

Nov. 15, 2006: TAO confirms arrest of two Taiwan businessmen; says Beijing considering approving a national Taiwan Invested Enterprise Association.

Nov. 18, 2006: Presidents Bush and Hu meet at APEC; discuss Taiwan. President Chen's representative Morris Chang attends APEC.

Nov. 21, 2006: AIT Director Young urges early agreement on direct flights.

Nov. 21, 2006: Morris Chang tells press of his conversations with President Bush.

Nov. 21, 2006: Former Japanese Prime Minister Mori arrives in Taipei.

Nov. 24, 2006: President Chen survives third recall motion.

Nov. 24, 2006: Carlyle Group announces bid for Advanced Semiconductor (ASE).

Nov. 26, 2006: National Taiwan University announces academic exchange program with six PRC universities.

Nov. 27, 2006: Bipartisan group of legislators proposes lifting investment cap to 60 percent.

Nov. 28, 2006: Economics Minister Steve Chen expresses support for lifting 40 percent cap on investments.

Nov. 30, 2006: *Beijing Evening News* says 15 tour agencies will handle tours to Taiwan.

Dec. 3, 2006: President Chen reiterates interest in applying to UN as Taiwan.

Dec. 5, 2006: LY committee fails to reach agreement on easing investment limits.

Dec. 6, 2006: CEPD estimates Chinese tourism will boost Taiwan GDP by 0.1 percent.

Dec. 7, 2006: AMCHAM's Topics magazine says Taiwan is becoming a "backwater."

Dec. 8, 2006: MAC Chairman Wu still hopeful tourism talks can finish this year.

Dec. 9, 2006: Taiwan mayoral elections held.

Dec. 10, 2006: Pacific Congressional Caucus inaugurated in Taipei.

Dec. 11, 2006: MAC's Tung Chen-yuan says window of opportunity in first half 2007.

Dec. 12, 2006: Taiwan Foundation for Democracy releases *2006 China Human Rights Report*.

Dec. 13, 2006: TAO releases its plan for charter flights during Spring Festival 2007.

Dec. 14, 2006: Taipei announces new approval procedures for China investments.

Dec. 15, 2006: Jia Qinglin receives KMT Youth delegation; KMT and CCP Youth Leagues hold conference in Beijing.

Dec. 15, 2006: MAC announces dates for 2007 New Year's charter flights.

Dec. 15, 2006: Nicaragua approves FTA with Taiwan.

Dec. 18, 2006: Taipei gives approval for three long-delayed China investments.

Dec. 19, 2006: DPP's Yu Shyi-kun calls for passage of Sensitive Technology Control Law.

Dec. 20, 2006: FPG gets PRC approval to build 600-megawatt thermal power plant in Henan.

Dec. 20, 2006: Taipei restricts number of residence permits for Chinese.

Dec. 20, 2006: PRC says Taiwan residents will no longer need to fill out entry cards.

Dec. 26, 2006: Taipei's Bank of China Gov. Perng advocates legalizing RMB exchange.

Dec. 27, 2006: Beijing relaxes rules for Taiwan journalists reporting on 2008 Olympics.

Dec. 29, 2006: 2006 Defense Supplemental sent to the LY Defense Committee.

Dec. 29, 2006: MAC instructed to work out RMB exchange throughout Taiwan.

Dec. 29, 2006: China publishes *2006 Defense White Paper*.