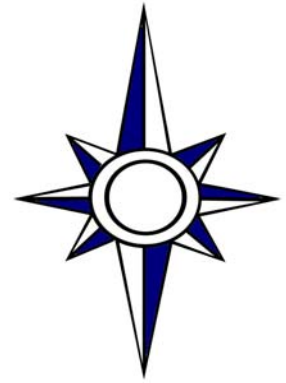


Comparative Connections

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China-Taiwan Relations: New Economic Challenges

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Beijing and Taipei have been making preparations for the third round of ARATS-SEF talks to be held in May or June at which time additional agreements on finance, flights, and crime are expected. The global recession has precipitated a dramatic decline in cross-Strait trade and that, in turn, has contributed to accelerated plans to negotiate a comprehensive cross-Strait economic agreement. However, the planning for such an agreement has produced a storm of opposition protest in Taiwan, which represents the most serious challenge yet to President Ma's cross-Strait policies. Officials on both sides are speaking optimistically about finding a formula under which Taipei could be an observer at the World Health Assembly (WHA) in May. Although defense reports from both sides acknowledge reduced tensions, there is as yet no sign that Beijing will reduce the military threat directed at Taiwan.

Hu's six points

On Dec. 31, President Hu Jintao gave a speech on the 30th anniversary of the 1979 "Message to Compatriots in Taiwan." He used the occasion to lay out the leadership's views on dealing with the Ma Ying-jeou administration in a six-point guideline. Since Hu's previous policy statements had been made to deal with the separatist challenge from Chen Shui-bian, Ma's election had led to a debate within the leadership on how to deal with new situation and a policy statement to set guidelines was needed. Hu was addressing audiences at home, in Taiwan, and aboard. Clearly the domestic audience was very important. The impression is that Hu felt it necessary to consolidate support among hardliners by asserting principled positions on "one China" and opposing separatism in his speech before moving ahead on conciliatory steps that might be controversial. This was similar to Hu's approach in late 2004 when he had the National People's Congress Standing Committee approve the draft Anti-Secession Law in December 2004 before he authorized the Taiwan Affairs Office (TAO) to negotiate the first New Year's charter flight agreement in January 2005. In fact, Hu's six points contain many elements that may provide the basis for further improving cross-Strait relations.

Generally, the Ma administration saw the six points positively. Nevertheless its initial comments reminded Beijing that Taipei's policy is based on the 1992 consensus, which allows for different interpretations of "one China" and on mutual non-denial, i.e., that neither should explicitly deny the other's sovereignty. Taipei considered making a formal public response, but thus far has decided not to as President Ma's policies are well-documented on the public record.

ARATS-SEF planning

Beijing's Association for Relations Across the Taiwan Strait (ARATS) and Taipei's Straits Exchange Foundation (SEF) have been preparing for their third meeting, which will take place in China, probably Shanghai, in May or June. At this point, both China's Taiwan Affairs office (TAO) and the Mainland Affairs Council (MAC) in Taipei are indicating that three agreements are expected to be signed at that time: one on cooperation in the supervision of financial service companies, which is needed to reciprocally open their financial services sectors; another on regular scheduled cross-Strait flights, and a third one on cooperation in combating crime, which would supersede the existing agreement between the respective Red Cross Societies. Some progress on other issues, including PRC investment in Taiwan, may also occur at the meeting.

Cross-Strait trade declines dramatically

Although cross-Strait trade grew modestly in 2008, total trade and particularly Taiwan's exports to China declined dramatically in late 2008 and early 2009. The MAC estimates that cross-Strait trade in 2008 reached \$105.4 billion, up 3.1 percent. Taiwan's exports were estimated at \$74 billion, down 0.4 percent and Taiwan's imports were estimated at \$31.4 billion, up 12.1 percent over 2007. Statistics from Beijing's Ministry of Commerce show similar trends but, as usual, showing higher imports and exports. Beijing put two-way trade at \$129.2 billion, up 3.8 percent. It showed China's imports at \$103.3, up 2.3 percent and China's exports at \$25.9 billion, up 10.3 percent.

These full-year figures mask the dramatic decline in trade that began in September 2008. In September, Taiwan saw the first monthly decline in exports to China compared with a year earlier since the global information technology recession in 2001. Taiwan's exports to China declined 16.3 percent in September, and the rate of decline accelerated rapidly to reach 58.6 percent in January 2009. February was the sixth month of successive declines, but the rate of decline fell to 28.6 percent. As exports are equivalent to about 70 percent of Taiwan's Gross Domestic Product (GDP), economists in Taiwan have been revising their projections for growth in 2009 downward and the government now predicts GDP will decline about 3 percent. Although exports from both China and Taiwan have suffered from the decline in global trade, Taiwan's exports to China have declined more sharply than Taiwan's exports to other markets. These factors have led to a new round of charges from pro-Democratic Progressive Party (DPP) economists in Taipei that Taiwan is too dependent on the China market.

As economics has been the most important positive element in cross-Strait relations, Beijing has recognized the potential political implications of this downturn and has announced a variety of programs to benefit Taiwan invested enterprises (TIEs). How effective these financial measures can be when the primary problem is not financing but a decline in foreign markets remains to be seen. The decline has also accelerated Beijing's interest in reaching an overall trade agreement with Taiwan. Premier Wen Jiabao has said that strengthening economic ties is the best way to respond to the global financial crisis.

Brewing confrontation in Taipei

President Ma too wishes to accelerate efforts to achieve a Comprehensive Economic Cooperation Agreement (CECA), but his efforts to do so have sparked political controversy with the opposition. Taiwanese exporters argue that a cross-Strait economic agreement is needed because the implementation of the ASEAN-China Free Trade Agreement in 2010 will significantly erode Taiwan's competitive position in those markets. A comment by National Security Advisor Su Chi on Feb. 13 that this issue would be discussed at the upcoming SEF-ARATS talks roused the opposition to action.

Although proponents portray the CECA as a purely economic agreement, the opposition both sees and portrays it in political terms as a move that would erode Taiwan's sovereignty and lay a basis for eventual reunification. On Feb. 22, Taiwan Solidarity Union (TSU) Chairman Huang Kuang-hui said that a CECA agreement would be grounds for impeaching President Ma. DPP Chairwoman Tsai Ing-wen said that a CECA would provide the basis for an all-out campaign against Ma and would likely lead to "social unrest." Her comments are an indication of pressure from deep-green activists, who will use the issue to mobilize street demonstrations to block the agreement and to rebuild public support for the DPP by making emotional appeals over fears about unification. The DPP has charged that China will condition a new agreement on Taiwan's acceptance of "one China." However, Chinese officials say that the agreement would be between ARATS and SEF and, like other ARATS-SEF agreements, would not touch on politics.

Government spokesmen have tried to calm opposition concerns by stating repeatedly that discussion of such an agreement is not on the agenda for the coming ARATS-SEF meeting and that the government has no timetable for its negotiation. On Feb. 27, President Ma gave a televised interview to address public concerns, emphasizing the economic rationale for an agreement and saying that plans would be reported to the Legislative Yuan (LY) in advance. Ma said his administration would no longer use the now politically charged term CECA but instead adopt the term Economic Cooperation Framework Agreement (ECFA). Just how much of a substantive difference this implies will not be known until the Ma administration defines the content it seeks in an agreement, which it has not yet done. MAC Chairperson Lai Shin-yuan gave assurance that the CECA or ECFA would be submitted to the LY for approval. The opposition saw little reassurance in that because Kuomintang (KMT) dominance in the LY would assure approval. Given its minority position, the DPP will see taking to the streets as its only effective means of blocking the agreement. The DPP and government have published competing polls showing public opinion favorable to their respective points of view.

To make its case and defuse criticism that the agreement would erode Taiwan's sovereignty, the administration plans to hold a series of public forums to air issues related to negotiating an ECFA. The first such forum produced evidence of support for an agreement from firms exporting to China and opposition from industries that would likely be hurt by imports from China. The MAC has said that it will take about three months for the government to complete the studies needed to define Taipei's ECFA negotiation objectives. As mentioned, Beijing sees the benefits of reaching agreement and has responded to the debate in Taipei by stating that it is flexible on what the agreement is called and seeks an agreement that will meet Taiwan's needs.

Taiwan and the WHO

Within two weeks of Hu's six-point speech, Beijing made a conciliatory gesture. On Jan. 13, Taipei received a letter from the World Health Organization (WHO) Secretariat inviting it to participate in the International Health Regulations (IHR). Until then, Taipei's well-known interest in participation had been blocked by Beijing. Now, deft behind-the-scenes compromises got around various political issues. Inclusion allows Taiwan to participate in IHR's international health alert systems, achieving some of the most important practical benefits Taipei seeks from participation in the WHO.

In welcoming this step forward, Taipei made clear that it was not a substitute for its desire to attend the WHA meeting in May as an observer. Rather than pursuing this goal through international lobbying as in the past, the Ma administration has indicated it will seek to reach an understanding with Beijing. President Ma said in March that the contacts with Beijing would take place abroad beginning in April. Many observers believe that some informal contacts on the issue have already occurred through one or more channels. While it is realistic for the Ma administration to try to reach an understanding with Beijing, the idea that it would do so has fed opposition fears that the administration would "sacrifice Taiwan's sovereignty" in a secret deal with the "Chinese Communists." The DPP has stated that it would not accept an arrangement in which Taipei would attend under the aegis of China as the sovereign state or an arrangement under which China would have a veto each year on whether Taiwan was invited. Ma has to weigh such concerns in seeking an arrangement with China.

Defense issues

Both Beijing and Taipei have recently published defense policy papers. In January, Beijing released its 2008 Defense White Paper and Taipei released its first Quadrennial Defense Report (QDR) in March. Not surprisingly, both reports state that tensions in the Taiwan Strait have been reduced. Despite Beijing's acknowledgement that tensions have lowered, its White Paper gives no indication that Beijing's deployments that threaten Taiwan have been or likely will be changed. When asked about deployments, all spokesman Hu Changming would say is that China's "limited deployments" reflect China's national interests and that changes would depend upon China's interests. On the eve of the National People's Congress (NPC) in March, Beijing announced that its published defense budget for 2009 would increase by 14.9 percent to \$70.27 billion. For its part, Washington released its 2009 Report on Chinese Military Power, which likewise concluded that despite the reduction of tension, there is no indication of a change in PRC deployments targeted at Taiwan.

Taipei's QDR was the first formal statement of the Ma administration's comprehensive policies for securing Taiwan. In presenting the report, the Ministry of National Defense (MND) emphasized that Taiwan's basic approach is "preventive defense." The QDR avoided some of the provocative ideas advocated by former President Chen such as active defense and fighting the "decisive battle outside our territory." Beijing commentators have noted the changed tone. At the same time, the QDR maintains the importance of air and sea defense of Taiwan. In answering questions on the report, Defense Minister Chen noted that the Legislative Yuan had

approved funds for the *Hsiungfeng IIE* land attack cruise missile and stated that the program would be continued. Chen said Taipei saw the *HF IIE* as a defensive system that would only be employed after war broke out and used to degrade military bases being used to attack Taiwan.

There has been no significant progress on defense-related Confidence Building Measures (CBMs). Hu Jintao's six points takes a very cautious approach saying only "The two sides can, in due course ... hold exploratory discussions on the issue of establishing a mechanism of mutual trust for military security." TAO Minister Wang Yi spoke somewhat more positively in March suggesting that exchanges of retired military officers could be conducted. However, as informal contacts by retired Taiwan officers have been occurring for some time, Wang's statement seems to indicate some official blessing and perhaps more structure for such exchanges. Taipei too is taking a very cautious approach to cross-Strait CBMs.

Hu Jintao's six points spoke more positively about reaching an agreement to end hostilities. This is seen as reflecting Hu's desire to reach such an agreement before his term ends in 2012. For Ma, under the constant barrage of opposition charges that he is sacrificing Taiwan's sovereignty, the idea of a peace agreement is currently seen as an issue that he would not plan to tackle until achieving a second term in 2012.

U.S. policy

Secretary of State Hillary Clinton's confirmation process and her first trip to Asia presented opportunities for the Obama administration to put on record statements reaffirming continuity in the key elements in U.S. policy on cross-Strait relations based on the three U.S.-China communiqués and the Taiwan Relations Act (TRA). Clinton said the U.S. was pleased with the reduction of tension and encouraged continued progress. She also said there would be no change in U.S. arms sales policy guided by the TRA. American Institute in Taiwan (AIT) Chairman Ray Burghardt reinforced some of these messages during a March visit to Taipei. He pointedly rebutted continuing comments in Taipei that the U.S. is concerned by the pace and direction of President Ma's cross-Strait policies. He reiterated that the U.S. wished to see this progress continue and stated that the U.S. is not worried by the prospect that the cross-Strait dialogue would proceed to consider a comprehensive economic agreement or political and military issues.

Looking ahead

May and June will witness two more tests of the two sides' abilities to sustain the progress that has reduced tensions in cross-Strait relations. The WHA meeting in May will be a litmus test of whether Beijing has sufficient pragmatism to reach a mutually acceptable way for Taiwan to participate as an observer. The 3rd ARATS-SEF meeting should demonstrate the two sides' abilities to continue reaching agreements of practical benefit.

In Taipei, the Ma administration will be developing its specific proposals for an ECFA negotiation with the PRC against the background of continuing opposition criticism. How the public will react to their opposing views on the issue will be important. The decline in cross-Strait trade is a negative influence, but how severe the impact of a prolonged decline would be is difficult to foresee. The trade and export order data for February shows that the rate of decline

has slowed and the drop in export orders may have bottomed out – providing a ray of hope that trade trends may begin to improve.

Chronology of China-Taiwan Relations January-March 2009

Dec. 31, 2008: President Hu Jintao delivers a six-point speech outlining the Peoples Republic of China (PRC) leadership's approach to dealing with Taiwan.

Jan. 1, 2009: President Ma Ying-jeou's New Year's address stresses Republic of China (ROC) sovereignty and dignity.

Jan. 5, 2009: Straits Exchange Foundation (SEF) sends the Association for Relations across the Taiwan Straits (ARATS) compensation claims for melamine contamination.

Jan. 7, 2009: SEF Chair Chiang Pin-kung visits China for consultations with Taiwan invested enterprises (TIEs).

Jan. 8, 2009: Reports show Taiwan's exports to China in December decline by 54 percent.

Jan. 8, 2009: Taiwan Affairs Office (TAO) Minister Wang Yi meets U.S. Deputy Secretary of State John Negroponte in Beijing.

Jan. 12, 2009: Beijing reports that PLA Navy escorts Taiwan ship near Somalia.

Jan. 13, 2009: World Health Organization invites Taiwan to participate in International Health Regulations (IHR).

Jan. 16, 2009: SEF Chair Chiang says the ASEAN-China Free Trade Agreement makes Comprehensive Economic Cooperation Agreement (CECA) with China necessary.

Jan. 17, 2009: President Ma Ying-jeou again calls for removal of Chinese missiles from the coastal region opposite Taiwan.

Jan. 20, 2009: Beijing releases its 2008 white paper on national defense.

Jan. 21, 2009: TAO Minister Wang Yi comments on the agenda for the 3rd ARATS-SEF talks.

Jan. 22, 2009: President Ma reiterates "resolute defense, effective deterrence" policy.

Jan. 22, 2009: Mainland Affairs Council (MAC) authorizes financial services, scheduled flights, and PRC investment as issues for 3rd SEF-ARATS talks.

Jan. 26, 2009: Taipei Zoo's panda house opens.

Jan.27, 2009: Raytheon wins a bid to upgrade Taiwan's *Patriot* missiles.

Jan. 30, 2009: President Barack Obama calls President Hu and makes no mention of Taiwan.

Feb. 1, 2009: Democratic Progressive Party Chair Tsai Ing-wen asserts Washington has doubts about President Ma's cross-Strait policy.

Feb. 6, 2009: Jia Qinglin, fourth-ranking member of the Politburo Standing Committee of the Communist Party of China and chairman of the People's Political Consultative Conference, attends a conference in Taiwan.

Feb. 13, 2009: President Ma is interviewed by *New York Times*.

Feb. 13, 2009: Secretary of State Hillary Clinton expresses hope that cross-Strait relations will continue to improve.

Feb. 14, 2009: MAC states that CECA is not on the agenda for the 3rd SEF-ARATS meeting.

Feb. 14, 2009: DPP chair Tsai says CECA requires social consensus in Taiwan.

Feb. 14, 2009: MAC Chair Lai Shin-yuan says the number of Chinese missiles aimed at Taiwan has increased to 1,500.

Feb. 15, 2009: The two Palace Museums ink an artifact exchange deal in Beijing.

Feb. 16, 2009: Secretary Clinton says U.S. encourages further progress in cross-Strait relations.

Feb. 16, 2009: Taiwan financial services delegation holds talks in Beijing.

Feb. 18, 2009: U.S. Pacific Command Commander Adm. Timothy Keating offers to host cross-Strait military talks.

Feb. 21, 2009: Secretary Clinton visits Beijing.

Feb. 21, 2009: DPP-Taiwan Solidarity Union National Policy Conference focuses on CECA.

Feb. 22, 2009: TSU Chair Huang Chu-wen says CECA will prompt all-out impeachment effort.

Feb. 22, 2009: DPP Chair Tsai says CECA would cause serious social conflict.

Feb. 24, 2009: Taiwan's Presidential Office says name CECA will be dropped from the discussions on the development of an agreement on economic issues with China.

Feb. 24, 2009: Premier Liu Chao-shiuan says there is no timetable for concluding CECA.

Feb. 24, 2009: SEF Chair Chiang says he hopes a framework for CECA can be reached in 2009.

Feb. 25, 2009: TAO spokesman says CECA would be mutually beneficial.

Feb. 26, 2009: Cross-Strait postal remittance of funds begins.

Feb. 27, 2009: President Ma's news conference introduces the term Economic Cooperation Framework Agreement (ECFA) in lieu of CECA.

Feb. 27, 2009: MAC says CECA would be sent to Legislative Yuan (LY) for approval.

Feb. 27, 2009: Premier Liu says CECA is not on 3rd SEF-ARATS agenda.

Feb. 28, 2009: U.S.-China Defense Policy Coordination Talks conclude.

March 1, 2009: In online dialogue, Premier Wen Jiabao calls for economic cooperation mechanism that meets Taiwan's needs.

March 2, 2009: DPP Chair Tsai calls for referendum on CECA/ECFA.

March 2, 2009: Speaker Wang Jin-pyng calls for LY task force on cross-Strait relations.

March 3, 2009: Group led by Frank Hsieh says CECA would mean unification.

March 3, 2009: Former Vice Premier Wu Rong-yi says ECFA is a trap set by China.

March 4, 2009: Former President Lee Teng-hui says ECFA not in Taiwan's interest.

March 4, 2009: President Ma says tensions with the mainland are at record low; PRC announces 15 percent increase in 2010 defense budget.

March 4, 2009: Kuomintang (KMT) Chair Wu Poh-hsuing returns from trip to Southeast Asia.

March 5, 2009: President Ma expresses hope that ECFA can be discussed at the 3rd SEF-ARATS meeting.

March 6, 2009: People's Bank of China President Zhou Xiaochuan says financial service memorandum of understanding with Taiwan could be based on HK agreement.

March 7, 2009: Taiwan Semiconductor (TSMC) Chair Morris Chang endorses goal of ECFA.

March 10, 2009: PRC Minister of Commerce Chen Deming calls for early talks on CECA to combat financial downturn.

March 11, 2009: TAO Minister Wang Yi is cautiously optimistic that Taiwan will be able to attend the World Health Assembly as an observer.

March 12, 2009: President Ma says talks on WHA participation will be held overseas in April.

March 16, 2009: Taipei releases its first Quadrennial Defense Report.

March 18, 2009: President Ma receives American Institute in Taiwan Chairman Ray Burghardt.

March 19, 2009: Taipei's Ministry of Economic Affairs (MOEA) holds first ECFA hearing.

March 24, 2009: DPP Chair Tsai says ECFA under "one China" principle would divide society.

March 25, 2009: U.S. Department of Defense releases *Military Power of the PRC 2009* report.

March 29, 2009: MOEA Minister Yiin Chii-ming says there have been talks on ECFA.

March 30, 2009: DPP Caucus calls for full transparency on ECFA.

March 30, 2009: Two Red Cross societies sign cooperation agreement in Taipei.

March 31, 2009: Taipei ratifies two UN human rights conventions.