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Chinese Economic Coercion Against Taiwan

A Tricky Weapon to Use

Murray Scot Tanner

Prepared for the Office of the Secretary of Defense

Approved for public release; distribution unlimited



The research described in this report was prepared for the Office of the Secretary of Defense (OSD). The research was conducted in the RAND National Defense Research Institute, a federally funded research and development center sponsored by the OSD, the Joint Staff, the Unified Combatant Commands, the Department of the Navy, the Marine Corps, the defense agencies, and the defense Intelligence Community under Contract DASW01-01-C-0004.

Cover Illustration by Tim Lee, Care of theiSpot.com

Library of Congress Cataloging-in-Publication Data

Tanner, Murray Scot.

Chinese economic coercion against Taiwan : a tricky weapon to use /

Murray Scot Tanner.

p. cm.

Includes bibliographical references.

ISBN 978-0-8330-3969-9 (pbk. : alk. paper)

1. China—Foreign economic relations—Taiwan. 2. China—Foreign relations—Taiwan. 3. Taiwan—Foreign economic relations—China. 4. Taiwan—Foreign relations—China. I. Title.

HF1604.T36 2006

337.5105124'9—dc22

2006033995

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Cover Design by Eileen Delson La Russo

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Published 2007 by the RAND Corporation

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Summary

This monograph analyzes the rapidly expanding economic relationship between mainland China and Taiwan and the prospects and challenges Beijing faces as it tries to exploit this economic relationship to gain political leverage over Taipei.

Since the early 1980s, the economic relationship between Taiwan and mainland China has exploded, driven by far-reaching economic and political reforms on both sides as well as powerful natural complementarities in the two economies. As a result, the two economies are now in a deep, wide-ranging relationship of “asymmetric interdependence” in which each side relies upon the other for important contributions to its economy, and each would suffer great economic pain and dislocation in the event of a major disruption in that relationship. But as Taipei’s leaders have long feared, Taiwan depends on the mainland market for a far higher percentage and a far broader range of its economic activities than the mainland depends on Taiwan.

From virtually no contact a quarter-century ago, by late 2001, China had replaced the United States as Taiwan’s number-one market for its exports. Cross-strait two-way trade has risen from an estimated \$950 million (U.S.) in 1986 to more than \$46.3 billion by the end of 2003, the latter figure being equal to 17.1 percent of Taiwan’s total trade. China is also the number-one venue for Taiwan’s foreign investment and the number-one production base for many of its most profitable exports—especially its information technology (IT) exports. Cross-strait economic ties now occupy terrific weight within both economies, particularly Taiwan’s. Exports to the mainland equaled more than one-tenth of Taiwan’s entire gross national product (GNP) by the end of 2003. Taiwan’s foreign direct investment (FDI) in the mainland accounts for more than half of all Taiwan FDI—or perhaps much more than half.

The expanding cross-strait relationship raises serious security questions, particularly for Taiwan. Many analysts have expressed concern that China will exploit the economic relationship with Taiwan in ways that could undermine the United States’ long-standing opposition to either side unilaterally or coercively altering the status quo across the Taiwan Strait and its insistence that any resolution to cross-strait conflict be acceptable to the people of Taiwan. Beijing has, in fact, either committed or publicly contemplated many forms of economic pressure against Taiwan at various times within the past two decades. Beijing has openly proclaimed that its key goals for

expanding economic relations with Taiwan include encouraging “peaceful reunification” and “using business to pressure politicians.” Over the years, Chinese leaders and analysts have often argued that cultivating economic ties with Taiwan might contribute to reunification in many ways, from the magnetic to the highly coercive.

Economic experts warn that if China were able to close down key parts of the cross-strait economic relationship, Taiwan would be vulnerable to a major recession and other severe forms of economic dislocation. The hundreds of thousands of Taiwan businesspeople now working on the mainland are also vulnerable to pressure and harassment from mainland authorities. In addition, China has demonstrated that it can disrupt key sectors of Taiwan’s economy, including its stock markets and information networks.

Since 1979, successive Taipei governments have struggled to strike a balance between growth and security in their cross-strait economic policies. Both government and business leaders strongly desire to draw on mainland China’s rapid growth as a vehicle to rescue Taiwan’s increasingly challenged international competitive position. At the same time, both the Lee Teng-hui and Chen Shui-bian administrations have sought to limit Taiwan’s economic dependency on Beijing. Politically, advocates of liberalizing cross-strait trade and investment relations—in particular, Taiwan’s influential mainland-invested business community (the “Taishang”)—have won the lion’s share of these battles. Presidents Lee and Chen, however, have periodically shown real willingness to resist such pressure and can point to some significant successes in limiting Taiwan’s dependence—most notably in slowing the pace of high-tech investment on the mainland and maintaining a significant technological “gap” or “lag” between what Taiwan firms produce on the island and what they produce across the strait. Taipei’s efforts to get Taishang to move their investments to less-threatening Asian venues have been far less successful.

Most experts on economic diplomacy agree, however, that the level of economic deprivation an “initiating” country (e.g., mainland China) can inflict rarely, by itself, determines the effectiveness of economic coercion. Several political factors—in particular the domestic political situation within the initiating and “target” countries—usually have a greater impact on the initiator’s ability to convert economic influence into political leverage. For Beijing to initiate economic pressure, a key challenge is identifying and effectively exploiting “conduits of influence” within the target’s (e.g., Taiwan’s) political system—that is, politically influential classes or groups in Taiwan with a stake in promoting the policies that Beijing also supports. These conduits of influence are a key factor in converting economic influence into effective political leverage.

Somewhat surprisingly, given the high level of Taiwan’s economic dependence on the mainland, these economic ties have not automatically translated into effective political leverage for China. Indeed, in recent years, Beijing has often been frustrated in its efforts to exploit this economic leverage, at least in the near term. From China’s perspective, the cross-strait economic relationship is potentially a very powerful

political weapon, but it is a weapon that Beijing is finding increasingly tricky to use. For example,

- Beijing's frustration was dramatically illustrated in the 2004 Taiwan presidential election. The elections proved that widespread forecasts that Taiwan's business leaders and Taiwan voters—both worried about the poor state of Taiwan's economy and anxious for expanded cross-strait economic relations—would combine to defeat President Chen Shui-bian were mistaken or at least badly exaggerated.
- A major reason why Beijing is having trouble exploiting its economic leverage is that most Taiwan businesspeople have become highly adept at “flying below the radar” politically—keeping their true political inclinations and activities hidden from political leaders in both Taiwan and mainland China, thereby frustrating Beijing's efforts to pressure them into forming a ready-made “lobby” for Beijing's interests. While mainland-invested Taiwan businesspeople have been, for the most part, successful in encouraging their government to loosen economic restrictions on cross-strait ties, the business community has been unwilling or unable to use its political influence to pressure Taipei into making significant political concessions to Beijing.
- Taiwan's voters have also frustrated Beijing's forecasters. Although the voters have largely supported candidates who favored improved cross-strait economic ties, it has not prevented the continuous slide in support for reunification with China on terms that Beijing prefers.
- Nor have Taiwan's political leaders sat back passively as Beijing attempted to exploit its burgeoning economic might. President Chen has frequently shown himself to be fairly adept at politically disarming or counterattacking many advocates of a more rapid opening up of cross-strait relations.
- Finally, China must reflect upon the potential blowback that large-scale efforts at economic coercion against Taiwan might have upon its own economy and society. Although Taiwan is, overall, more economically dependent upon mainland China than China is on Taiwan, there are key regions and sectors of China's economy that are enormously dependent upon Taiwan investment, and these would likely suffer very badly in the event of a serious cutoff of trade and investment.

But Beijing's difficulty in translating economic leverage into political leverage is not necessarily good news for either Taiwan or for U.S. interests in the region. There is significant evidence that in the wake of the 2004 Taiwan presidential election, China's growing frustration over its problems in employing economic levers of power temporarily undermined the position of those policy advisors who were most optimistic about the long-term efficacy of economic power and cross-strait economic integration—and perhaps correspondingly strengthened the hands of those Chinese analysts who advocate using more nakedly coercive measures against Taiwan. These tensions

have eased in the past year as Beijing adopted a more restrained, seductive strategy toward Taiwan, and Chen Shui-bian has encountered numerous political setbacks at home. But Chinese analysts overwhelmingly attribute Chen's problems to factors other than the power of the growing cross-strait economic relationship.

Taipei's fears about cross-strait economic relations may also increase threats to stability in the region. Many in Taipei do not share this report's conclusion that Beijing is having difficulty transforming its economic influence into political leverage. Fearing that Beijing's rapid economic growth will eventually grant it overwhelming political leverage, many of Taiwan's more strongly pro-independence leaders believe that the time to push for constitutional reforms or other measures to formalize a more independent relationship is "now or never."

This study indicates that, for Beijing, there is an irony in its efforts to exploit its economic leverage to bring Taiwan closer to a reunification deal. Cross-strait economic links appear to have the greatest impact on Taiwan's politics when Beijing is least aggressive in trying to exploit them, as it has been since early 2005. When Beijing uses high-profile, high-pressure economic tactics, they have tended to backfire, creating powerful opposition in Taiwan and undermining the political effectiveness of those with a stake in closer cross-strait economic and political ties. Taiwan business and political leaders seem more inclined to reflect positively on the importance of future cross-strait economic relations when Beijing keeps a low profile and refrains from overt pressure tactics. But when Beijing's leaders have become frustrated with Taipei's "envelope-pushing," they all too often see the Taishang as a convenient target for their momentary wrath. The Beijing leadership—by attacking one of the few groups left in Taiwan with a reasonably positive impression of it—has, in the words of an old Chinese saying, "lifted a rock only to drop it on its own foot." China has at its disposal a potentially powerful weapon to keep Taiwan from drifting away. But there is serious doubt whether Beijing's leaders have the political self-restraint to use this weapon effectively over the long run. Whenever Beijing has grown irritated with Taipei, Taiwan businesspeople operating in China have made exceedingly tempting targets.