The Past and the Future: The Taiwan Relations Act (TRA) and the Changing Dynamics of Trilateral Economic Relations*

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Economic activities have political consequences and give rise to security concerns. A political institutional framework and security alignment will in turn pave the way for economic interaction between states. Over the years the dynamics of trilateral economic interaction between the United States, Taiwan, and China have presented scholars with some intriguing theoretical puzzles, since the empirical evidence is not always compatible with existing theories. This article explores how the Taiwan Relations Act (TRA)—a long-lasting institutional framework regulating the interaction of three parties—has contributed to Taiwan’s economy in the past, and then it shifts its focus to the challenges the TRA faces in the future, given the growing economic impact of a rising China on its target—Taiwan. Drawing on existing theories and empirical evidence, it is argued

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that China's increasing propensity to utilize its economic leverage on the Taiwan issue not only undermines Taiwan's security, but also significantly test the viability of the TRA in the years to come.

KEYWORDS: Taiwan Relations Act; asymmetrical economic interdependence; security externality; relative gain; economic coercion.

Since 2009, there have been a number of instances of disagreement over economic policy or trade friction involving Taipei, Washington, and Beijing. One example concerned the decision of President Ma Ying-jeou (馬英九) of Taiwan to sign the Economic Cooperation Framework Agreement (ECFA) with China, which was the subject of some controversy and fervent debate within Taiwan. While Ma regards the ECFA as a panacea for Taiwan's economic ills, the opposition views it as an economic Trojan horse which will undermine Taiwan's sovereignty and independence. Another example is the bickering between the United States and Taiwan over imports of U.S. beef. Surprisingly, lawmakers of Ma's party, the Kuomintang (KMT, Chinese Nationalist Party, 中國國民黨), joined with the opposition to overturn a U.S.-Taiwan agreement to lift a ban on the import of U.S. beef parts. This incident led Washington to postpone bilateral trade talks with Taiwan indefinitely. Trade disputes between Washington and Beijing have also grown increasingly heated over the last two years. Not only has the United States imposed high tariffs on Chinese steel and tires, provoking China to retaliate by raising tariffs on U.S. exports of car parts and poultry, but the U.S. Congress is also threatening to take retaliatory measures against China if the latter does not allow its undervalued currency to appreciate.

1“Seconds Out, Round One: And the President Wins the Points,” The Economist, April 29, 2010.
Thirty years ago, when there was a situation of intense political rivalry across the Taiwan Strait and U.S.-Taiwan-China relations were at a crossroads, people in Taiwan could hardly have imagined that these problems would occur. When President Jimmy Carter announced in December 1978 that the United States would terminate diplomatic relations with the Republic of China (ROC, hereafter Taiwan) and shift recognition to the People’s Republic of China (PRC, hereafter China), the United States inaugurated a new era in trilateral interaction. In March the following year, the U.S. Congress passed the Taiwan Relations Act (TRA) which offered Taiwan de facto recognition and a U.S. security guarantee that was designed to maintain peace and stability between the two sides of the Taiwan Strait.\(^4\)

The TRA has enabled Taiwan to preserve all substantial ties with the United States, although not under its official title, and given Washington a legal basis for continuing to provide weaponry for Taiwan's defense, despite there being no U.S. military presence on the island. From various perspectives, the fact that Taiwan has been able to survive politically and the way the TRA has been implemented over the past thirty years have intrigued scholars of international relations, given the asymmetry in military capability between Taiwan and China as well as Taiwan's minimal strategic value to the United States. Without doubt, the TRA is a highly political and security-defined piece of legislation. The provisions of the TRA and the way they have been implemented by successive U.S. governments have set ground rules for three decades of interaction between the three players—the United States, Taiwan, and China. Undeniably, U.S. military supremacy enables Washington to have the final say in defining the rules of the trilateral relationship. This power also allows the United States to deter both Taiwan and China from undertaking military aggression, thus ensuring peace and stability in the Taiwan Strait.

Although the implementation of the TRA has effectively maintained the status quo between the two sides of the Taiwan Strait for three decades,\(^4\)

the dynamics of trilateral economic interactions have changed considerably over that time and they offer a challenge to the continued existence of the TRA. In particularly, the rapid growth of cross-Strait economic activities indicates that the two sides have begun a process of economic integration. This development ignites the hope among liberal institutionalists that closer economic ties may narrow the political gap between Taiwan and China. To liberals, the global division of labor across the Strait should have the effect of reducing the likelihood of military conflict, while the success story of the European Union (EU) provides a compelling example of how a peaceful process of political unification between states can be carried out through economic integration.\(^5\) Realists, however, take a more pessimistic view, pointing out that China’s rising military and economic power makes its political leaders more assertive and more likely to seek to coerce Taiwan into submission.\(^6\) Despite the lack of agreement on the future development of cross-Strait relations, the status quo prescribed in the TRA seems unlikely to be maintained. It is beginning to be apparent, however, that economic factors are playing an increasingly important role in driving political responses in the trilateral relationship. For example, one latest debate in the United States regarding the viability of the TRA was triggered by the dramatic economic rapprochement between Taiwan and China that has taken place in the last two years.\(^7\)

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Indeed, as numerous studies in political economy suggest, while economic activities are constrained by the political relations between states, economic activities can also influence inter-state political cooperation. In this regard, the implementation of the TRA and the evolution of the trilateral economic relationship over the past thirty years both provide fertile ground for theoretical debates and deserve further investigation. However, while this article emphasizes the impact of economic factors in shaping the course of trilateral relations, it does not claim that economic factors are the only force determining political developments. Nevertheless, given the salience of economic ties across the Strait, the main focus here will be on the way that China's increasing economic influence on Taiwan is likely to challenge the implementation of the TRA in the future.

In this article I will first outline the contributions of the TRA to Taiwan's economy in the past and then analyze the upcoming challenges the TRA is likely to face by scrutinizing the dynamics of trilateral economic relations. It is argued here that, without the legal framework of the TRA to ensure the continuity of the U.S.-Taiwan commercial relationship and peace across the Taiwan Strait, Taiwan would have found it difficult to achieve the economic results that it has done since 1979. Next, I will point out that the rise of China's economic power has fundamentally altered the structure of trilateral economic relations and therefore it poses a critical challenge to Taiwan's economic security. Here, three empirical and theory-driven puzzles concerning the trilateral relationship are addressed: (1) what is the institutional foundation behind the burgeoning cross-Strait economic activities? (2) why does Taiwan fail to reduce its economic dependence on China? and (3) why should Taiwan be more concerned about the detrimental impacts of this dependence on its security? Based on extant theoretical arguments and empirical evidence, the subsequent section of this article

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therefore suggests that there are two possible sources of challenges to the TRA: from China's employment of economic coercion and from political infiltration through its growing economic leverage on the island. This article concludes by asserting that the United States must play a more active role in reinforcing the U.S.-Taiwan economic relationship. The relevance of the TRA depends on Washington's continued commitment to Taiwan's economic security and the robust progress of U.S.-Taiwan economic relations.

**The Origin of the TRA and Its Contributions to Taiwan's Economy**

In 1978, Taiwan's trade with the United States accounted for 32 percent of its total trade. Taiwan exported more than 30 percent of its products to the U.S. market and obtained 20 percent of its imports from the United States. Meanwhile, U.S. investment accounted for 51 percent of Taiwan's total foreign investment. Since the United States was Taiwan's top trading partner and its largest source of foreign direct investment (FDI), one could doubtless say that Taiwan was economically dependent on the United States. The opposite was by no means true, however, as Taiwan was the eighth largest trading partner of the United States that year.

Given that, from a relative-gains perspective, this unequal economic relationship benefited Taiwan more than the United States, realists may wonder why it was the United States that sought to preserve this relationship by means of the TRA. Also, from a power-politics perspective, since after de-recognition Taiwan was no longer a formal ally of the United States, the United States should have reduced its intra-alliance generosity to Taiwan, as it previously did to its European and Asian allies. Furthermore, the loss of Taiwan would not have threatened the vital interests of the United States, while continued relations with the island would create a political liability to Washington in its engagement process with China.⁹

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⁹President Richard Nixon and his national security advisor Henry Kissinger both saw Taiwan
Hence, realist theories do not provide adequate explanations for the creation of the TRA and the preservation of U.S.-Taiwan economic relations.

In fact, the existence of the TRA to some extent reveals a certain idealist component in U.S. foreign policy. Voices in favor of preserving substantial relations between the United States and Taiwan came mainly from the U.S. Congress. Putnam and Gourevitch have pointed out the importance of domestic politics in international cooperation; and the TRA is no exception to this influence. The separation of powers in the U.S. government allowed dissidents to express their concerns over de-recognition through the legislative branch. Although President Carter desperately needed a diplomatic breakthrough, such as the normalization of relations with China, to boost his declining popularity in the run-up to the 1980 election, he recognized that the decision to abandon a long-term ally without appropriate compensation would draw huge amounts of criticisms and opposition from his domestic audience, especially from the ranks of the Republican Party. Therefore, he declared that the "American people and the people on Taiwan will maintain commercial, cultural and other relations without government representation and without diplomatic relations," and submitted the Taiwan Omnibus Bill to the U.S. Congress to serve as a guideline for future U.S.-Taiwan relations. This bill, however, was held to lack "attention to the details of managing such a complex [commercial] relationship." It was left to Congress to fill the void, with assistance from the U.S. business and legal communities. The latter addressed their apprehension to members of Congress, their staffs, and relevant officials in

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the executive branch. After a long process of congressional deliberation, the TRA emerged in its final version that was more attentive to Taiwan's needs and was more pragmatic for sustaining viable U.S.-Taiwan relations.\footnote{According to one explanation, President Carter was well aware that Congress would amend the Taiwan Omnibus Bill, so both he and the State Department were willing to let Congress address Taiwan's concerns. See Tucker, \textit{Strait Talk}, 116-26.}

If the most important contribution of the TRA lies in its undertaking to maintain peace and stability in the Taiwan Strait, as many have argued,\footnote{Relevant analyses include David S. Chou, "ROC-US Political Relations as Seen from the Implementation of the Taiwan Relations Act," in \textit{ROC-US Relations Under the Taiwan Relations Act: Practice and Prospects}, ed. King-yuh Chang (Taipei: Institute of International Relations, National Chengchi University, 1988), 14-39; Stephen P. Gilbert 1989, "Safeguarding Security," in \textit{The Taiwan Relations Act: A Decade of Implementation}, ed. William B. Bader and Jeffery T. Bergner, (Indianapolis, Ind.: Hudson Institute & SRI International, 1989), 51-83; Dennis Van Vranken Hickey, \textit{United States-Taiwan Security Ties: From Cold War to Beyond Containment} (Westport, Conn.: Praeger 1994); Bih-jaw Lin, "Taipei-Washington Relations: Moving toward Institutionalization," in \textit{ROC-US Relations under the Taiwan Relations Act: Practice and Prospects}, ed. King-yuh Chang (Taipei: Institute of International Relations, National Chengchi University, 1988), 40-51.} another of its merits that should not be ignored is the peace dividend it has delivered to the benefit of Taiwan's economy. Taiwan is now a full-fledged democracy, the world's seventeenth largest trading nation, and the twentieth largest economy in the world, with per capita GDP of US$17,507 in 2008. These political and economic achievements would have been impossible if there had not been an environment of peace across the Taiwan Strait. Thus, this externally-imposed institutional framework—the TRA—has not only fulfilled its security undertaking and sustained U.S.-Taiwan economic relations, but it has also made a significant contribution to Taiwan's economic success. The continuation of the U.S.-Taiwan commercial relationship may have been a crucial factor in Taiwan's economic success, considering that the United States has in the past been Taiwan's largest trading partner and export market, and continues to be its largest source of foreign investment. The four areas in which the TRA has contributed to Taiwan's economy are discussed below.

1. \textit{The Provision of a Comprehensive Legal Framework for the Continuation of U.S.-Taiwan Economic Activities:} First and foremost, the TRA
provides an umbrella of legal protection aimed at preserving U.S.-Taiwan commercial relations from the consequences of de-recognition. Arguably, this may be the TRA's most important contribution to Taiwan's economy, since the absence of official recognition would otherwise have severely obstructed Taiwan's commercial interactions with the United States in many aspects.\(^\text{15}\)

In the text of the law itself it is stated that the TRA is necessary to authorize "the continuation of commercial, cultural, and other relations between the people of the United States and the people on Taiwan."\(^\text{16}\) Furthermore, the TRA also states that it is U.S. policy to "preserve and promote extensive, close, and friendly commercial . . . relations between the people of the U.S. and the people on Taiwan."\(^\text{17}\) These statements clearly articulate an intention to maintain all existing relations with Taiwan, with the exception of diplomatic relations.

Secondly, the TRA exceptionally grants Taiwan, a de-recognized country, all the legal rights that are in normal circumstances only available to governments officially recognized by the United States. In other words, the TRA creates a precedent and allows the United States "to treat Taiwan as a state and its governing authorities as a government, despite the formal de-recognition of both by Washington."\(^\text{18}\) Specifically, the TRA stipulates that "the absence of diplomatic relations shall not affect the application of

\(^{15}\) In this regard, Wheeler and Caranfil make six points: (1) U.S. courts deny ownership rights to unrecognized governments on U.S. soil; (2) the laws of an unrecognized government cannot be used as a valid basis for resolving disputes or establishing rights among parties located outside the territory under the control of that government; (3) judicial decisions and other actions of an unrecognized government are not accepted by U.S. courts; (4) an unrecognized government cannot appear as a litigant before a U.S. court; (5) the applicability of many U.S. statutes, particularly those governing international commerce and foreign policy, is ambiguous regarding unrecognized governments; (6) unrecognized governments cannot use any of the institutional mechanisms of communication and dispute resolution which have been developed under the structure of formal diplomatic relations. See Wheeler and Caranfil, "Commercial Relations Under the Taiwan Relations Act," 96.

\(^{16}\) TRA, Section 2.

\(^{17}\) TRA, Section 2.

the laws of the United States with respect to Taiwan.” The TRA also endows Taiwan with a legal status equivalent to other "foreign countries, nations, states, governments, or similar entities" under U.S. law. The U.S. government is thereby authorized to "conduct or carry out programs, transactions, or other relations" with respect to Taiwan in accordance with U.S. law. Taiwan and the people on Taiwan continue to have access to the U.S. courts, and the assets and property of Taiwan's private organizations and individuals still enjoy legal protection under U.S. law. These legal provisions ensure the continuation of U.S.-Taiwan commercial relations and minimize the negative effects of political de-recognition.

Thirdly, in order to encourage U.S. multinationals to continue to their invest in Taiwan, the TRA created a legal basis for the Overseas Private Investment Corporation to provide insurance to U.S. companies investing in Taiwan. Furthermore, citizens of Taiwan receive the same treatment regarding immigration, visa applications, and clearance as they did prior to de-recognition. These measures facilitate the continuation of business activities and civilian travel between the United States and Taiwan.

Two examples highlight the significance of the clauses mentioned above in preserving U.S.-Taiwan economic relations. One is the fact that in 2009, Taiwan ranked fifth in the world in terms of the number of U.S. patents granted to its firms (a total of 54,582 patents in the years 2005-2009). The second is that, in May 2010, Taiwan's second-largest producer of liquid crystal display (LCD) panels, AU Optronics Corp., won a patent lawsuit against its Korean rival, LG Display Co. Ltd., in a U.S. court. These two examples underline the significance of the TRA to Taiwan's business operations in the United States: without the TRA, Taiwanese

19TRA, Section 4.
20Ibid.
21Ibid.
22TRA, Section 5.
23TRA, Section 4.
companies would have no right to apply for U.S. patents or to file U.S. lawsuits. It would have a devastating economic impact if Taiwan's technological innovations could not be recognized and protected in the United States, the most important consumer market in the world.

2. The Continued Application of the Generalized System of Preferences (GSP) and Most-Favored Nation (MFN) status: As noted above, Taiwan's economy has been predominantly export-led and the U.S. market has played a crucial role in Taiwan's export performance, with exports to the United States accounting for one-third of Taiwan's total exports before 1990. For this reason, the continued application of GSP and MFN has been vital to Taiwan's outward-oriented economy, as GSP allowed Taiwan's products to enjoy the same tariff reductions as those of other developing countries, while MFN status means that imports from Taiwan enjoy equally favorable treatments in the U.S. market as those from any other country.

Taiwan was only able to enjoy these privileges because of the clause in the TRA that allows for "the continuation in force of all treaties and other international agreements, including multilateral conventions" previously concluded by the United States and Taiwan "unless and until terminated in accordance with law." It was because of the TRA that the application of GSP to Taiwan was extended until 1989. In contrast, China, at that time in 1979, did not enjoy either of these favorable trade treatments from the United States.

3. Support for Taiwan's Participation in International/Regional Economic Organizations: The TRA explicitly states that "nothing in this Act may be construed as a basis for supporting the exclusion or expulsion of Taiwan from continued membership in any international financial institution or any other international organization." This provision is essential since it is deliberately aimed at preventing the adverse effects of de-recognition from spilling over into international organizations, and it was

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26TRA, Section 4.
27Wang, "The Taiwan Relations at 30."
28TRA, Section 4.
crucial to Taiwan's Nationalist government at that time. Given that a series of diplomatic failures in the 1970s had already severely undermined the legitimacy of the authoritarian rule of the KMT, any further diplomatic setback would have triggered more political unrest and social turmoil on the island.\textsuperscript{29}

Thanks to the TRA and the U.S. government—predominantly in the form of congressional oversight—Taiwan has been able to maintain its membership in regional economic organization, such as the Asian Development Bank (ADB), in the face of China's protests. The United States has also assisted Taiwan to join new regional economic forums, such as the Asia-Pacific Economic Cooperation (APEC) in the late 1980s. Needless to say, the United States played a significant role in supporting Taiwan's entry into the World Trade Organization (WTO) in 2002. These efforts by the United States have done much to reduce Taiwan's fears of being isolated from the international economic community.

4. Guarantee for Taiwan's Economic Security: The TRA stresses that the United States considers "any effort to determine the future of Taiwan by other than peaceful means, including by boycotts or embargoes, a threat to the peace and security of the Western Pacific area and of grave concern to the United States." It also directs the president to "inform the Congress promptly of any "threat to the security or the social or economic system of the people on Taiwan." The United States undertakes to maintain the capacity to "resist any resort to force or other forms of coercion that would jeopardize the security, or the social or economic system, of the people on Taiwan."\textsuperscript{30} These clauses provide legal justification for the United States to take appropriate action against any attempt by China to damage Taiwan's economy, whether by means of military intimidation or economic coercion.

\textsuperscript{29}In December 1979, Taiwan's opposition held a pro-democracy demonstration in Kaohsiung. The protesters clashed with the KMT's military police and troops. The KMT used this incident as an excuse to arrest and prosecute the opposition leaders. This incident symbolizes the frustration and resentment of Taiwanese people to the KMT's rule.

\textsuperscript{30}TRA, Sections 2 and 3. Emphasis added by the author.
The litmus test for determining whether Washington intended to abide by the letter of the TRA was the Taiwan Strait Crisis of 1995-96. After President Lee Teng-hui (李登輝) of Taiwan paid a visit to the United States in 1995, China initiated a series of military exercises and missile tests along its eastern coast that were specifically aimed at intimidating Taiwan.\textsuperscript{31} These military maneuvers triggered a precipitous fall in both the Taiwan stock market and the value of the Taiwan dollar. During one month in the summer of 1995, the stock market fell by 25 percent and an estimated US$4 billion-worth of capital was withdrawn from the island.\textsuperscript{32} On two occasions during this crisis, in December 1995 and March 1996, the United States deployed aircraft carrier battle groups to areas near the Taiwan Strait, the largest U.S. military deployment in East Asia since the Vietnam War. In retrospect, the U.S. military presence at that time not only demonstrated Washington's determination to honor its commitment under the TRA to Taiwan's security, but also effectively boosted commercial confidence within Taiwan society.

These are the four ways in which the TRA has contributed to Taiwan's economy. Above all, the comprehensive legal protections prescribed in the TRA provided a solid foundation for the continuation of U.S.-Taiwan commercial activities after de-recognition. However, the author does not intend to overstate this point or claim that the TRA can ensure an everlasting progress in U.S.-Taiwan economic relations. It is the legal system and the protection of property rights that allows market forces to govern economic relations between the two sides, free from the political influence of de-recognition. Nevertheless, whether U.S.-Taiwan commercial relations improve or decline is largely determined by the forces of the market. This point will be demonstrated in the following section.

\textsuperscript{31}Beijing mobilized 150,000 troops for the military exercises in February and March in 1996 and fired missiles into the sea near Taiwan's two major harbors.

The Development of U.S.-Taiwan Economic Interactions under the TRA

In international relations literature, most scholarly attention is concentrated on interstate trade since trade represents one of the most important economic activities across states. The political implications of trade and its impact on international conflict have been at the center of debates among scholars. In addition to trade, researchers have also noted the increasing importance of FDI in the international economy and its growing influence on interstate and domestic politics. As early as the 1970s, dependency theorists criticized FDI and western multinational corporations (MNCs) for negative impacts they created in developing countries, whereas some recent studies discovered that FDI has had a pacifying effect on interstate conflict and can facilitate economic development. Although the debate continues, there is a widely-accepted consensus that these two forms of economic activity possess different extents of political repercussions and affect political leaders' decisions. Trade and FDI should therefore be two important aspects of any examination of U.S.-Taiwan economic development under the TRA.

As mentioned earlier, realists and liberals disagree on the economic benefits of international trade. Liberals, emphasizing the absolute gains of interstate trade, would expect institutional frameworks for economic exchanges to breed cooperation between states. The growth of cross-border


The TRA and the Changing Dynamics of Trilateral Economic Relations

Figure 1
Taiwan-U.S. Trade, 1979-2009, (US$ Million)

Source: Ministry of Finance, Taiwan, ROC.

Commercial activities facilitates interstate coordination and vice versa. Realists, however, who emphasize the security dilemma and relative gains, predict that increasing economic interdependence will raise states' sensitivity to relative gains and spark off a wide range of economic conflicts. These two schools constitute two different perspectives from which to examine U.S.-Taiwan economic relations after the enactment of the TRA.

As liberals anticipated, the institutional framework of the TRA has mitigated the negative impacts of de-recognition and paved the way for the continued development of the U.S.-Taiwan commodity trade (see figure 1). However, from a realist relative gains perspective, the critical question here should be which state has benefited more from this economic link by gaining a trade surplus. Under the TRA, Taiwan's export dependence on the United States rapidly climbed to its peak of 48.8 percent in 1984, and then de-

creased thereafter, and Taiwan's trade and import dependence on the United States followed a similar pattern (see figure 2). Accordingly, Taiwan's trade surplus with the United States also reached its highest point of US$13 billion in 1986 and gradually declined thereafter. Despite this falling trend, the proportion of U.S.-Taiwan trade in Taiwan's total trade surplus had been more than 50 percent for nearly two decades (see figure 3). As a result, the U.S. had regularly suffered enormous trade deficits with Taiwan.

Taiwan is also extremely reliant on the United States for inward FDI. U.S. investment in Taiwan was worth US$69 million in 1978 and increased to US$80 million in 1979, seemingly unaffected by derecognition. The flow of FDI from the United States to Taiwan has increased continuously over the years. Between 1952 and 2009, U.S. investment accounted for 20 percent of Taiwan's total FDI inflow, making the United States

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38Data come from the Department of Investment Services, ROC. See http://investintaiwan.nat.gov.tw/zh-tw/env/stats/idi_area.html.
Taiwan's most important source of FDI. Taiwan's investments in the United States also increased dramatically after Taiwan's financial liberalization in 1987 and reached a value of US$4.7 billion in 2007.
The above statistics suggest that de-recognition did not damage U.S.-Taiwan commercial exchanges. Conversely, Taiwan's economic dependence on the United States increased so rapidly that in the 1980s, imports from Taiwan accounted for the second largest share of the U.S. trade deficit after Japan. From a realist perspective, this enormous trade deficit with Taiwan became unbearable for the United States in the 1980s, especially in view of its aggravated current account deficit at that time. As a consequence, Washington began to press Taipei to allow its currency to appreciate, restrain its exports, and open its domestic market to U.S. agricultural products. Being heavily dependent on the United States, both economically and for its security, Taipei had little choice but to submit to Washington's pressure. Within a few years, Taiwan's currency had appreciated by nearly 30 percent against the U.S. dollar, and by the late 1980s, U.S. products, such as cigarettes and liquor, were available all over the island. The mid-1980s was therefore an important watershed in the history of U.S.-Taiwan economic relations. Since then, Taiwan's trade dependence on the United States has steadily declined. This development was a mixed blessing for Taiwan. On the positive side, trade disputes with the United States became less frequent, but on the down side, Taiwan's U.S.-centered, export-led growth model was significantly challenged and this necessitated a number of structural adjustments.

To conclude, the TRA has successfully served as an institutional framework for maintaining the flow of business after de-recognition. It also has functioned flawlessly by allowing market forces to flourish between the United States and Taiwan, as liberals expected. But as its economy weakened, the United States became less willing to sustain its economic generosity to its former ally. As realist relative gains thinking became dominant in U.S. foreign economic policy in the 1980s, it was inevitable that Taiwan's overwhelming economic dependence on the United States would be reduced. Influenced also by other factors, such as the changing international political economic environment, the realignment of the global division of labor, the rise of Taiwan's environmental movement,

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39Taiwan's currency rose from NT$39.8 to the dollar in 1985 to NT$28.5 in 1987.
and, most importantly, the emergence of China in the world economy, Taiwan inevitably moved away from the United States.

The Changing Dynamics of Trilateral Economic Interaction

During the Cold War, regional politics in East Asia was mainly dominated by the political confrontation involving the United States, the Soviet Union, and China. Economically, this region was divided by competition between Western capitalism and Soviet-style socialism. As the only hegemon in the free world, the United States was responsible for ensuring the security of its allies and also for offering them various kinds of economic assistance, in order to strengthen the solidarity of its alliances. Taiwan, like Japan and South Korea, was one of the countries that benefited significantly from U.S. security protection and economic support.

However, as the U.S. economy started to decline in the 1970s, Washington became increasingly concerned about its trade deficit with its allies and decided to exert its political influence to address the issue. The economic relationship between the United States and Taiwan under the TRA has exemplified this scenario, as discussed above. As trade conditions in Taiwan deteriorated and Taipei liberalized its financial regulations and opened cross-Strait socio-economic exchanges toward the end of the 1980s, Taiwan’s traditional industries began moving to China to preserve their competitiveness, a development which represented an important turning point in cross-Strait economic relations. Similarly, U.S.-China economic exchanges also made some significant progress after 1979. In 1985 China registered its first trade surplus with the United States. The pace of economic interaction slowed slightly under the sanctions regime imposed after the 1989 Tiananmen Massacre, but the granting of Permanent Normal Trade Relations (PNTR) status to China by the Clinton administration in 1999 was an important milestone in the history of U.S.-China economic relations. Since then, U.S. import dependence on China has dramatically increased and China has gradually become an indispensable player in trilateral economic interactions.
China's Growing Role in Taiwan's Economy

In 2003, China overtook the United States to become Taiwan's top trading partner (see figures 5, 6, and 7). However, as early as 1992, Taiwan's trade surplus with China had surpassed that with the United States and the surplus with China has been Taiwan's largest trade surplus for almost two decades now (see figure 8). The most important aspect of this unbalanced trade relationship is the massive volume of Taiwan's exports to China compared to its imports from there. Furthermore, cross-Strait FDI interaction also reveals a similar pattern. The level of Taiwan's investment in China has steadily increased since 1987. According to estimates from Taiwan's Mainland Affairs Council (MAC), Taiwan's accumulated investments in China were worth US$75.5 billion by 2008, accounting for 57 percent of Taiwan's total FDI outflow.\(^4\) In contrast, Taiwan's investment in the United States over the same period represented a mere 7 percent of

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\(^4\)Since a large proportion of Taiwan's investment in China is undertaken through third parties (e.g., Hong Kong and other tax havens), the actual value of Taiwan's investments most likely exceeds this figure.
Figure 6
Taiwan's Export Dependence on U.S. and China

Source: Ministry of Finance, Taiwan, ROC.

Figure 7
Taiwan's Import Dependence on U.S. and China

Source: Ministry of Finance and Mainland Affairs Council, Taiwan, ROC.
Figure 8
Taiwan's Trade Surplus with U.S. and China

Source: Ministry of Finance and Mainland Affairs Council, Taiwan, ROC.

Figure 9
Taiwan's FDI Outflows to the U.S. and China, 1987-2008 (US$ Million)

Sources: Data on FDI outflow to China come from Taiwan's Mainland Affairs Council's (MAC) and the PRC's Ministry of Commerce. Data on FDI outflow to the U.S. come from the U.S. Bureau of Economic Analysis.
Taiwan's total outward FDI.\textsuperscript{41} Based on official statistics, China has been Taiwan's top FDI recipient country since 2001, but it might have overtaken the United States as early as sometime in the 1990s, if indirect investments were fully taken into account. It should be noted that, for security reasons, Taiwan has imposed restrictions on Chinese investment in Taiwan, so there are no official data on FDI inflow from China.

\textit{U.S.-China Economic Interaction}

U.S.-China economic interaction has also made significant progress in recent years. The volume of U.S.-China trade increased from US$7.7 billion in 1985 to US$365.8 billion in 2009. U.S. trade dependence on China also rose from 1.39 percent in 1985 to 14 percent in 2009, while U.S. trade dependence on Taiwan decreased to 1.79 percent in 2009. China overtook Taiwan in terms of exports to the United States in 1992, although it would be another ten years before U.S. exports to China exceeded those to Taiwan (see Figures 10, 11, 12, and 13). In 2005 China became the

\textsuperscript{41} Data come from the MAC. This figure differs from those issued by the PRC and the U.S. Bureau of Economic Analysis.
Figure 11
U.S. Trade Dependency on Taiwan & China

Source: U.S. Bureau of Economic Analysis.

Figure 12
U.S. Import Dependency on Taiwan & China

Source: U.S. Bureau of Economic Analysis.
United States' second largest trading partner, surpassing Japan and Mexico, and generated a considerable trade surplus with the United States. In 2009 China accounted for 45 percent of the total U.S. trade deficit, compared to Taiwan's record level of 15 percent in 1991 (see figure 14).

Prior to 1998, U.S. investment in Taiwan exceeded investment in China, but since 2003, China has rapidly overtaken Taiwan as a destination for U.S. FDI. In 2008, U.S. FDI in China was worth US$45 billion, representing 1.45 percent of total U.S. outward FDI, while U.S. investment in Taiwan was worth US$16 billion, 0.53 percent of the total (see figure 15). Taiwan's FDI in the United States has consistently exceeded that of China by a large margin, rising from US$199 million in 1987 to a peak of US$4.7 billion in 2007. Chinese investments in the United States rose from US$182 million in 1997 to US$1.2 billion in 2008. However, this difference becomes negligible in the context of global FDI inflows to the United States. The ratio of Taiwan's FDI to total U.S. FDI has never exceeded 0.5 percent (see figure 16).

The preceding discussion reveals two notable trends. First, for the United States, economic relations with China are now more important than
Figure 14
U.S. Trade Deficit with Taiwan & China

Source: U.S. Bureau of Economic Analysis.

Figure 15
U.S. FDI Outflows to Taiwan & China

Source: U.S. Bureau of Economic Analysis.
economic relations with Taiwan. This brings with it a higher chance of economic friction as well as cooperation with China than with Taiwan. Second, Taiwan and the United States are economically dependent on China in different ways. Taiwan is excessively dependent on China for exports and relies on China to maintain its trade balance. As a consequence, Taiwan's economy is extremely vulnerable to the developments in the Chinese market. This unbalanced economic interdependence has bred security concerns in Taiwan, as many studies have suggested. In contrast, the United States' disproportionate import dependence on and enormous trade deficit with China have become the major source of U.S.-China trade disputes.

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43According to the WTO website, there are seventeen outstanding trade disputes cases against China, eight of which were filed by the United States.
The ongoing economic developments discussed above have different political repercussions both externally and domestically. As existing literature suggests, the political and security implications to states of cross-border economic exchanges vary. For instance, the "trading state" is less likely to initiate conflict.\(^44\) A state's economic dependence on other states can result in a loss of its bargaining power or it can be used to extract political concessions.\(^45\) An economic engagement policy toward a non-democratic adversary may affect that adversary's domestic politics and elicit its cooperation in foreign policy; or the reverse can occur, depending on the political structure of the non-democratic adversary.\(^46\) Given that trilateral economic exchanges involving the United States, China, and Taiwan carry important political connotations for all three parties, it is important to explore the following three intriguing puzzles in the trilateral relationship, since these empirical developments are seemingly not always compatible with theoretical explanations.

The first puzzle is that: if, as liberals argue, the TRA, by providing basic protection for property rights and ensuring the validity of contracts, was essential for the development of U.S.-Taiwan economic relations after de-recognition,\(^47\) how is it that cross-Strait economic relations have developed so rapidly despite the lack of political trust between Taiwan and China? Is there any institutional factor supporting commercial activities between these two political adversaries?

The development of cross-Strait economic interaction after the TRA can be attributed to two factors: the detente between Taiwan and China in


The TRA and the Changing Dynamics of Trilateral Economic Relations

the 1980s and the TRA's guarantee of Taiwan's security. One strategic implication of the TRA is the way it constrains both China and Taiwan from launching a military offensive across the Strait.\textsuperscript{48} This feature of the TRA, endorsed by the superiority of U.S. military forces, effectively ensures a non-conflict environment in the Taiwan Strait. Furthermore, the flourishing of cross-Strait economic interaction has benefited from the following three factors: a reduction in political hostility, irresistible economic incentives, and a legal framework.

First, in the same way that the TRA, a U.S. domestic law, provided legal guidance for U.S.-Taiwan economic relations and was embraced by Taiwan, cross-Strait commerce has been undergirded by regulations enacted by Taiwan and China. It is important to note that cross-Strait trade and investment had been prohibited by the governments on both sides of the Strait since 1949. Taiwan's "Regulations on Prohibition of Commercial Products from Bandit-Controlled Areas," for example, regarded any business transaction with China as treason. The hostility was gradually eroded as a result of changes in China's policy toward Taiwan. In 1979 China issued a "Message to Compatriots on Taiwan," a gesture of peace which proposed the establishment of "three links" between the two sides of the Strait.\textsuperscript{49} In the same year, China also promulgated the "Temporary Regulations Regarding Opening Trade with Taiwan" which provided a legal foundation for the cross-Strait trade. In 1981, the chairman of China's National People's Congress Standing Committee, Ye Jianying (葉劍英), announced nine-point policy," that not only promised Taiwan autonomy after reunification, but also requested the opening of direct trade between the two sides.

Taiwan initially responded to these initiatives with its "three nos" policy to reject China's proposals,\textsuperscript{50} but in 1985 Taipei dropped its antagonistic attitude and decriminalized indirect trade with China under the

\textsuperscript{48}This is referred to as "double deterrence."
\textsuperscript{49}The three links are direct transportation, direct mail, and direct trade between Taiwan and China.
\textsuperscript{50}The "three nos" were no contact, no negotiation, and no compromise.
"Non-interference Principle of Indirect Exports to the Mainland." After Taiwan lifted its controls on foreign exchange and allowed family visits to China in 1987, Taiwanese FDI in China increased rapidly. In 1988, China sought to further encourage Taiwanese investment by introducing "Regulations for Encouraging Investment by Taiwan People," which granted certain privileges and favorable treatments to Taiwan's investments, including exemptions from taxes. In 1990, while continuing to uphold its new policy toward China, embodied in the "Guidelines for National Unification," Taipei lifted the ban on indirect investment in China by promulgating the "Regulations on Indirect Investment and Technology Cooperation with the Mainland Area." This law provides a legal basis for Taiwanese indirect investment in China. Beijing, for its part, has continued to promote Taiwan's investment by strengthening legal protection. It is clear that burgeoning cross-Strait economic interaction was not built upon rhetorical sand but was provided with a legal foundation of property rights and contract enforcement. Taipei's initially neutral attitude toward indirect trade and investment with China alleviated the anxiety of Taiwanese entrepreneurs who had feared that they might be persecuted for their commercial activities in China. This lack of concern on Taipei's part seemed to grant implicit permission for cross-Strait economic activities. On the other hand, China's active role was a crucial factor in promoting the rapid growth of trade and investment between the two sides. Beijing has not only enacted laws to guarantee the safety of Taiwanese commercial operations in China, but has also introduced numerous economic incentives to attract investment from Taiwan. Since the governments on the two sides of the Strait have either explicitly or implicitly reduced the political impediments to cross-Strait commerce, it is hardly

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51 Taiwan relaxed its foreign exchange controls for economic reasons, whereas the lifting of the ban on family visits to China was a response to rising domestic political pressure.

52 For example, in 1994, the National People's Congress enacted the "Law to Protect Investment by Taiwan Compatriots." In 1999, Beijing established a Taiwanese Businessperson Investment Service Center and a Complaints Center for Taiwanese Businesspersons. In the same year, China promulgated the "Detailed Implementation Guidelines for the Law for the Protection of Investment by Taiwan Compatriots in the PRC."
surprising that cross-Strait economic interaction has developed so rapidly. Given economic complementarities, geographical proximity, and cultural and language similarities between the two sides, as well as the structural shift in East Asian international supply chains, once political obstacles had been largely removed, China naturally became the primary destination for Taiwanese investment. From the preceding line of reasoning, the argument of liberal institutionalism remains valid in cross-Strait relations.

The second puzzle is this: since realists would argue that relative gains should be more salient in economic exchanges between adversaries than between quasi-allies such as the United State and Taiwan, on the ground that political antagonism sharpens awareness of the security externalities of economic activities and leads states to be more cautious and sensitive about trading with a (potential) enemy, why has Taiwan been unable to take effective action to reduce its economic dependence on China, and why has China, unlike the United States, not taken any action to reduce its huge trade deficit with Taiwan?

The answer to this question largely rests on the differences in the domestic politics of the three parties. Taipei has not been unaware of the potential dangers involved in its asymmetrical economic dependence on China. In fact, as realists would anticipate, Taipei has attempted on several occasions to reduce, divert, and constrain Taiwan's overheated "China mania" since the 1990s. From Lee Tung-hui's "no haste, be patient" policy

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53 The role of international supply chains is also an important factor in the rapid growth of trade and investment across the Strait. The majority of Taiwan's exports to China are goods that are assembled in China and then exported to the United States and other developed countries. Taiwan's investments in China are largely export-oriented. Buyers in the United States and Europe are also inclined to recognize that Taiwan's production can move to China in order to save production costs. The author is grateful to the reviewer for contributing this point.

of 1995, to Chen Shui-bian's "proactive liberalization with effective management" of 2000 and "proactive management and effective liberalization" of 2005, these measures have failed to slow down the pace or to reduce the scale of Taiwan's trade and investment with China. In addition, now that the economic integration of the two sides has been largely consolidated, via the vertical division of labor across the Strait, would be too costly to disrupt this. Needless to say, the consequences of democratization in Taiwan in the 1990s have also affected the direction and effectiveness of Taiwan's economic policy toward China.  

Given the aforementioned constraints on Taiwan's economy in the mid-1980s on the issue of cross-Strait economic interaction, even the most pro-independence politicians had to strike a balance between economic growth and national security. Since economic growth tends to the issue more attractive to the Taiwanese electorate, election-minded politicians were less willing to address the concerns of national security. Moreover, intense electoral competition in Taiwan had destroyed the remnants of the developmental state, in which economic policies were decided by a few technocrats and remained unaffected by pressure from the business community. Now, various interests groups in society were attempting to penetrate the decision-making process in order to influence the direction of Taiwan's economic policy toward China. Using a number of different channels, companies and industries which either already had a huge stake in China or were eager to enter the Chinese market pressed the Taiwan government to lift the restrictions on cross-Strait commerce. Furthermore, the political impasse caused by the standoff in the Legislative Yuan between the two main political blocs, the pan-Blue and the pan-Green coalitions, during Chen's eight-year presidency to some extent paralyzed the government. Wracked by domestic political struggles, Taiwan was

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56 For example, the former chairman of the Formosa Plastics Corporation, Wang Yung-chin, wrote press articles urging the Taiwan government to lift the ban on investing in China.
unable to generate a consistent policy to adjust its asymmetrical economic dependence on China during Chen's tenure. Ironically, this period under the pro-independence presidency epitomized the fastest growing period of economic interaction in cross-Strait history. The above scenario demonstrates Papayoanou's argument that economic interdependence may make it difficult for a potential defender state to mobilize its domestic support to resist a potential aggressor state.\(^5^7\)

Compared with Taiwan's powerlessness, China, with its one-party political system, has been able to execute its Taiwan policy effectively. With the ultimate political goal of reunification in mind, Beijing has adopted a more flexible and sophisticated policy toward Taiwan since the failure of military coercion in 1995-96. By skillfully exercising such tactics as *yi shang wei zheng* (以商圍政, exploit business to press politics), *yi min bi guan* (以民逼官, utilize the public to press the officials), and *ying de geng ying, ruan de geng ruan* (硬的更硬, 軟的更軟, sweetening the carrot, hardening the stick), China is not only employing a variety of political and economic tools to influence the Taiwanese business community, while at the same time broadening its target to include the average Taiwanese. From Beijing's point of view, Taiwan's huge trade surplus with China is tolerated for both political and economic reasons, as economics can be made to serve its political ends. Economically, Taiwan's abundance of capital, know-how, marketing networks, and technology is attractive to China, since these complement China's enormous labor force and space for development. Furthermore, Taiwan's investments in China are mainly export-oriented and its trade with China is mainly investment-driven, and these features are compatible with China's grand economic strategy of establishing an export-led economy. As a result, Taiwan's huge trade surplus with China is currently acceptable to Beijing.

The large number of Taiwanese businesspeople who now live in China also provide Beijing with an opportunity to enhance its political influence in Taiwan. Studies indicate that states can utilize economic en-

engagement to develop sympathetic interest groups within other states.\textsuperscript{58} One notable example in the case of Taiwan and China is that of Hsu Wen-lung, chairman of the Chi-Mei Electronic Corporation, who in 2004, having been generally regarded as a supporter of Chen's Shui-bian's Democratic Progressive Party (DPP, 民主進步黨), unexpectedly changed his political stance and openly criticized Chen's China policy. It was generally believed that Hsu's pro-China statement was related to tremendous pressure from China and its campaign to crush the "Green" Taiwanese businesspeople doing business in China. Given that the Chi-Mei Electronic Corporation had widespread investments and numerous business operations in China, Hsu's political backdown was not totally unexpected. Hence, with its political ambitions in mind, China views its asymmetrical economic relationship with Taiwan as useful in achieving its final goal of reunification; while it serves China's economic strategy, it also increases China's political influence in Taiwan. Therefore, in this case, the realist relative gains consideration must yield to the grand strategy of China's long-term political goal.

The third puzzle is this: if, according to the analysis above and realist relative gains logic, Taiwan should be concerned about its economic dependence on China, \textit{should Taiwan have been equally concerned about its previous economic dependence on the United States?}

Indeed, over-dependence on either the United States or China should invoke similar security concerns in Taiwan. But, Taiwan is obviously more anxious about its economic dependence on China simply because China, unlike the United States, has ambitions to annex Taiwan, and thus poses a serious military threat to the island. Realists argue that "under bipolarity, most smaller powers ally with the superpower least dangerous to them, usually the one the furthest away, and security dependence assures their loyalty."\textsuperscript{59} This is exactly the situation in which Taiwan finds itself.


\textsuperscript{59}Liberman, "Trading with the Enemy," 153.
China has been a threat to Taiwan's political survival since 1949, and U.S. military deterrence, endorsed by the TRA, has been the main reason why China has not been able to successfully conquer Taiwan. U.S. military intervention in the Taiwan Strait would not only make the final outcome of any Chinese military action more uncertain, but it may also have costly political and economic consequences that Beijing's political leaders would not be able to bear. In order to eliminate the U.S. factor in the Taiwan Strait, China has opposed U.S. arms sales to Taiwan while at the same time striving to develop its asymmetrical strike capability to block the U.S. forces from intervening in its military operations against Taiwan. Thus, in order to survive, Taiwan has no choice but rely on U.S. military protection, although the U.S. security umbrella has not come without its prices and consequences. For instance, Taiwan has limited bargaining power in its weaponry purchase negotiations with the United States. Needless to say, Taiwan's self-defense capabilities are also constrained and closely monitored by the United States, without possessing a substantial self-reliant capacity. Although, from a realist perspective, this asymmetrical security dependence should evoke fears of abandonment by the superpower, it still remains a practical option for the small power, since it is at least protected from attack by its major enemy.

Having said that, it would be misleading to claim that security dependence on the United States is always beneficial to Taiwan. Asymmetrical interdependence between states in both the economic and security spheres can increase the likelihood that the less dependent states will take advantage of the vulnerability of its more dependent counterparts to extract concessions in linked issue-areas. For example, Taiwan's double dependence (both economic and security) on the United States in the early 1980s enabled Washington to force Taipei to make concessions on the U.S.-Taiwan trade imbalance issue. Although Taiwan had to bear the negative consequences of the unequal power relationship, its political survival was ensured. Since the United States has no territorial ambitions regarding

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60 For this part of the analysis, see Wei-chin Lee, "Arms Twisting: U.S.-Taiwan Arms Transfer in the First Decade of the Twenty-first Century," Issues & Studies (this issue).
Taiwan and poses no military threat to the island, economic dependence on the United States is not likely to endanger Taiwan's survival. Nevertheless, this logic may not be applicable to Taiwan's economic dependence on China for one obvious reason—China's unwavering ambition to annex Taiwan.

In this regard, Walt's "balance of threat" argument is useful in explaining the evolution of cross-Strait relations from the early 1990s. In contrast to the traditional realists and neorealists who focus on military capabilities, Walt argues that states balance threats rather than power. A state's threat perception is based on an assessment of the other state's intentions rather than its capabilities. Indeed, since the mid-1990s, there has been an increase in mutual distrust and hostility between the two sides of the Strait. To be fair, this escalation of bad feeling is due as much to the provocative statements of Taiwan's political leaders as to military intimidation by Beijing. Given that the primary military threat to Taiwan comes from China, economic dependence on China can only further expose Taiwan to blackmail by China. It is only fear of the United States that stops China from resorting to direct military bullying or using open economic coercion against Taiwan. The above considerations force China to seek indirect means to achieve its ultimate political goal. Therefore, China is more than willing to extend economic favors to Taiwan in exchange for political concessions on some high-profile issues, such as sovereignty issue and the "One China" principle. Since 1979, China has consistently repeated the aforementioned message in its countless political statements on Taiwan. Taiwan's growing economic dependence on China can only make Taiwan more vulnerable and increase China's influence over Taiwan's politics. The Chi-Mei case mentioned above is proof that China is already capable of using its economic leverage to achieve its political goals.

To conclude, in the trilateral relationship, Taiwan's primary concern for national survival trumps its feelings of discomfort about the security externalities of economic dependence on the United States, and makes it

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realize where the major threat to its survival is coming from. Taiwan's economic dependence on the United States, though not healthy, remains acceptable since it strengthens the commercial ties of the quasi-alliance and does not endanger Taiwan's political survival. Economic dependence on China, on the other hand, is risky, because although trade and investment ties with its malicious neighbor are profitable in the short term, Taiwan never knows when it may be held to ransom by Beijing.

The Political Impacts of Trilateral Economic Interactions and the Future Role of the TRA

The rise of Chinese economic power has brought about some fundamental changes in trilateral economic interaction. Given that these structural changes have produced a very different political-economic environment from the one in which the TRA was promulgated in 1979, the first question we should ask is whether the TRA remains a viable means of facilitating U.S.-Taiwan economic relations and upholding Taiwan's economic security. Thus, the following section focuses on the political implications of the recent changes in the dynamics of trilateral economic interaction and how these changes challenge the TRA. While not claiming that economic factors are the only critical determinants of the political evolution in trilateral interaction, the subsequent section outlines two potential challenges to the TRA.

One reason why economic factors have become a crucial variable in the trilateral political relationship is that although the TRA is a political/security-defined document, it contains an explicit commitment to upholding Taiwan's economic security. However, given the important security externalities of cross-Strait economic exchanges, it is questionable whether the TRA can fulfill this commitment. Another reason is that, of the three countries concerned, it is Taiwan, with its export-oriented economy, relatively small economies of scale, and volatile democracy, that is most vulnerable to external economic pressure. And, any political shift in Taiwan driven by economic factors is likely to disrupt the status quo across
the Strait and to pose a challenge to the TRA.

In addition, the original purpose of the TRA was to maintain the status quo in the Taiwan Strait, but that status quo may be destabilized as a result of cross-Strait commerce, thus making the TRA irrelevant. Integration theorists, for example, assert that economic integration leads to political union. Hence, one fundamental question is, under what conditions will the TRA become obsolete in the future. One way in which it could become obsolete is if there was a change in Taiwan's current political status. The TRA seems to take a neutral stance on Taiwan's status, as long as it is not changed through any form of threat or coercion. Thus, if the people of Taiwan decide that they want to become part of China through a democratic procedure, it seems that the TRA provides no grounds for the United States to reject this outcome. As a consequence, integration theory is quite attractive to some people on both sides of the Strait, since a peaceful process of political unification would offer no excuse for U.S. intervention and employing economic interaction as a foundation for political detente across the Strait has the potential to ease mutual distrust and legitimatize further cross-Strait political negotiation.

Another situation in which the TRA could become obsolete would be if there was a change in U.S. interests in East Asia. Since the TRA is a U.S. statute, any reassessment of U.S. strategic interests in the Western Pacific is likely to affect Washington's will to implement the TRA. Although this subject is beyond the scope of this article, it cannot be denied that changes in the dynamics of cross-Strait economic exchanges might cause the United States to reconsider its Taiwan policy. As noted at the beginning of this article, one recent debate in Washington over U.S. policy toward Taiwan was triggered by Taiwan's latest efforts to accommodate China. Although the U.S. government officially supports Taipei's efforts to ease tensions with China, some are still concerned whether this economic rapprochement might lead to a shift in Taipei's political direction and how the United States would handle such scenario.\footnote{Sutter, "Cross-Strait Moderation and the United States."} This suggests that in its
policy making, the United States keeps a close eye on the economic dynamics in cross-Strait relations. Despite the recent debate on U.S. policy toward Taiwan, it seems unlikely that the United States would accept the "Finlandization" of Taiwan and abrogate the TRA in the foreseeable future, given Taiwan's geo-political importance to U.S. strategic interests in East Asia and the possible political repercussions of this policy change on the hegemonic status of the United States.\(^{63}\) As a result, between the date of the alteration of Taiwan's current status and the time of the fundamental change in U.S. strategic interests in East Asia, the TRA is likely to remain relevant.

Considering the ongoing trends toward increased economic and social exchanges across the Taiwan Strait, and the development of institutional linkages, the chances of military conflict between the two sides seem very remote. From the liberal point of view, the enormous opportunity costs of war, the increasing numbers of stakeholders on the two sides, and the reduced likelihood of miscalculations by either party all improve the prospects for peace. Nevertheless, from a realist perspective, given China's growing military power, rising nationalism, and increased assertiveness, without the TRA and U.S. military deterrence Taiwan's meager defense capability and economic vulnerability would make it an easy prey for China's aggression.

One area in which the dynamics of economic exchanges across the Strait pose a significant political and security challenges to Taiwan and the future of the TRA is that concerning the possible threat of economic coercion by China. Although some scholars believe that the likelihood of military conflict between the two sides of the Taiwan Strait is remote,\(^{64}\) others warn that there is a real possibility that China will wage economic warfare against Taiwan and that Taiwan is incapable of resisting this.\(^{65}\) However,
as theorists suggest, economic coercion is a double-edged sword, since
the attacker and the defender are both likely to be hurt. Moreover, the in-
volvement of international factors in the cross-Strait industrial division of
labor further increases the cost of utilizing economic warfare. Neverthe-
less, given China's growing propensity to use economic leverage on Tai-
wan, economic coercion is not such a remote possibility, as Hsu argues.

China has taken advantage of asymmetrical economic interdepend-
ence in the past, notably with South Korea during the "garlic war" in 2000,
when Beijing retaliated against the imposition of higher tariffs on imports
its garlic by imposing high tariffs on imports of South Korean manufac-
tured products, thus costing South Korean companies nearly $100 million.
In the end, pressure from the business sector force Seoul to allow increased
imports of Chinese garlic. This simple case suggests that Beijing is will-
ing and able to utilize economic coercion against a more dependent trading
partner.

The current state of detente across the Strait, attributed to Ma Ying-
jeou's more moderate policy toward China, may not last forever. If a pro-
independence candidate were to win a future presidential election, China
might regard economic coercion as a useful option for forcing Taiwan to
make political concessions. Furthermore, given that cross-Strait economic
exchanges are expected to become more intense and comprehensive after
the signing of the ECFA, Taiwan is likely to be even more economically
dependent on China. The political consequences and economic impact
of China waging economic warfare against Taiwan would be even more
severe and costly more than Taiwan could ever bear.

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66 S. Philip Hsu, "The U.S. Strategic Ambiguity under the TRA in Cross-Strait Economic Conflict in the Long Run," a conference paper presented at the Taiwan Conference on the Thirty Years after the Taiwan Relations Act, University of South Carolina, Columbia, S.C., September 25-27.

Thus, although the TRA states that the United States will consider "any effort to determine the future of Taiwan by other than peaceful means, including boycotts or embargoes, a threat to the peace and security of the Western Pacific area and of grave concern to the United States," it is unclear what Washington could do, if China were to utilize a sophisticated form of economic coercion against Taiwan in order to obtain political ransom. Economic warfare may not necessarily threaten "the peace and security of the Western Pacific," neither would it necessarily be limited to "boycotts or embargoes." The implementation of economic coercion can be both sophisticated and subtle. A recent case suggests that China could use its economic leverage to incrementally undermine Taiwan's sovereignty. For example, by simply requiring Chinese customs to stop imports that state they are "made in the ROC" or "made in Taiwan," China could force Taiwanese companies to label their goods "Taiwan province, China." In this way, even during a period of cross-Strait economic rapprochement, Beijing is still willing to use economic leverage to pursue its political agenda on the Taiwan issue. Once Taiwan's economic dependence on China expands to include highly security-sensitive goods or daily non-substitutable products, Taiwan's ability to resist China's economic coercion is likely to be weakened. The powerlessness of the TRA to address these contingencies is evident. The lack of preparedness and contingency planning for this type of economic warfare for both Taiwan and the United States poses the first and foremost challenge to the continuing implementation of the TRA.

Another challenge to the TRA comes from the risk of undermining Taiwan's political resistance through economic penetration. As noted before, the political economy literature suggests that economic engagement can be utilized by an aggressor to mobilize interests groups sympathetic to

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68TRA, Section 2.
its cause within a target country.\textsuperscript{71} As in the case of Nazi Germany’s economic strategy toward the Balkan states observed by Hirschman, "vested interests" in the targeted state can become an influential "commercial fifth column" and affect that state’s security policy.\textsuperscript{72} Furthermore, studies also reveal that international commerce generates domestic welfare redistribution and this is likely to be the cause of political struggles between different interests groups.\textsuperscript{73} Similarly, dependency theorists have pointed out that an export-oriented alliance, composed of external forces and internal dominant classes, may aggravate tension with less privileged groups and classes and result in political strife over the direction of economic development.

The theories and empirical findings discussed above provide some valuable insights into the possible political impacts on Taiwan of China’s economic importance. It is obvious that cross-Strait trade and investment have been the cause of a redistribution of welfare in Taiwan society. The fact that Taiwan’s economic growth has been driven by foreign trade suggests that it is export-oriented industries with production links with China that are the primary beneficiaries of cross-Strait commerce. Conversely, industries oriented toward the domestic market, farmers, industrial workers, and owners of small and medium-sized businesses are likely to be among the disadvantaged groups, since they gain less from cross-Strait economic links. Unsurprisingly, wealth inequality has dramatically increased in Taiwan in recent years, with the gap between rich and poor reaching an all-time high in 2009. There are signs that this uneven distribution of income is causing socioeconomic divisions between the various economic groups, and there is evidence of this in the political appeals made


\textsuperscript{72}Hirschman, \textit{National Power and the Structure of Foreign Trade}, 26-29.

by the opposition parties and from advertisements issued by the current administration to promote the ECFA.\textsuperscript{74} With the emergence of economic cleavages on the island, there are signs that Beijing has begun to use business people with investment in China to expand its political influence among the Taiwanese people.\textsuperscript{75} Moreover, in order to ameliorate the societal divisions caused by the unequal distribution of the benefits of cross-Strait trade and investment, China has extended its economic favors to Taiwanese farmers, fishermen, and the owners of small and medium-sized businesses. This can be observed from China's early harvest list in the ECFA, which includes products of the aforementioned sectors, which did not benefit from previously cross-Strait trade and investment. These examples reveal that China is actively striving to recruit sympathizers on the island and attempting to enlarge its sphere of influence within Taiwan society.

Still, it remains unclear whether Hirschman's "commercial fifth column" will ever emerge in Taiwan. However, if an explicit "pro-China" coalition does emerge as it has in Hong Kong, composed of capitalists and pro-Beijing lawmakers, this would severely damage Taiwan's democracy and fundamentally undermine the island's resistance to China's demands regarding its sovereignty. The recent moves toward economic accommodation with China do signify a policy shift in Taipei and a different political attitude toward China. Ma's decision to sign the ECFA with China is widely viewed as the culmination of the decades of cross-Strait commerce. The change in Taipei's policy is also an indication of how rapidly China's economic influence over Taiwan is growing. On the positive side, Taipei... 

\textsuperscript{74}One controversial TV commercial made by the current administration to promote the ECFA in 2010 emphasizes divergent opinions between the "educated and global perspective" trading businessman in the northern Taiwan and the "narrow-minded and uneducated" farmer in the southern Taiwan regarding the pros and cons of the ECFA. Despite its false use of stereotypes to blur the center of this debatable public policy, this commercial does point out the emerging division between business interests and agricultural farmers as well as laborers' concerns regarding the economic consequences of ECFA.

\textsuperscript{75}In one notable case, one of Taiwan's main newspapers, the \textit{China Times}, was purchased by the Want-Want Group, which is generally believed to have close ties with Beijing. A recent Freedom House report accused the \textit{China Times} of failing to print negative news about China.
hopes that the more moderate policy will encourage Beijing to reciprocate and ease China's military and diplomatic pressure on Taiwan.

Whether this policy will achieve its goals only time will tell, but it has already begun to have negative effects. The ECFA decision-making process seems to have aggravated Taiwan's existing political cleavages and, to some extent, upset democratic practices in the country. For instance, it is evident that strong objections by the opposition parties and pleas for a referendum were all brushed aside by the government. Tolerance of dissent and willingness to allow space for public deliberation on government policy, two essential characteristics of modern democracy, went out of the window in this case. Whether this is an indication of China's economic clout penetrating Taiwan's politics remains debatable. Nevertheless, it is worrying that some future political move toward Beijing might be decided according to the decision-making model used in the case of the ECFA and without thorough deliberation and the consent of the Taiwanese people. Given that people on Taiwan hold divergent opinions about the future relationship with China, any consequential political decision relating to China should be subject to broader public deliberation and a democratic process in order to obtain a consensus. This way of conducting democratic practice would effectively prevent Taipei's policy making from being penetrated and manipulated by China sympathizers on the island.

Given that the TRA states that "the preservation and enhancement of the human rights of all the people on Taiwan are hereby reaffirmed as objectives of the United States," the United States clearly has a role in preserving Taiwan's democratic system and ensuring that the political will of "the people on Taiwan" is fully respected and expressed through the democratic process. With the United States keeping a close eye on Taiwan's democracy, the risk of China being able to manipulate Taiwan's political future through infiltration by its economic adherents can be min-

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77 TRA, Section 2.
imized. In those circumstances, Taiwan can be more confident in de-
fending its national interests and the welfare of its people in any future political negotiations with China.

To sum up, the changing dynamics of the trilateral economic relationship challenge the TRA in two ways. Externally, Taiwan's economic dependence on China provides Beijing with an opportunity to exercise economic coercion against Taipei. Internally, growing Chinese economic influence increases the likelihood that China will mobilize its followers on the island to affect Taiwan's political direction. The political consequences of both developments could be consequential, as they could jeopardize Taiwan's national survival, disrupt the status quo in the Taiwan Strait, and impair the goals of the TRA.

Conclusion

The TRA has been the cornerstone of U.S.-Taiwan relations for three decades now, and it has ensured peace in the Taiwan Strait and a mutually beneficial economic relationship between the United States and Taiwan. In the future, the United States, within the framework of the TRA, should reinforce its guarantees of Taiwan's economic security and strengthen U.S.-Taiwan economic relations by enhancing the U.S. role in Taiwan's economy.

As argued above, one important contribution of the TRA was its provision of comprehensive legal framework to sustain U.S.-Taiwan economic interaction after the de-recognition. However, given the changing dynamics of trilateral economic interaction, Taiwan's economy has moved toward China. Only time will tell if this economic shift will lead to a political re-orientation toward Beijing. But, if Washington keeps a close eye on Taiwan's political development and maintain its unwavering commitment to the TRA, this will effectively alleviate the negative impacts of the asymmetrical economic interdependence between the two sides of the Taiwan Strait. Furthermore, by employing its economic leverage, the United States can enlarge its relevance in Taiwan's economy. A U.S.-
Taiwan free trade agreement would strengthen bilateral economic ties and signal the intent of the U.S. to continue to play a significant role in Taiwan's economy, something which will also fulfill the goals of the TRA.

From Taiwan's perspective, the continued implementation of the TRA is crucial for three reasons. First, the United States remains Taiwan's most important source of FDI and a global leader in technological innovation. In terms of its contribution to Taiwan's economic development and industrial upgrading, there is unlikely that the United States could be replaced by China in the near future. Thus, the institutional framework of the TRA remains indispensable to Taiwan.

Second, the security promise contained in the TRA remains crucial and irreplaceable to Taiwan. Taiwan's past economic achievements and future economic prospects have been based on a non-conflict environment across the Strait. China's accelerating military buildup and Taiwan's volatile political climate make the TRA and U.S. military deterrence crucial in preserving peace between the two sides of the Strait.

Finally, it is in Taiwan's interests to encourage the United States to abide by the TRA and continue its support for Taiwan's democracy and for the stability of cross-Strait economic interaction. Most importantly, with the United States behind it, Taiwan is likely to be more confident in any future political negotiations with China. Given China's determination to annex Taiwan and the asymmetrical power relationship between the two sides of the Strait, Taipei needs U.S. backing to resist China's political demands. It is because of the TRA and U.S. military superiority that China is willing to grant economic favors to Taiwan, hoping to exchange these for the latter's political concessions, rather than employing barely concealed military coercion. With the United States paying constant attention to cross-Strait developments and Taiwan's democratic practices, Taipei will be less likely to submit to Beijing's political pressure, and Taiwan's sovereignty and national interests will be less likely to be compromised or sacrificed during future political negotiations with China. All the arguments above indicate that the continuation of the TRA and active U.S. involvement are essential for the survival of Taiwan and the healthy development of cross-Strait interaction.
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