Even before the recent U.S.–China spy plane standoff, many observers have called a conflict between mainland China and Taiwan the most likely scenario in which the United States could be drawn into a major war. This continuing risk and the complex history and diplomacy among the People’s Republic of China (PRC), Taiwan, and the United States keep relations across the Taiwan Strait continually in the news.

With the election in the spring of 2000 of Chen Shui-bian—a former advocate of Taiwan's formal independence from China—as Taiwan's new president, many anticipated a chill in Taiwan–PRC relations. Some in China have expressed doubts about Chen's ultimate objectives, but relations have not obviously deteriorated. In fact, China and Taiwan have initiated new journalist exchanges, and Taipei has allowed the Chinese press to establish new offices in Taiwan.1

On the economic front, Beijing and Taipei are expanding contacts. Taiwan and China have agreed to direct shipping between some of Taiwan's outlying islands and the mainland. More importantly, both Taiwan and China are likely to join the World Trade Organization (WTO) in the near future. Each has sought membership in the world trading system for more than a decade, but Taiwan's application process is now essentially complete, and the PRC's membership bid is approaching completion. Despite some early objections, Beijing seems prepared to support Taiwan's membership in the WTO provided that the PRC is allowed to enter first; Taiwan has publicly supported China's effort to join the trading system. According to published reports, China is likely to complete its negotiations on membership this year, opening the door for mutual membership of the “two Chinas.”

Greg Mastel was the director of the Global Economic Policy Project at the New America Foundation when he wrote this piece. Since then, he has been named the chief trade counsel and chief economist for the minority staff of the U.S. Senate Finance Committee.
These economic issues often receive limited attention in a discussion dominated by weapons sales and territorial claims, but in the end, they may prove at least as important to establishing a stable, peaceful relationship between Taiwan and China. Although progress in other areas often proves elusive, economic ties have expanded robustly during the past decade despite ongoing tensions between Taipei and Beijing. Membership in the WTO for each could serve to expand cross-strait commerce further as well as establish a formal consultation and binding dispute settlement process accessible to both Taiwan and China. In short, commercial ties—although often overlooked by Western analysts—may have greater potential to transform relations between Taiwan and China than the more frequently discussed diplomatic and military avenues.

Economic Ties Today

Since the government of the Republic of China was forced to retreat to the island of Taiwan after the Communist takeover of mainland China, the relationship between Taipei and Beijing has been almost uniformly hostile. For many years, each claimed to be the legitimate government of all of China and battled over control of small islands between Taiwan and the mainland. Their respective militaries continue to view each other with great suspicion and hostility.

On the political front, the future continues to appear difficult. Although a few efforts have been made at establishing direct contacts, Taipei and Beijing have little formal direct dialogue. China continues to regard Taiwan as merely a renegade province destined to reunite eventually with the mainland through political or military means. In Taiwan, however, Taiwan and China are increasingly seen as having separate and distinct destinies. As Chen's election demonstrated, since Taiwan switched to democratic elections in the 1990s, Taiwan's leaders seem to be advocating a vision of Taiwan's future that is increasingly independent of China—although they stop short of formal declarations of independence that would likely spark Beijing's wrath. This approach seems to reflect the feelings of Taiwan's public—a majority of Taiwanese residents stop short of advocating formal independence; nevertheless, an equally large number oppose putting Taiwan under Beijing's control.

Based on these military and political realities, one might expect that commerce between Beijing and Taipei would be quite limited. In this area, however, culture, historic ties, geography, and economic realities have proved to be enough to overcome the otherwise frosty official environment. After some diplomatic progress in 1987, China and Taiwan began to allow more direct commerce. Since that time, cross-strait trade has exploded.
Trade between Taiwan and China now totals more than $25 billion annually and continues to grow at a pace of 7 percent per year. Owing in part to Taiwan's trade restrictions on commerce with China, Taiwan enjoys a continuing trade surplus with the mainland. In 1999 this surplus totaled $16.8 billion and is likely to be even larger when the statistics for 2000 are released.

As in most cases, expanded investment has accompanied expanded trade. Taiwan's prohibitions on direct investment from the mainland have limited the amount of this investment, but because Chinese companies engage in limited overseas direct investment, flows from China into Taiwan would
likely be circumscribed anyway. Taiwan, however, is largely a developed economy. Like most developed, export-oriented economies in the world, it perceives China to be an attractive investment site because of both low labor costs and the potential access to a large PRC market.

Statistics on Taiwan’s investments in the PRC have been somewhat controversial because the government in Taipei has often tried to discourage Taiwanese companies from investing in China through various means. This policy has led some Taiwanese businesses to be less than direct in reporting their investments, which are often made through Hong Kong and are difficult to trace. Still, the Taiwanese government estimates the total for Taiwanese investment in the mainland at $15.6 billion. Mainland figures put the amount much higher, at $24.8 billion.

Despite an effort by Taipei to encourage Taiwanese businesses to “diversify” their foreign investments, China is by far the largest recipient of Taiwanese overseas investment, a designation China has held for the past half-century.

Because of the continued suspicion between Taipei and Beijing, cross-strait commerce has flourished while facing considerable governmental and bureaucratic interference. Taiwan’s formal restrictions are particularly notable, imposing a number of limitations on shipping, trade, travel, and investment out of concern that these activities could pose a threat to the

---

**TAIWANESE INDIRECT INVESTMENT IN CHINA, 1991–2000**

**(IN BILLIONS OF U.S. DOLLARS)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Taiwanese Statistics</th>
<th>Chinese Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>.17</td>
<td>.84</td>
</tr>
<tr>
<td>1992</td>
<td>.25</td>
<td>1.05</td>
</tr>
<tr>
<td>1993</td>
<td>3.17</td>
<td>3.14</td>
</tr>
<tr>
<td>1994</td>
<td>.96</td>
<td>3.39</td>
</tr>
<tr>
<td>1995</td>
<td>1.09</td>
<td>3.16</td>
</tr>
<tr>
<td>1996</td>
<td>1.23</td>
<td>3.48</td>
</tr>
<tr>
<td>1997</td>
<td>4.33</td>
<td>3.29</td>
</tr>
<tr>
<td>1998</td>
<td>2.04</td>
<td>2.92</td>
</tr>
<tr>
<td>1999</td>
<td>1.25</td>
<td>2.60</td>
</tr>
<tr>
<td>2000 (Jan.–June)</td>
<td>1.10</td>
<td>.95</td>
</tr>
<tr>
<td>Cumulative</td>
<td>15.59</td>
<td>24.82</td>
</tr>
</tbody>
</table>

Source: Mainland Affairs Council, Republic of China
China, Taiwan, and the WTO

island. Typically, these threats take the form of Beijing gaining effective control over important parts of Taiwan’s economy or perhaps even using commercial shipping as a guise for a military attack or intelligence gathering. Given the long history of military animosity and ongoing political tensions, these concerns are understandable, although perhaps overstated.

Whatever the merits of its policies, however, Taiwan maintains a complete ban on investment from China, a near-complete ban on direct shipping from China, and numerous other trade restrictions on Beijing. Mainly because of these restrictions, most trade between Taiwan and China takes place through Hong Kong—which is hardly the most direct route. Recently, Chen proposed, and Beijing accepted, a pilot project on direct shipments. Initially, these shipments have been only from one Chinese port to tiny islands controlled by Taiwan in the straits between the Chinese mainland and the main island of Taiwan. In the future, both sides may agree to expand these shipping links.

For its part, Beijing has generally been more positive toward cross-strait commerce. This attitude is apparently the result of the feeling in Beijing that investment moving into China is generally in the PRC’s best interest. Also, some in Beijing seem to feel that expanded commercial ties may advance the more general goal of attempting to bring Taiwan back into China. As a result, the PRC maintains fewer formal restrictions on cross-strait commerce. Some Taiwanese goods, like products from many countries, face Chinese trade barriers. Although China generally welcomes Taiwanese investment, Taiwanese investors apparently do not enjoy some of the protections that investors from other countries have in China, because Taiwan lacks formal status in China.

<table>
<thead>
<tr>
<th>Region</th>
<th>Amount</th>
<th>Percentage of Total Overseas Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mainland China</td>
<td>16.11</td>
<td>39.51</td>
</tr>
<tr>
<td>British Central America</td>
<td>8.18</td>
<td>20.06</td>
</tr>
<tr>
<td>United States</td>
<td>5.10</td>
<td>12.51</td>
</tr>
<tr>
<td>Singapore</td>
<td>1.30</td>
<td>3.18</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>1.11</td>
<td>2.71</td>
</tr>
</tbody>
</table>

Source: Mainland Affairs Council, Republic of China
Despite these restrictions, the growth of cross-strait commerce has changed political realities in both Taipei and Beijing. In Taiwan, the business community has become a powerful advocate for improved cross-strait ties. As noted, Taiwanese businesses have often pursued investment in the mainland against the wishes of the government of Taiwan. Now, with some signs that ties will improve in the future, many Taiwanese businesses are actively seeking the opportunity to expand investment in the mainland—largely to gain access to a low-cost labor pool that speaks the same language they do.

Dealing with the United States and the European Union (EU), the PRC has effectively used the promise of its developing market to entice U.S. and EU business communities to support improved relations with China. Many have characterized the U.S. business community as Beijing’s most effective lobbyist in Washington. The same process seems to be under way in Taiwan.

Taiwanese businesses have often complained about the trade and investment restrictions imposed by Taipei, advocating that they be changed or removed. Largely as a result of the political activity of the Taiwanese business community, each of the three major presidential candidates in the last election advocated relaxing restrictions on shipping and trade over the Taiwan Strait. Even Chen—until recently an advocate of Taiwan’s independence from China—endorsed and is now implementing direct shipping between Taiwan and the mainland.

In many ways, the commercial policy situation in Taiwan parallels that in the United States. Over the last 10 years in the United States, both major political parties have begun supporting expanded commerce with China despite friction over human rights abuses, a rising U.S. trade deficit with China, and many other bilateral tensions. In a notable change from its 1990s policy, the United States has gone from advocating the denial of Most-Favored-Nation (MFN) trading status for China (now called normal trade relations, or NTR status) to granting China permanent MFN status and welcoming China into the WTO. Because the bilateral friction from the early 1990s remained (and in some cases, worsened) at the end of the decade, this political reversal is somewhat surprising.

A number of factors, such as the end of the Cold War and a general decline in faith in economic sanctions as a tool of national policy, contributed to this marked change in U.S. policy. Undoubtedly, however, one of the im-

---

Business connections with China have changed the political landscape in Taiwan.
portant political factors driving the change were the efforts of the U.S. business community to lobby for improved economic relations with Beijing. These efforts appear to have been influential in both U.S. political parties.16

Thus, lobbying by the U.S. business community turned a U.S. president once committed to imposing economic sanctions on China into an advocate for expanded U.S.–China commerce. Similarly, lobbying by the Taiwanese business community appears to have turned a Taiwanese president once openly hostile to Beijing into an advocate for expanding direct commerce. Clearly, many political factors brought about this change. One of those factors, however, was certainly the enthusiasm of the Taiwanese business community for improved ties with China. Business connections with China have changed the political landscape in Taiwan regarding cross-strait relations, forcing politicians to adjust their positions.

In addition, many Taiwan leaders perceive growing economic ties with China as a disincentive to military action against Taiwan by Beijing. This viewpoint ensures a generally sympathetic ear in many quarters for the lobbying effort of the Taiwanese business community.

In China, the political process is much less transparent. Therefore, tracing the impact of commerce on political decisionmakers in Beijing is difficult. Apparently, similar forces are working to change the political environment in China. The Chinese military has traditionally advocated a military solution to the “Taiwan problem.” According to close observers of Beijing’s actions, however, more moderate Chinese thinkers have come to advocate commercial engagement with Taiwan as an alternative to military action.17 Beijing’s continued interest in expanding commercial ties with Taipei suggests that economic ties are an important component of Beijing’s Taiwan strategy. Assuming that the political dynamics in Beijing are identical to those in Taipei and Washington can be dangerous and likely incorrect, but some of the same forces appear to be at work.

Growing cross-strait economic ties have clearly changed mutual attitudes and policies in China and Taiwan. Twenty years ago, Taiwan and the PRC were engaged in perhaps the most dangerous subplot in the Cold War drama. Obviously, tensions are still high, but growing commercial ties have created incentives for peaceful cooperation on both sides of the Taiwan Strait. By themselves, these economic ties are not sufficient to erase political and military conflicts, but they have become strong countervailing forces that have changed at least some attitudes in Taipei and Beijing.

Commercial ties may transform relations between Taiwan and China.
The WTO and Cross-Strait Commerce

On their face, many of the restrictions imposed on cross-strait commerce would seem to conflict with the provisions of the WTO, which Taiwan and the PRC seek to join. A complete analysis of these laws and regulations and the WTO provisions that affect them could run several hundred pages, but the conflict between the WTO and current policies is obvious.

At a basic level, two of the core principles of the WTO, MFN treatment and national treatment, generally require that all WTO members be treated similarly and that foreign trade and investment generally be treated the same as that of domestic origin. Although exceptions are sometimes permissible, the laws and policies described earlier seem to violate one or both of these basic principles. In particular, Taiwan’s ban on shipments and investment from China and certain other restrictions would seem obviously to violate the MFN principle, which also applies to services under the WTO agreement. Similarly, China’s discriminations against Taiwan would be difficult to justify. Thus, mutual WTO membership would likely put pressure on Taipei and Beijing to liberalize trade and commerce vis-à-vis the other.

The WTO, however, does provide options that Taiwan or China might use to defend current restrictions. Either party could, for example, employ the nonapplication clause to avoid granting WTO benefits to the other side, while still applying the WTO rules to other WTO members. Although this option has been discussed in this context, it has many drawbacks. It is seldom used, is likely to draw criticism from other WTO members, and is a relatively blunt instrument that must be triggered upon accession. Many observers have concluded that neither Taiwan nor China is likely to attempt to use the nonapplication clause against the other.

Employing the so-called security exemption to defend particular trade or commercial policies is a more attractive and likely option. The security exemption gives members broad discretion to utilize trade and commercial policies that are necessary to protect their security. It has been employed about 20 times under the world trading system, and dispute settlement panels have historically been very reluctant to second-guess the country claiming the exemption. In a number of the cases, such as U.S. actions against Nicaragua in the 1980s, the security threat—at least the immediate
threat—seemed fairly tenuous. Still, dispute settlement panels convened to apply the rules of the world trading system have been unwilling to challenge the judgment of the country invoking this exemption. Given the considerably more plausible security threat that could be argued to exist in the Taiwan Strait, the judgment of Taiwan or China would not likely be challenged if either used the exemption to defend its policies.

Unlike the nonapplication clause, the security exception could be raised on a case-by-case basis as a defense before a dispute settlement panel. The matter could still be subject to consultations and, as has been the case in other disputes involving the security exception, both parties may still reach at least a partial settlement of the underlying dispute.

The legal problems and pressure from other WTO members would likely weigh against employing either the nonapplication clause or the security exception too liberally. The primary reason that Taipei and Beijing will likely steer clear of these options, however, is that each would see real advantages in complying with the WTO.

As noted, political forces in Taiwan and China are pressing for more open commercial ties. Particularly in Taiwan, the support for increased commerce with the mainland has already changed the political landscape. The political process in China is far more opaque. Still, China would likely welcome increased trade, direct shipping, and investment opportunities as a way to strengthen its economy while building closer ties with Taiwan that may ultimately result in more influence over Taiwan. For this reason, China has been willing to support Taiwan’s current WTO membership application, provided that China is allowed to enter first.

In short, mutual WTO membership may provide both with a convenient pretext for undertaking commercial policies that would likely be desirable even in the absence of the WTO. The WTO would provide Taiwan and China with a convenient rationale for liberalizing commerce without appearing to be capitulating to the wishes of the “other side.”

Mutual WTO membership would also have other less obvious advantages, particularly for Taiwan. Because of the “one China” policy, which causes most countries to officially recognize only the PRC as the legitimate government of China while denying Taiwan legal status, Taiwan is excluded from most international organizations. The WTO, however, does not require that all members be independent countries. Provided that they can demon-
strate control of their trade policy, entities can apply for membership as customs territories. Hong Kong and Macau have used this route to gain WTO membership independent of China. Once granted membership, customs territories enjoy all the rights and have all the responsibilities of other WTO members; they stand on an equal legal footing with all others.

In one swoop, entry into the WTO would allow Taiwan to gain considerable prestige and membership in an international forum of great importance to Taiwan. It also allows Taiwan access to a forum where it can deal with China directly as equals through a mediated process. In addition, in WTO disputes between two members, other interested members can join in the dispute. Thus, in a commercial dispute between Taipei and Beijing, members such as the United States, the EU, and Japan could formally enter into the discussions. Obviously, WTO membership would have considerable diplomatic and political value to Taiwan.

**Mutual WTO membership will likely change the relationship between Taipei and Beijing.**

**Boldly Going Where No Diplomat Can**

For Beijing, Taipei, and Washington, the military dimension of Taiwan-China relations always demands attention. Simply put, the military issue is potentially more dramatic and far-reaching—at least in the short term—than any other issue. As a result, the diplomatic agenda and the public debate seem always to begin on security and its close relative, sovereignty.

Undeniably, arms sales, regional military balances, and international status are critical issues. In the end, however, there may well be no military solution to the half-century standoff in the Taiwan Strait. The costs of military conflict have always been enormous and, with the deployment of new weapons systems, may be rising. Further, no actor, including the PRC, can be assured of the successful use of military force. Diplomatic solutions have been attempted several times, but none thus far has been acceptable to all players. Given political events in Taiwan, such a solution may be more remote than it was a decade ago.

With this in mind, it is easy to be pessimistic about the future of cross-strait relations. Commercial ties have, however, been the shining exception to this dreary forecast. At times, almost in spite of the attitudes of the governments involved, trade and investment have flourished, and commerce has proved a powerful force for improved cross-strait relations.
The leading roles of China and Taiwan in global trade and commerce have now driven them to seek WTO membership. Doubtless, both sought membership to secure their trading status with the rest of the world more than with each other. Still, mutual WTO membership will likely force changes in the economic relationship between Taipei and Beijing. Although the issue has barely been discussed, mutual WTO membership may soon bring changes in cross-strait relations that are in the interest of both sides, an eventuality that likely could not have been achieved by other means. Ultimately, economic ties may make the China–Taiwan relationship more stable and mutually advantageous, perhaps even setting the stage for improvements on other fronts.

Notes


2. The two sides have numerous back channels and intermediate contacts, and public statements made by both governments seem obviously intended as communications with the other side.


4. Figures from the Ministry of Economic Affairs, Republic of China, located at <http://www.chinabiz.org.tw/maz/Eco-Month/home.htm> (March 31, 2001). Table 10. Taiwan indirect investment in mainland China was used.

5. Figures from the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), People’s Republic of China, located at <http://www.chinabiz.org.tw/maz/Eco-Month/home.htm> (March 31, 2001). Table 10. Taiwan indirect investment in mainland China was used. Because the PRC only had investment statistics through May 2000, this date was used in calculating both China’s and Taiwan’s investment estimates.


7. Figures from the Ministry of Economic Affairs, Republic of China, located at <http://www.chinabiz.org.tw/maz/Eco-Month/home.htm> (March 31, 2001). Table 13. Taiwan-approved outward investment was used. Statistics were available only through July 2000.

8. British Central America is a term used by the Taiwanese government to refer to a group of Central American and Caribbean countries that grant Taiwan favorable tax status.


12. A number of examples of this lack of protection have been documented. See “China to Protect Taiwanese Investors,” Straits Times (Singapore), August 9, 1999; Mure Dickie, “Taiwan Welcomes China’s Investment Safeguards,” Financial Times, December 14, 1999, 10; Dexter Roberts et al., “Uneasy Collaborators,” Business Week, August 14, 2000, 28.


19. Some holdouts in both Taiwan and China, however, claim WTO membership need not affect the status quo. See “MAC Chairman Sees WTO Entry Not Affecting Cross-Strait Trade,” China News, November 18, 1999.


21. Both Taiwan and China have warned each other against employing the opt-out clause; most observers do not believe this option will be used. Lu Ning, “China Warns Taiwan over Free Trade Pact,” Business Times (Singapore), March 10, 1998, p. 11; Fang Wen-hung, “Taiwan May Invoke GATT Articles XXXV, XXI in WTO Bid,” Central News Agency (Taiwan), July 28, 2000.

22. Article 21 of the GATT.