

Pax Mercatoria in the Taiwan Strait?*

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Since President Ma Ying-jeou assumed Taiwan's top office on May 20, 2008, relations across the Taiwan Strait have undergone a significant turnaround. Rapprochement has become the predominant policy objective for both sides, while confrontational tactics have been put on the back-burner. Both sides have so far signed eighteen agreements, including a free trade agreement, i.e., the Economic Cooperation Framework Agreement (ECFA) that has China making significant trade concessions to Taiwan without reciprocal gains. In addition, since the warming of relations, Taiwan's economy has also benefited from the influx of Chinese tourists (four million to date) and the numerous purchasing missions led by Chinese delegations. An investment guarantee agreement that would further facilitate cross-strait investments is now in the offing. Cross-strait relations are expected to remain peaceful and prosperous as long as both sides are satisfied with the pace of progress they are making. The crucial question is how China's new economic statecraft will impact Taiwan. This paper intends to assess the potential implications of China's economic power on Taiwan's security. First, it will review the literature surrounding this topic. Then it will discuss the effects of China's economic statecraft on Taiwan, proposing that it is a bargaining game. The paper then conjectures a list of situational variables that may bear weight on the success and failure of China's economic statecraft. A conclusion then follows.

I. Literature Review

For the purpose of this paper, this author found three domains of literature relevant. The first domain has to do with the effectiveness of deterrence, compellence and sanctions (both positive and negative) as power levers between states. This area of research, accumulated in security studies during the Cold War, is vast. A complete review of this literature domain is beyond the scope and purpose of

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this paper.¹ Briefly, deterrence refers to the use of military threat to *prevent* an adversary from carrying out an action undesired by the other state. In the words of Schelling, a leading scholar in deterrence theory, to deter is “to turn aside or discourage through fear; hence, to prevent from action by fear of consequences.”² In contrast, compellence employs the threat of punishment to persuade the target state to do something desired by the other state.³ Although both deterrence and compellence involve the use of threat to change the incentive structure of the adversary, they are different in terms of the underlying dynamics, i.e., time horizons, and expectations⁴. Some of these variables will be applied to analyze China’s statecraft toward Taiwan in Section 3. Underlying deterrence or compellence is the assurances the initiating state offers in return for compliance by the target state. If the target state chooses to comply, it should expect the initiating state to refrain from carrying out punishments. In actuality, the assurances offered by the initiating state can go beyond merely the retraction of threats should the target state comply. The initiating state can reward, make concessions to, or compensate the compliant state.⁵ Deterrence and compellence are about the use of “sticks,” while assurance is about the use of “carrots.”

The second domain of literature relevant to this research is the effectiveness of economic statecraft. It examines how an initiating state employs its economic strength to change the policies of a target state in its favor. Albert O. Hirschman’s 1945 classic *The National Power and the Structure of Foreign Trade* serves as the foundation to this genre of scholarly research. Hirschman argues that when trade

¹ Morgan, among others, offers an excellent review of the development of deterrence and compellence, both as a theoretical concept and a strategy during the cold war. See Morgan, Patrick M., *Deterrence Now* (New York: Cambridge University Press, 2003).

² Schelling, Thomas C., *Arms and Influence* (New Haven, CT: Yale University Press, 1966), p.71.

³ *Ibid.*, p.71. Schelling uses the term “compellence” to emphasize the offensive nature in the threat employed by the initiating state. In contrast, deterrence emphasizes the defensiveness in the threat. George, on the other hand, believes that “coercion” is a better theoretical concept, in the sense that it not only captures the defense/offense distinction in statecraft, but also denotes a wider spectrum of levers that states can employ to change the incentives, hence the behavior, of their opponents. See George, Alexander L., “Coercive Diplomacy: Definition and Characteristics,” in Alexander L. George and William Simmons, eds., *The Limits of Coercive Diplomacy* (Boulder, CO: Westview Press, 1994), pp.7-11. Despite the theoretical nuances between compellence and coercion, scholars in general tend to use these two terms interchangeably. For example, Sperandei, Maria, “Bridging Deterrence and Compellence: An Alternative Approach to the Study of Coercive Diplomacy,” *International Studies Review* 8:2, June 2006, pp.253-280. In this paper I also use these two terms interchangeably.

⁴ Schelling, *Arms and Influence*, pp.69-91.

⁵ David A Baldwin’s theoretical treatment of how positive incentives (inducement) work with negative incentives, i.e., threats, provides an incisive review of the exercise of power. Baldwin, David A., “The Power of Positive Sanctions,” *World Politics* 24:1, October 1971, pp.19-38. For case studies, see Davis, James W., *Threats and Promises: the Pursuit of International Influence* (Baltimore, MD: Johns Hopkins University Press, 2000).

interdependence between states is asymmetrical, the stronger state can use bilateral trade as an effective lever to extract political concessions from the weaker state. Trade asymmetry exists when one state is less dependent on the bilateral trade relations than the other state. Hirschman uses Germany's inter-war trade relations with Central and Eastern European small states to illustrate his theoretical points.⁶ Hirschman's work failed to generate meaningful interest in this area of research during the Cold War years, as international relations scholars were preoccupied with the high-politics statecraft of the two superpowers. However, since the waning years of the Cold War scholarly interest has revived in research of how states use sanctions, embargos, currency manipulations, trade preferences, direct investments, technology transfers, foreign aid programs, and general market power to deter, compel, cajole or induce a target state to change its foreign policy. The main area of research has focused on the effectiveness of these economic levers in achieving the initiating state's foreign policy goals.⁷ Since its inception, this area of research has relied largely on American-centric case studies and datasets as the US has been the largest economy for over a century and hence has had the means to exercise economic statecraft. However, lately, case studies have shown that, for example, Russia has also attempted to use its vast energy resources to exact political compliance from its CIS neighbors.⁸ Similarly, China's impressive economic growths in the last thirty years has not only transformed it into the second largest economy in the world but also armed it with significant economic might. According to recent reports, China has employed economic coercive strategies in its foreign policy with the Philippines, Japan, and Norway.⁹

The third domain of literature concerns economic statecraft in the

⁶ Hirschman, Albert O., *National Power and the Structure of Foreign Trade* (Berkeley, CA: University of California Press, 1945).

⁷ Two good resources, among others, of works along this line of research are Mansfield, Edward D., and Brian M. Pollins, eds., *Economic Interdependence and International Conflict* (Ann Arbor: University of Michigan Press, 2003), and Blanchard, Jean-Marc F., Edward D. Mansfield, and Norrin M. Ripsman, eds., *Power and the Purse: Economic Statecraft, Interdependence and National Security* (Portland, OR: Frank Cass, 2000).

⁸ Drezner, Daniel W., *The Sanctions Paradox: Economic Statecraft and International Relations* (New York: Cambridge University Press, 1999).

⁹ Glaser, Bonnie S., "China's Coercive Economic Diplomacy: A New and Worrying Trend," <http://csis.org/publication/chinas-coercive-economic-diplomacy-new-and-worrying-trend>, August 6, 2012. Also, using aggregate trade data, scholars have shown that the bilateral trade between China and the country that received the Dalai Lama would decrease in the wake of his visit. See Davis, Christina, Andreas Fuchs, and Kristina Johnson, "State Control and the Effects of Foreign Relations on Bilateral Trade," paper presented at the Annual Meeting of the International Political Economy Society, Charlottesville, Virginia, November 10, 2012. For a general description of China's use of economic sanctions, see Reilly, James, "China's Unilateral Sanctions," *The Washington Quarterly* 35:4, Fall 2012, pp.121-133.

China-Taiwan dyad. Undoubtedly, both sides of the Taiwan Strait have adopted a strategy of economic engagement in hopes of influencing the other side. For China, economic engagement is the mainstay of its “peaceful offense” grand strategy toward Taiwan.¹⁰ The ever-growing mainland market and the host of trade and investment preferences China has offered to Taiwan have attracted Taiwanese investment, trade, and tourism. China has become Taiwan’s largest trade partner and recipient of Taiwan’s outgoing investments as well as the primary destination for Taiwanese tourists. On the other hand, until 2008 Taiwan was quite leery of the negative effects that the exodus of Taiwanese businesses to China would have on its economy and politics.¹¹ As a result, Taiwan adopted its own set of strategies to counter China’s economic statecraft. President Lee Teng-Hui installed a “Go Slow, Be Patient” policy in the late 90s to slow the outflow of Taiwan businesses to China. President Chen Shui-Bian followed suit with “Active Opening, Effective Management” from 2000-2008, which in practice emphasized the latter part of the policy. Both policies were aimed to reduce Taiwan’s economic dependence on China.¹² However, China’s expanding market proved too much of a lure for Taiwan’s businesses, which effectively circumvented government regulations to increase their presence in China.¹³ On the domestic front, both the Lee and Chen administrations set up tariff and non-tariff barriers to reduce China’s economic presence in Taiwan.

As a result of these developments, there has been a growing literature that examines the political economy across the Taiwan Strait. Tanner has thoroughly researched on China’s economic “weapons”--conduits China can use to exercise its economic influence--and Taiwan’s vulnerabilities. But Tanner did not draw any firm conclusion from his study, citing that it is hard to forecast Taiwan’s possible response to Chinese coercive attempts.¹⁴ Saunders and Kastner speculate on the bargaining situation between China and Taiwan over a peace agreement, assuming Taiwan is already willing to sit at the negotiation table.¹⁵ However, Taiwan may not be willing to negotiate with China over its future, in which the reasons will be expanded later in

¹⁰ Zhao, Suisheng, “Military Coercion and Peaceful Offense: Beijing’s Strategy of National Reunification with Taiwan,” *Pacific Affairs*, 72:4, winter, 1999-2000, pp.495-512.

¹¹ Tung, Chen-yuan, “Cross-Strait Economic Relations: China’s Leverage and Taiwan’s Vulnerability,” *Issues & Studies*, 39:3, September 2003, pp.137-175.

¹² Kahler, Miles, and Scott L. Kastner, “Strategic Uses of Economic Interdependence: Engagement Policies on the Korean Peninsula and Across the Taiwan Strait,” *Journal of Peace Research*, 43:5, September, 2006, pp.534-539.

¹³ Leng, Tze-kang, “State and Business in the Era of Globalization: the Case of Cross-Strait Linkages in the Computer Industry,” *China Journal*, No.53, January 2005, pp.63-79.

¹⁴ Tanner, Murray Scott, *Chinese Economic Coercion against Taiwan: A Tricky Weapon to Use* (Rand Corporation, 2007).

¹⁵ Saunders, Phillip C., and Scott L. Kastner, “Bridge over Troubled Water: Envisioning a China-Taiwan Peace Agreement,” *International Security*, 33:4, Spring 2009, pp.87-114.

this paper. In addition to the literature written in English, there is a great deal of research in Taiwan written in Chinese (e.g., government reports, think tank analyses, academic papers, op-eds, etc.) with regard to the political implications of Taiwan's dependence on the Chinese mainland market. By and large, two schools of thought emerge from the Chinese literature. The first, based on standard trade theory, argues that trade is mutually beneficial to both sides of the strait, thus it is only natural for both Taiwan and China to consolidate their economic relations. China is unlikely to exploit Taiwan's economic dependence on the mainland market with coercive strategies, because doing so will only boomerang. At least for the foreseeable future, China cannot afford to dismiss the business and employment opportunities generated by Taiwanese businesses. The second school of thought argues that China has both the intention and capability to use its economic strength to force Taiwan into unification (the historical analogy of Zollverein that led to German unification is often a convenient reference point). Assuming that China has both the capability and ill-intent, this school of thought believes that to survive China's economic menace Taiwan has no other choice but to reduce its trade with and investment in China. While both schools of thought recognize the deepening business relations across the strait, one views this as an opportunity for Taiwan to piggyback on China's rapid growth, while the other views this as a crisis for Taiwan's autonomy.

II. China's Economic Statecraft toward Taiwan

Chinese statecraft toward Taiwan is three pronged: military, diplomatic and economic. Before 2008, China emphasized military and diplomatic measures over economic strategies. While Chinese military strength may be the ultimate deterrence against *de jure* Taiwan independence, it is handicapped. First, prevailing international norms no longer view war as a legitimate means to solve disputes. If China ever employs force against Taiwan, it will have to bear the brunt of world opinion. Second, America's policy of "constructive ambiguity" deliberately obfuscates the potential course of action the US would take in the event of a China-Taiwan conflict, hence according it a greater degree of freedom in policy decisions. Third, China's saber-rattling toward Taiwan has raised alarms in other East Asian nations regarding its true regional intentions. These incidents work against China's national interest of creating a stable international environment conducive to its goal of "peaceful development." Compared with military deterrence, China's diplomatic statecraft against Taiwan has fewer consequences. Through the years, China has relentlessly strived to limit Taiwan's international space and reduce the number of countries that recognize its sovereignty. Taiwan can participate in only a handful of international

organizations with the participation severely conditional. Presently, only 23 countries formally recognize Taiwan, all of which are small players on the international stage. However, Taiwan has been able to navigate around the diplomatic isolation imposed by China. For example, 127 countries offer visa-free entry or landing visas to Taiwanese nationals. Taiwan has 97 representative offices in 65 countries that do not formally recognize Taiwan. These examples demonstrate that Taiwan has been moderately adept at compromising China's diplomatic offensive. The marginal utility of diplomatic isolation of Taiwan has decreased over the years. If anything, it only further alienates the Taiwanese public from China. Therefore, economic statecraft has become the predominant strategy for China in its dealings with Taiwan since the Ma administration came into office in 2008.

As Hirschman suggests, the precondition for economic statecraft is asymmetrical interdependence in a trade dyad. Country A, if it intends to exert economic statecraft, must be economically powerful enough so that it becomes exorbitantly costly for country B to replace country A as a market. Asymmetry indeed exists in cross-strait trade relations. In 2011, Taiwan's GDP was only 7.2% of that of China's. Moreover, China is Taiwan's largest trading partner; it accounts for 28% of Taiwan's total exports. If including Hong Kong, China accounts for 42% of Taiwan's total exports. In 2011, Taiwan's trade surplus with China was 78.8 billion US dollars, dwarfing its global trade surplus of 26.8 billion US dollars. Taiwan's trade dependence on China was ultimately driven by the outflow of Taiwanese businesses to the Chinese mainland market. By and large, these businesses primarily choose the mainland market as the final destination of their companies' FDI, as oppose to other countries.¹⁶ In contrast, Taiwan is China's 7th largest trading partner, absorbing only 1.85% of China's total exports. Taiwan's economy is also highly dependent on trade, more so than that of China's. According to the most recent WTO statistics, foreign trade is 132% of Taiwan's GDP, but only 55% of China's. Taiwan's democratic system and periodic elections make the government highly accountable to trade-related interest groups (e.g., export-oriented manufacturers, trade-related financial and insurance companies, transportation companies, etc.). On the other hand, China's authoritarian single-party state is comparatively autonomous of special interests groups (other than those within the Communist Party).¹⁷ The Chinese state controls strong administrative leverages that can be instrumental to the exercise of economic statecraft. For example, the number of tourists that are allowed to visit Taiwan is decided by city and provincial governments. Furthermore, the process of obtaining

¹⁶ Leng, Tze-Kang, unpublished manuscript, July 2012.

¹⁷ For a general picture of state-enterprise relations in China, see *China 2030*, The World Bank, 2012.

travel permits is highly opaque at the local level. In contrast, the Taiwan government has little control regarding its citizens' decisions to travel, invest, trade, or receive education in China. As a result, the Chinese government is undoubtedly capable of exercising economic statecraft as a lever against Taiwan. If it so chooses, China can exercise economic statecraft in the form of inducements, deterrence, or compellence.

Since May, 2008, as a result of Ma's election to office, China began to increase economic inducements to Taiwan. China was willing to cooperate with the Ma administration's rapprochement policy, because it no longer feared inadvertently rewarding Taiwan's "defecting" behavior, i.e., the pursuit of Taiwan independence. Other than signing ECFA that granted Taiwanese goods preferred access to the Chinese market, Chinese tourists and purchase missions to Taiwan received a high degree of public attention in Taiwan, as reflected in local media coverage. For many in Taiwan, Taiwan's investments in and exports to China cannot be "seen." In fact, from their perspective, China is to blame for Taiwan's outflow of capital investments, loss of job opportunities and slow-growing economy. However, Chinese tourists and purchase missions are a different matter; the obvious economic benefits from their activities are tangible and highly visible. Tourism infrastructure, i.e., hotels, restaurants, duty-free shops, tour buses, bus drivers, tour guides, night stands, etc., have expanded to meet the demands of Chinese tourists.

While Chinese tourists bring profits to Taiwan's small enterprises, China's purchase missions bring business to Taiwan's large industrial enterprises and agricultural producers. According to the data collected by this author, between May 2009 to July 2011 China sent 55 purchase missions to Taiwan, which averages to slightly over two missions per month. These missions committed over 50 billion US dollars to the purchase of Taiwan's industrial products, and over 500 million US dollars to agricultural products.¹⁸ Tables 1 and 2 show the origins of these purchase missions.

¹⁸ The dollar amount of actual delivery is difficult to find. There are two reasons for this: first, the contracting parties have no incentives to make public the terms of their contracts; and two, many of the contracts span multiple years, hence there are no specific figures for any one year. To put things in perspective, the committed amount to purchase industrial goods is worth about 20% of Taiwan's exports to China in 2009.

Table 1. Chinese Purchase Missions to Taiwan
by Provincial Location

	N	%
Inland Provinces	23	41.8
Coastal Provinces	32	58.2
Total	55	100

Table 2. Chinese Purchase Missions to Taiwan by
Government Level

	N	%
Central Government	13	23.6
Provincial Governments	30	54.6
City Governments	12	21.8
Total	55	100

Table 1 shows that a significant number of Chinese purchase missions were from the inland provinces, which presumably would have fewer trade interests with Taiwan. This may indicate China's ability to mobilize provinces, inland or coastal, to provide economic inducements to Taiwan. Table 2 shows the level of purchase missions. Again, it is noteworthy that the purchase missions were not just limited to the central government; they also included those dispatched by provincial and city governments.¹⁹ What is not shown in Table 2 is that purchase missions formed by provincial and city governments tended to be quite high-profile, as they were frequently led by the top officials from the administrative units, thus attracting considerable press coverage in Taiwan. For example, a purchase mission from Jiangsu Province in November 2009, was led by the provincial party chief and deputy-governor. Clearly, China intends to highlight the economic benefits it can bring to the island.

As Table 3 demonstrates, there were more purchase missions for agricultural products than for industrial goods. Specifically, of the 55 purchase missions, 23 bought agricultural products exclusively, 17 bought industrial products, and 15 bought both. This reflects China's claim that it wants to build a more lasting

¹⁹ The administrative jurisdictions of cities in China, such as Chongqing, can sometimes be more important, both politically and commercially, than the province.

relationship with Taiwan’s agricultural sector, which has been a strong voting bloc for the Independence-leaning DPP. Qualitative evidence also supports this assessment. In July 2011, when Taiwan’s banana farmers suffered from a long stretch of bad market prices as a result of overproduction, Shangdong provincial governor, who was leading a purchase mission to Taiwan, announced an emergency plan to purchase 6,800 tons of bananas at above-market price. This announcement quickly raised banana prices in Taiwan.²⁰ Frequent visits to Taiwan’s agricultural areas by Mr. Zheng LiZong, Vice President of China’s Association for Relations across the Taiwan Straits and Deputy Director of PRC State Council’s Taiwan Affairs Office, also indicate China’s efforts in reaching out to “villages, households, minds, and hearts” (入村,入戶,入腦,入心). Figure 1 shows the routes of a recent visit by Mr. Zheng, which were exclusively in agricultural producing areas.

Table 3.Chinese Purchase Missions
By Purchased Products

	N	%
Agricultural Products	23	41.8
Industrial Products	17	30.9
Both	15	27.3
Total	55	100

The significance of Chinese tourists and purchase missions is that they are more visible and directly felt by the general public. These business opportunities have political implications. As Nincic observes, there are two models underlying economic inducements, the exchange model and the catalytic model.²¹ In the exchange model, the *quid pro quo* was specified *ex ante*. For example, West Germany offered a handsome total to the USSR in exchange for Gorbachev’s promise to withdraw the Red Army from East German territory. In the catalytic model, however, there is no specification of *quid pro quo*. The initiating state that provides economic inducements (as a catalyst) only aims to change the overall policy preferences of the target state so that the latter’s policy preferences becomes better aligned with those of the initiator. West Germany’s economic aid to Poland in the 1980s and 1990s is a

²⁰ <http://www.chinareviewnews.com>, 2011-07-22.

²¹ Nincic, Miroslav, “Getting What You Want: Positive Incentives in International Relations,” *International Security* 35:1, Summer 2010, pp.138-183.

case in point.²² Although China's economic inducements to Taiwan as described appear to adhere to the catalyst model, i.e., "winning the hearts and minds of Taiwan's people," and China's purchase missions never mention the politics of economic engagement, it should be noted that there may be a tacit understanding of the *quid pro quo* in the offering. As Baldwin observes, "Today's reward may lay the groundwork for tomorrow's threat, and tomorrow's threat may lay the groundwork for a promise of the day after tomorrow."²³ Furthermore, subsidy can be a source of bargaining power for the subsidizing state that can be exploited to gain political concessions from the subsidized state, regardless of asymmetrical dependence.²⁴ Therefore, if Chinese tourists and purchase missions to Taiwan are considered by China as subsidies to Taiwan, rather than a mutually beneficial trade in services and manufacturing, then suspension of tourism and purchase missions to Taiwan can be used by China as a coercive threat.

China used economic inducements as a deterrent threat in late 2011 when incumbent President Ma was in a neck-to-neck race with DPP candidate Tsai Ing-wen for the 2012 presidential election. Since the pro-independence DPP denies the very existence of the "92 Consensus,"²⁵ which conversely has been accepted by both the KMT and CCP governments as the foundation for cross-strait negotiations since 2008, a presidential victory by Ms. Tsai would mean Taiwan potentially becoming a flash point for China once again. As a result, China undertook a series of actions to "remind" Taiwan the importance of the "92 Consensus." On November 7, 2011, Jia Qinglin, Chairman of the National Committee of the Chinese People's Consultative

²² Davis, Patria A., *The Art of Economic Persuasion* (Ann Arbor, MI: The University of Michigan Press, 1999.)

²³ Baldwin, David A., "The Power of Positive Sanctions," *World Politics* 24:1, October 1971, p.24.

²⁴ Wagner, R. Harrison, "Economic Interdependence, Bargaining Power, and Political Influence," *International Organization* 42:3, Summer 1988, pp. 479-481.

²⁵ Coined by Su Chi, former-Secretary-General of the National Security Council under the Ma administration, the "92 Consensus" means the consensus of "One China, Different Interpretations" agreed by both sides of the Taiwan Strait allegedly in 1992. This is a formula that has helped navigate the differences between the two sides' legal interpretations of the situation across the Taiwan Strait, which has existed since 1949. For China, Taiwan is part of China; therefore, in principle Beijing cannot negotiate with Taipei, the capital of a renegade province. For the KMT, both Taiwan and the Chinese mainland are part of the Republic of China; therefore, the KMT government cannot recognize the government in Beijing. For the DPP, Taiwan is not part of China; Taiwan's national title should be Republic of Taiwan. For Beijing, the DPP's position that Taiwan is an independent state is political anathema. Beijing has long maintained that should Taiwan declare independence, Beijing will use force against Taiwan. On the other hand, from Beijing's perspective, the KMT's position on cross-strait relations is more compatible with that of its own; that is, KMT considers both Taiwan and the mainland as part of China (though not People's Republic of China.) Since the "92 Consensus" equivocates on the contentious issue of sovereignty, it is used by both the KMT government and Beijing as a device for agreeing to disagree. However, for the DPP, the "92 Consensus" will invalidate the sovereignty of the Republic of Taiwan, which explains the DPP's vehement denial of its existence.

Conference, stated when addressing a group of Taiwanese businessmen visiting Beijing that, “If the “92 Consensus” is denied, cross-strait negotiations will have to be stopped, the current development will be arrested, and cross-strait relations may be thrown into turmoil.” Five days later, Chinese president Hu Jintao met with Lien Chan, Taiwan’s former vice president, during the 2011 APEC meeting, reiterated that “identification with the “92 Consensus” is a major precondition to cross-strait negotiations, and it is also the foundation for peaceful development in the Strait.” And on November 17, the director of the State Council’s Taiwan Affairs Office, Wang Yi, openly warned of the consequences should the existence of the “1992 Consensus” be denied. In a keynote speech at the Taiwan Week exhibition in Chongqing, Wang stated that “China will not tolerate the denial of the “92 Consensus,” nor the backpedalling of cross-strait relations, nor the lapse of peace in the Taiwan Strait, and nor the destruction of the welfare of the people on both sides of the strait.” This action demonstrates a classic deterrence strategy whereby Beijing publically drew a line in the sand, and waited to see if Taiwan would cross the line.²⁶

Taiwan’s business sector did respond to China’s attempt at deterrence.²⁷ Between mid-November, when China voiced its threats, and Election Day (January 14, 2012), Taiwan businesses gradually came out to support Ma’s campaign. This surge in support for KMT’s Ma would have been unlikely had it not been for China’s deterrence strategy, given that various surveys showed that in terms of candidate likability and personal quality Tsai was equally popular. A case in point is that five of the traditionally pro-DPP conglomerates rallied behind the “1992 Consensus” (hence, by default, Ma’s candidacy) for the first time. Furthermore, rarely had Taiwan’s businesses come out to support one policy on such a significant scale or number. Historically, businesses tended to remain neutral in presidential elections, at least superficially, lest they wager on the wrong bet. The 21 big businesses that publically pledged their support for the “1992 Consensus,”-- the majority of which refrained from mentioning Ma’s candidacy --ranged from electronics, retailing, transportation, general manufacturing, to banking.²⁸ Moreover, according to Taiwan’s most respectable business magazine, *The Commonwealth*, Taiwan’s top 1,000 businesses

²⁶ Theoretically, in Taiwan’s two-candidate presidential election, deterring against votes for DPP’s Tsai is tantamount to compelling votes for KMT’s Ma. But given that China’s actions in this period of time were aimed at maintaining the “1992 Consensus”-based status quo, Beijing’s actions were more of deterrence in character than of compellence. I want to thank Professor Wu Yu-shan to point this out.

²⁷ It should be noted that measuring the effectiveness of deterrence can be problematic due to context-specific variables. In determining the success or failure of deterrence, researchers are required to prove that a non-event (i.e., the fact that the target country does not cross the red-line) was due to the deterrent threat, and not the target country’s own voluntary decision to comply even in the absence of threat.

²⁸ <http://gate.sinovision.net:82/gate/big5/news.sinovision.net/portal.php?mod=view&aid=201335>.

were overwhelmingly supportive of Ma's candidacy.²⁹ This indicated that by and large, Taiwan's business sector preferred the status-quo to possible changes under a DPP administration.

However, in contrast to Taiwan businesses, China's economic deterrence strategy had less clear of an effect on traditionally DPP electoral districts. Five townships that were historically DPP strongholds have since greatly benefited from China's economic inducements in terms of tourism or large-scale purchases of agricultural produce. Presumably, if China were to withdraw its economic favors from these five townships, voter turnout rate would likely drop sharply, thus harming the DPP's election prospects. Based on aggregate electoral data (Table 4), this author found that the respective voter turnout rates remained relatively constant compared with the previous two elections. In comparison with all other townships, the voter turnout rates of these five townships were well within ± 1 standard deviation. Therefore, the data does not indicate that the townships in question were significantly impacted by China's deterrence strategy. However, anecdotal evidence suggests otherwise. According to an in-depth article on Xyue-Jia Township by *Business Weekly*, a major business magazine in Taiwan, the township's heavy dependence on milkfish exports to China had a dampening effect on its voter support for the DPP.³⁰ In addition, the DPP's post-election report that reviewed why DPP lost the presidential election surmises that China's deterrence "card" negatively impacted voter turnout in DPP strongholds, whereby Tsai received significantly fewer votes than DPP's legislative candidates. This author's tentative observation is that China's deterrence did not change the orientation of DPP supporters, except perhaps their fervor. This suggests that only once China's economic incentives reach a certain threshold would its strategy of economic deterrence significantly affect voter choice in townships like Xyue-Jia. However, it is difficult to forecast whether China's economic deterrence toward Taiwanese voters will be successful in the future. This is because the variables that impact Taiwan's presidential elections are multifarious, i.e., that span international politics (China and the United States, in particular), party identification, policy issues and the popularity of the candidate.

²⁹ *The Commonwealth*, December 27, 2011.

³⁰ Yi-ling, Kuo, "Communists, Money, and Milkfish," *Business Weekly*, No.1249, October 26, 2011.

Table 4. Voter Turnout in Presidential Elections:
Measured in Deviation from All-Townships Mean

	2012	2008	2004
Yu-Chih (tourism)	-2.03	-2.65	-2.17
Gu-Keng (citrus)	-1.04	-1.27	-0.60
Alishan (tourism)	-2.45	-2.45	-2.25
Xyue-Jia (milkfish)	-0.73	-0.70	+0.03
Yong-An (grouper)	-0.55	-0.09	+0.40
±1 Standard Deviation	±3.98	±4.01	±3.35

I now conjecture whether China's economic engagement with Taiwan will become an effective means of compellence to force Taiwan into political negotiation. China is yet to show any intention to do so, but should it become impatient with the rate of progress in the Taiwan Strait, economic compellence is clearly one of the tools in its arsenal.

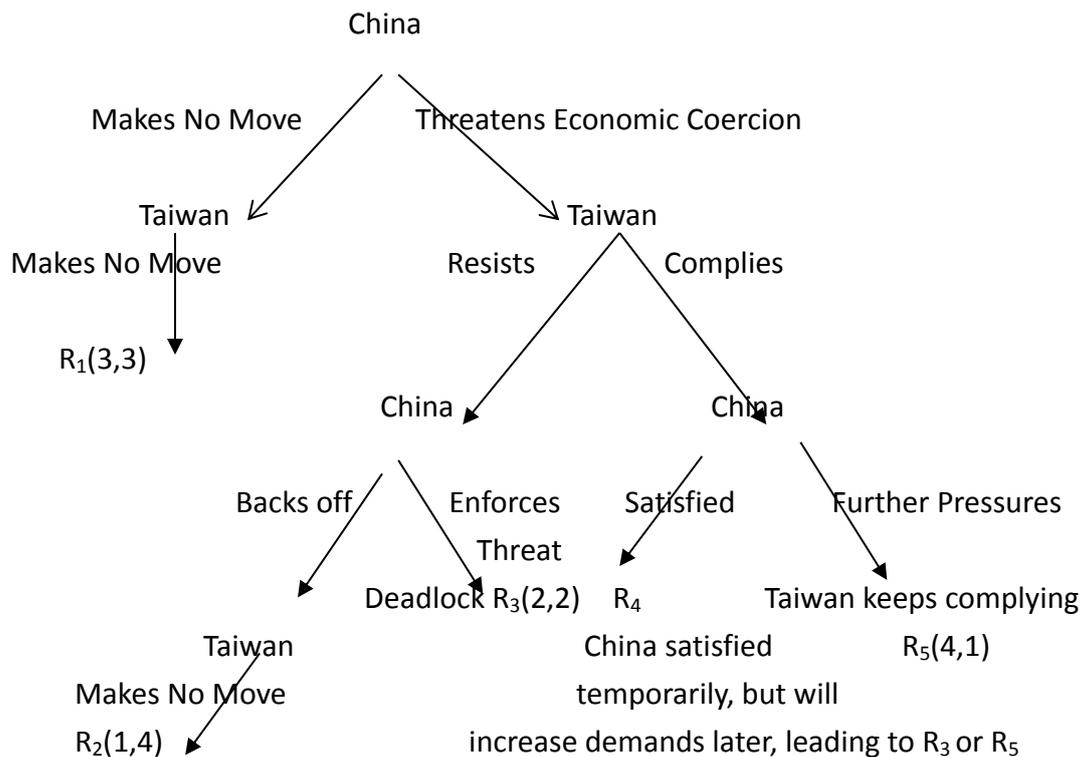
To analyze this problem, I use a decision tree, as shown in Diagram 1, to layout the possible scenarios in the event China exercises economic coercion against Taiwan. In this simple model, China and Taiwan place different values on each outcome, as indicated by the paired numbers. The first number indicates the value of China's preference, while the latter is that of Taiwan's, with higher numbers representing higher ordinal preference. In the first decision tier, China, as the initiator, has two options: making no move against Taiwan or using economic threats to compel Taiwan to engage in political negotiations. The threats may include suspension of tourism and purchase missions to Taiwan, stalling trade negotiations under the ECFA framework, thwarting Taiwan's efforts to sign FTAs with other countries by pressuring its trading partners, etc. On the other hand, if China makes no move then the status quo is preserved. Under the first scenario whereby China chooses compellence, Taiwan can resist or comply. However, it is important to note that China will never directly demand of Taiwan to engage in negotiations over reunifications. Rather, the demands will usually be couched in terms more politically palatable, such as "talks over reasonable arrangement for cross-strait political relations," or "talks over military confidence-building measures," or "talks over peace accord."³¹ However, no matter how the demands are worded, Taiwan will essentially have two options: to comply or not to comply. If Taiwan decides to sit at the negotiation table for

³¹ These terms appeared in a speech delivered by China's retiring-president Hu Jintao at the 18th Party Congress of the Chinese Communist Party on November 8, 2012.

political talks, its greatest concern would be whether China will be sufficiently satisfied with the move or will it construe this action as a sign of appeasement to be further exploited, i.e., China making further demands on direct negotiations over reunification terms. This author postulates that Taiwan is more likely to view the latter scenario to be true; the reason is what Sechser calls the “Goliath’s curse.”³² According to Sechser, coercive threats in a highly asymmetric power relationship tend to make the target state leery of reputation costs. The challenger state then should compensate the target state’s reputation cost so that it is more willing to acquiesce. But the overwhelming power of the challenger often leads it to underestimate the reputation cost of the target state, hence resulting in insufficient compensation. For Taiwan, China’s relentless pursuit of military power and diplomatic maneuver against its international space means only one thing—reunification. Therefore, should Taiwan comply with China’s demands, it would only be appeasing an aggressor that will continue to demand more in the future. Even in the former scenario whereby Taiwan complies and China is satisfied in the short-term (Result₄), there is no guarantee that China would not be recidivist given its national goal of reunification. Even if Taiwan continues to comply (R₅), the result is the least desirable for Taiwan, while most desirable for China, i.e., R₅(4, 1). However, if Taiwan resists China’s threat of economic compellence and China subsequently retreats, the result would be most preferable for Taiwan and least preferable for China, R₂ (1, 4). In this scenario, Taiwan would learn that it is capable of warding off China’s economic pressures and maintain the status quo. However, China’s reputation would suffer. Should Taiwan resist and China follow through with its economic threats the Taiwan Strait would inevitably be deadlocked. As a consequence, cross-strait relations may revert back to its prior state before the Ma administration came into office in 2008. In this scenario, China will lose its economic leverage over Taiwan, while Taiwan will lose the economic concessions it enjoyed from China, hence slowing down its economic growth. For both China and Taiwan, this scenario R₃(2, 2) is inferior to the current status quo R₁ (3, 3), where China continues its economic engagement with Taiwan while keeping Taiwan Independence at bay, and Taiwan refrains from provoking China while reaping profits from its business relationships with China. It is clear that the status quo is the better option given the other three scenarios. But if China makes an economic compellent threat, a deadlock could easily result, making both sides worse off. The preference structure across the Taiwan Strait is therefore similar to that of a prisoners’ dilemma game. But there is one important difference: in the compellence scenario only China has the

³² Sechser, Todd S., “Goliath’s Curse: Coercive Threats and Asymmetric Power,” *International Organization* 64, Fall 2010, pp.627-60.

capability to make the first move. Such may be the reasoning behind an editorial of the generically nationalistic *Huanqiu Shibao*, an affiliate of the *People's Daily*. The editorial, published after Ma's successful re-election, argued that ““detering Taiwan independence” and “compelling reunification” are related, but at the same time they are remotely separate...In cross-strait relations, we must not force the issue (reunification)...we have to give ourselves some strategic flexibility.”³³



III. Variables That May Impact on Chinese Economic Statecraft

Following George and Simons' discussion of coercive diplomacy, I analyze two levels of variables that may be relevant to the success or failure of coercion: contextual variables and negotiation process-specific variables.³⁴

Some contextual variables that are omitted from the simple model of China's economic compellence toward Taiwan may nevertheless influence the sequential

³³ January 16, 2016, <http://opinion.huanqiu.com/roll/2012-01/2359674.html>.

³⁴ George, Alexander L., and William E. Simons, eds., *The Limits of Coercive Diplomacy*, 2nd Edition (Boulder, CO: The Westview Press, 1994). A litany of variables that may bear upon the success or failure of coercion ultimately depends on the subject matter of study at hand. George and Simon give a list of 14 variables, while other researchers offer different sets of variables. See, for example, the different case studies edited by Freeman, Lawrence, *Strategic Coercion: Concepts and Cases* (Oxford University Press, 1998).

dynamics of China's economic engagement, deterrence, and compellence. First, China's economic inducements to Taiwan (mainly tourism and purchase missions) are predicated on Taiwan's willingness to adopt the "1992 consensus" over the diametrically opposed sovereignty claims across the Taiwan Strait. Since Taiwan is a democracy, change of government is inevitable in the long run. Should a new administration in Taiwan deviate from the "1992 consensus" formula as formulated by the current Ma administration, and move Taiwan towards independence, then China is likely to oppose Taiwan's new position. The reason being that this allows China to maintain its credibility and avoid being outmaneuvered by Taiwan—i.e., successive Taiwan administrations may try "salami tactics" that push against the precedent set by the prior administration, hence driving Taiwan further away from China's "one China policy" (aka One-China "Framework"). Should this scenario pan out, China is likely to pursue a tit-for-tat tactic, i.e., punishing Taiwan such as suspending tourism to the island. If Taiwan retaliates by pursuing actions that are highly politically symbolic, e.g., applying for membership in the UN under the name of Taiwan, we can expect the end to the current cross-strait rapprochement.

Secondly, even if future administrations in Taiwan adhere to the formula of the "1992 consensus," China may change its current position by compelling Taiwan toward reunification. That is, China may get impatient. For example, Luo Yuan, a retired PLA general regarded by many as interlocutor for the Chinese military, stated in a high-profile speech that, "Although the mainland had released a great deal of goodwill to Taiwan, the proportion of those who support reunification with China had not risen, and the proportion for Taiwan independence not declined....Ma, by keeping China at arm's length, is sacrificing "reunification" to achieve "incremental secession."³⁵ Interlocutors from various Chinese think tanks also expressed criticism at Taiwan's seeming reluctance to negotiate with China on political issues. If the new Chinese leadership (fifth-generation and beyond) are dissatisfied with the status quo and interpret it as a lack of progress toward reunification, rather than progress toward "peaceful development" as under former PRC President Hu Jintao, then economic leverages can be instrumental to compelling Taiwan into political talks. The possible scenarios under which the Chinese leadership may display greater impatience toward the pace of cross-strait relations include a more assertive PLA in

³⁵ Luo Yuan, "On Using Force to Solve the Taiwan Issue," Keynote Speech at Conference on Chinese Economic Growth and Economic Security Strategy, Beijing, November 21, 2009. What is significant is that Luo Yuan was still an active serving PLA general when he made the speech. The wording by Lo Yuan hints at the Anti-Secession Law the PRC passed in 2005 to give mainland a legal basis for using force against Taiwan.

China's political system,³⁶ or a wider "selectorate" for the new-generation leadership in which the winning coalition is strongly nationalistic,³⁷ or the political inclination of new leaders whose formative years dovetail the rise of China, hence harbor a strong sense of entitlement. Furthermore, if China begins to democratize, cross-strait relations may not necessarily benefit. As Mansfield and Snyder amply demonstrate, ruling elites in a democratizing country tend to agitate nationalistic feelings to coalesce its supporters, fencing off competition from new opposition.³⁸ The pent-up nationalism in the general populace and netizens in particular, can provide fertile ground for this tactic.³⁹

The third contextual variable of China's economic statecraft is the development of interest groups in Taiwan that have an economic stake in China's economy. Albert Hirschman's ground-breaking study on the political effect of asymmetrical trade structure addresses this issue. In Hirschman's words,

"What we have called the influence effect of foreign trade derives from the fact that the trade conducted between country A, on the one hand, and countries B, C, D, etc., on the other, is worth *something* (italic original) to B, C, D, etc., and that they would therefore consent to grant A certain advantage—military, political, economic—in order to retain the possibility of trading with A. If A wants to increase its hold on B, C, D, etc., it must create a situation in which these countries would do *anything* (italic original) in order to retain their foreign trade A."⁴⁰

Theoretically, the asymmetrical trade structure is not necessarily a source of bargaining power for the stronger in the trade dyad. This is because the weaker side may attach more value to the issue under negotiation than the losses suffered as a result of punishment from the stronger side.⁴¹ In other words, for Taiwan, benefiting from trade with China is one thing, putting its political future on the negotiation table is quite another. However, empirical case studies have shown that if the

³⁶ Assessments vary with regard to PLA's political clout in China's political system.

³⁷ The term "selectorate" is from de Mesquita, Bruce Bueno, Alastair Smith, Randolph M. Siverson, and James D. Morrow. *The Logic of Political Survival* (Cambridge, MA: MIT Press, 2003).

³⁸ Mansfield, Edward D., and Jack Snyder, *Electing to Fight: Why Emerging Democracies Go to War* (Cambridge, MA: Harvard University Press, 2005).

³⁹ For Chinese nationalism in general, see Zhao, Suisheng, *A Nation-State by Construction: Dynamics of Modern Chinese Nationalism* (Palo Alto, CA: Stanford University Press, 2004). For nationalism expressed on the internet, see Wu, Xu, *Chinese Cyber Nationalism* (Lanham, MD: Lexington Books, 2007).

⁴⁰ Hirschman, p.17.

⁴¹ Wagner, R. Harrison, "Economic Interdependence, Bargaining Power, and Political Influence," *International Organization* 42:3, Summer 1988, pp 465-475...

economic stakeholders with interests in the stronger state attain significant political presence in the target state's domestic politics, then national interests of the target state can be redefined.⁴² It is therefore not entirely inconceivable that China may someday succeed in coercing (or cajoling then) Taiwan to sit at the negotiation table, if Taiwan's ruling coalition at that point values trade with China more than its political future.

In addition to contextual variables, there are certain process-specific variables that may also influence the success and failure of China's statecraft. These process variables may include, as Schelling, in his insightful analysis of compellence, argues, timing, the challenger's skill at communicating expectations to its adversary, assurance guarantees, and the nature of compliance. In terms of timing, Schelling elaborates,

"compellence has to be definite: We move, and you must get out of the way...there has to be a deadline, otherwise tomorrow never comes. If the action carries no deadline it is only a posture, or a ceremony with no consequences. Compellence, to be effective, can't wait forever. Still, it has to wait a little; Collision can't be instantaneous...Too little time, and compliance becomes impossible; too much time, and compliance becomes unnecessary."⁴³

Therefore, if China fails to set a firm deadline for Taiwan's compliance, then Taiwan may foil China's coercive attempt by procrastinating. If China sets a deadline, Taiwan will still procrastinate to test China's determination.⁴⁴

With regard to communicating expectations, the initiator can also encounter difficulties. Schelling argues that "a compellent advance has to be *projected* as to destination, and the destination can be unclear in intent as well as in momentum and braking power."⁴⁵ Hence, any demands from China for political negotiation will make Taiwan highly wary of the potential ramifications, such as inadvertently binding Taiwan to greater demands in the future or opaque commitments.

In respect to the assurances that the challenger state can guarantee the

⁴² Abdelal, Rawi, and Jonathan Kirshner, "Strategy, Economic Relations, and the Definition of National Interests," *Security Studies* 9:1-2, pp. 119-156. Abdelal, Rawi, *National Purpose in the World Economy* (Ithaca, NY: Cornell University Press, 2001).

⁴³ Schelling, Thomas C., *Arms and Influence* (New Haven, CT: Yale University Press), p.72.

⁴⁴ Even ultimatums, which are the most forceful form of communicating a state's determination to another state, frequently are dismissed by the target state. See Lauren, Paul Gordon, "Ultimata and Coercive Diplomacy," *International Studies Quarterly*, 16:2, June 1972, pp.131-165.

⁴⁵ *Ibid.*, p.73.

target state for its compliance, Schelling once again offers insight into the subject:

“Actually, any coercive threat requires corresponding *assurances*; the object of a threat is to give somebody a choice...They are, furthermore, confirmed and demonstrated over time...The assurances that accompany a compellent action...are harder to demonstrate in advance, unless it be through a long past record of abiding by one’s own verbal assurances...[B]oth sides of the choice, the threatened penalty and the proffered avoidance or reward, need to be credible...[T]he assurances are a critical part of the definition of the compellent threat.”⁴⁶

In analyzing the game tree above, this author has argued that China will find it difficult to offer credible assurances to Taiwan affirming that it will *not* make further demands on Taiwan to engage in reunification talks should it agree to initial talks over “political issues.” Furthermore, economic inducements are likely to be more effective as a strategy of deterrence than compellence. With deterrence, the threat of punishment in the event of noncompliance carries with it an underlying assurance of reward in the event of compliance. Hence, the threat of punishment should Taiwan’s voters elect a candidate unfavorable to Beijing is accompanied by the promise of reward, i.e., continued economic favors should Taiwan voters elect a candidate supportive of Beijing. In contrast, with compellence, noncompliance leads to punishment but compliance leads to further demands, such as China demanding further engagement in political talks. As a result, under the scenario of compellence, Taiwan can only choose noncompliance.

The nature of compliance as a result of compellence may also impact the outcome of the strategy. Compliance under the condition of compellence is “more conspicuously compliant, more recognizable as submission under duress, than when an act is merely withheld in the face of a deterrent threat.”⁴⁷ In other words, compliance under compellence is tantamount to losing face. One can imagine that the ruling party of Taiwan can simply “publicize” the compellent threat to leverage the negative reaction from Taiwan’s general public against Beijing’s pressuring. A “losing face” tactic can prove effective to undermine a threat of compellence.

⁴⁶ Pp. 74-75.

⁴⁷ P. 82.

IV. Conclusion

China's rapid development has given rise to innumerable interest and research in China's economic statecraft, and hence Taiwan's economic security. While most of the research on this topic provides strong descriptive statistics on the economic interdependence between Taiwan and China, they do not attempt to specify the conditions under which China exercises its economic clout over Taiwan. In this paper I argue that since 2008 China has greatly increased its economic inducements toward Taiwan. The economic inducements, i.e., Chinese tourism and high-profile purchase missions in particular, can serve as the cornerstone of China's statecraft in economic deterrence and compellence. China's economic deterrence appeared to be effective, as illustrated in the 2008 presidential election in Taiwan. In contrast, economic compellence, i.e., China's use of its economic power to extract political concessions from Taiwan, may prove difficult to accomplish because of interactive dynamics embedded in a compellence game. But if China's economy continues to expand, and the Chinese leadership is sufficiently satisfied with a policy of economic engagement with Taiwan, then those in Taiwan with economic stakes in China may steadily grow. If in the future, these stakeholders form a ruling coalition in Taiwan, China's economic statecraft may prove more effective.⁴⁸

⁴⁸ Rogowski, Ronald, *Commerce and Coalitions* (Princeton, NJ: Princeton University Press, 1989). My former colleagues at Taiwan's National Chengchi University also did research on the impact of cross-strait commerce on Taiwan's political coalition. See Keng, Shu, and Lu-Huei Chen, "Cross-strait Trade and Taiwan's Political Blocs," (in Chinese), *Wenti-yu-Yenju* 42:6, November 2003, pp.1-27.

Figure 1. Itinerary of Visits to Taiwan's Agricultural Producing Areas by a High Chinese Official in 2012

