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POLITICAL RISK IN TAIWAN

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POLITICAL RISK IN TAIWAN

I. The Government and Economic Management

After Singapore, Taiwan has the best-managed economic institutions, including both private firms and government ministries and planning agencies, in the developing world. Taiwan has fared better in the 1979-1982 world recession than South Korea for several reasons. First, and above all, Taiwan did not suffer the kind of political discontinuity which South Korea experienced after the assassination of President Park in October 1979. Second, Taiwan avoided the overinvestment in heavy industry, excessive wage rises, and resultant inflationary pressures which hampered South Korea in the late 1970s and early 1980s. Third, Taiwan's management strategy is different, for political reasons. South Korea has encouraged the growth of huge conglomerates, thereby achieving the economies of scale which, to take one example, its enormous Middle East construction business requires. Taiwan, on the other hand, sacrifices such economies of scale because the government fears the emergence of huge firms in Taiwanese hands; such economic power might one day be used against the mainlander government. As a byproduct of their greater specialization, Taiwanese firms now find that their management has a much tighter grip on the detailed problems of managing through a difficult period.

Prime Minister Chiang Ching-kuo is elderly and ill, so Taiwan faces a succession in the foreseeable future, but Taiwan's institutions are capable of a smooth transfer of power. A change in leadership is unlikely to entail changes of economic policy adverse to foreign banks and corporations. However, it should be noted that, along with Chiang Ching-Kuo, an entire generation will be passing from the scene, at a time of significant international tension. Thus, although the likelihood of sound management is very high, the possibility of a misstep bears watching.

II. The Opposition

Taiwan's principal domestic political problems arise from the division between the Kuomintang government, which is still largely controlled by people who came over from the mainland in the 1940s, and the majority of indigenous Taiwanese. Economically, the two function smoothly together, with the mainlanders preferring to be government administrators and the Taiwanese preferring to be private entrepreneurs. But the constitution is still based on the fiction that Taipei is the capital of China; the legislature is therefore composed largely of aging mainlanders who came from Sichuan, Fukien, and so forth. The government has managed this situation masterfully, since a bloody uprising in 1949, by giving the Taiwanese the full benefits of the economic takeoff, by very gradually promoting Taiwanese to higher and higher administrative and political positions, and by managing the military the economy with extraordinary success. This does not completely solve the problem, and there are sporadic demonstrations and jailings, but there is little likelihood of any financially consequential dissidence in the next few years, unless the Taiwanese come to fear that the Kuomintang mainlanders might jeopardize their economic well-being through negotiations with the mainland (see below).

The Taiwan opposition does not include a major component sympathetic to communism or interested in affiliation with the People's Republic of China. The opposition seeks independence for Taiwan, or more democratic governance within Taiwan. This makes Taiwan's politics difficult for the People's Republic of China to manipulate. The Peking regime can hope to influence Taiwan's politics not through direct subversion, but through creating a sense of insecurity by threatening Taiwan's trade or by reducing its access to modern weaponry. Either strategy would create a hostile reaction from the West which would in turn damage China's economic modernization programs.

III. International

Thus, the political risks to short and medium-term business in Taiwan are mainly international. Compared with political risks elsewhere in the developing world, the risks in Taiwan are minimal. However, the situation has evolved in unfortunate ways in recent months, so it is important to follow the flow of events.

In 1972, Nixon and Kissinger reversed the old policy of isolating mainland China. Diplomatically, they opened a liaison office in Beijing and emphasized building relations with China on vital global issues while not degrading Taiwan's security. Carter subsequently took this policy to its logical conclusion, agreeing to recognize China diplomatically, while formally de-recognizing Taiwan and formally terminating the military alliance with Taiwan. However, the U.S. maintained a liaison office, which was an embassy in all but name, in Taipei, and pledged itself to maintain Taiwan's economic vitality and its military security. China and the U.S. disagreed about future U.S. arms sales to Taiwan, which the Carter administration was determined to maintain, but went ahead with the normalization anyway. The Chinese promised privately never to attack Taiwan, but they refused to make a public or formal promise, since that would compromise their sovereignty over Taiwan.

The Reagan administration came to office committed to upgrade diplomatic relations with Taiwan, on the the argument that China would have to swallow such a policy due to its vital need for U.S. security, financial and technological assistance. This argument was not valid, the Chinese reacted with outrage, and the Reagan backed off and endorsed the Carter policy almost immediately after taking office. Despite that backing off, the Chinese felt that Reagan was following a "de facto two Chinas policy." The dispute came at a delicate time in Deng Xiaoping's administration on the mainland, and China responded by backing way from its previously expressed desire to be "an honorary member of NATO" China is now very critical of American policy toward itself, toward U.S. allies, toward southern Africa and the Caribbean, and toward the Third World generally. It has announced a new policy of "openmindedness" toward the two superpowers, the essence of which is to declare the period of Sino-American entente to be ended, although economic cooperation, diplomatic recognition, and limited security cooperation will continue. Simultaneously, the Chinese have agreed to negotiate with the Russians for the first time since December 1979.

These geopolitical conflicts have been compounded by the acrimonious course of Sino-American textile negotiations and by the defection of Chinese tennis player Hu Ha.

The most recent specific Sino-American conflict over Taiwan was a Chinese challenge to U.S. arms sales. In August 1982, China and America compromised this severe dispute. The Chinese dropped their demand for a firm cut-off date for arms sales. The U.S. agreed "gradually" to reduce sales, "leading over time to a final resolution," and also promised that sales would not exceed peak levels reached since normalization of relations (\$830 million in 1980). This could create major problems for Taiwan -- for instance, if China purchases Mirage 2000 fighters and the U.S. can only sell F-5Es. The U.S. also came closer than ever to conceding Chinese claims to sovereignty over Taiwan. In response to U.S. demands for assurance that China would not attack Taiwan, China declared in the Joint Communique that "striving for peaceful unification" is a "fundamental policy," even while insisting that unification is an internal affair.

These compromises were the product of negotiations underway since the beginning of the year. The U.S. had delayed formal notification to Congress of the decision, announced in January, to permit Taiwan to continue co-producing the F-5E fighter aircraft, pending talks with Beijing. Deng Xiaoping, whose domestic critics have used the Taiwan issue against him, was able to agree to the compromises only after Vice President Bush delivered several letters from President Reagan that sought to allay the suspicions which Chinese leaders have had about his ultimate intentions, and to assure them that Reagan valued the relationship with China. American concessions were motivated by fears of "losing" China at a time of acute U.S.-Soviet tensions; China, in other words, successfully played a "Soviet card" on Taiwan.

The new agreement does not end the conflict over arms sales. Each side interprets it differently, if only to mollify domestic critics. In the American view, peaceful unification and arms sales are linked: if China adopts a hostile approach to Taiwan, U.S. sales policy will change. The Chinese reject this linkage and threaten that, if arms sales are not in fact terminated "over a period of time," it is "highly probable" that U.S.-China ties will retrogress.

The broader issue of Taiwan will continue to cause conflict. America feels a moral commitment to ensure peaceful settlement of the issue. If the Taiwanese voted to accept China's offer of autonomy within the Chinese system, retaining their current economic and political system, the U.S. would welcome the decision. But the Taiwanese question the long-term consequences of incorporation into China and fear loss of their high standard of living, currently 10 to 15 times the income level of the mainland. Meanwhile, U.S. ties to Taiwan are sustained by Taiwan-U.S. trade more than twice the size of PRC-U.S. trade.

China's negotiating strategy toward Taiwan is detailed in the attached paper.

The probability of serious diplomatic problems between China and Taiwan, and between China and the U.S. over Taiwan, is clearly rising. But such problems will not destabilize or threaten Taiwan, and are unlikely through the mid-1980s to affect its commerce. Thus, despite international and domestic political problems, Taiwan remains one of the most stable and secure third world countries.