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"Taiwan-China: Recent Economic, Political, and Military Developments across the Strait, and Implications for the United States."

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Describe the Current Status of, and Trends in, Cross-Strait Trade and Investment

Cross-Strait trade discussions are currently dominated by the ongoing negotiations of the Economic Cooperation Framework Agreement (ECFA) between Taiwan and China. The ECFA is a Free Trade Agreement (FTA) designed to normalize and then liberalize the bilateral commercial relationship.

Upon his inauguration in May 2008, Taiwan's President Ma Ying-jeou undertook a decisive policy of engagement with China. Ma has focused on certain areas, such as direct transportation and mail links, to highlight the change in atmosphere and the increase in substantive talks between the two sides.

Since May 2008, the two sides have consummated numerous bilateral agreements. The agreements have been negotiated under the auspices of the Straits Exchange Foundation (SEF) on the Taiwan side and the Association for Relations Across the Taiwan Strait (ARATS) on the Chinese side, and negotiations have ranged from commercial matters to logistics, law enforcement, and tourism. Just in the past week, Taiwan and China have consummated an agreement on banking, which will allow for limited Chinese investments in Taiwan financial institutions and vice versa.

In early 2009, Taiwan's Petrochemical Industry Association challenged the Ministry of Economic Affairs (MOEA) to explain how the Ma government would address the impending challenge of the ASEAN plus 1 trade agreement with China - implemented on January 1, 2010 - and the zero tariffs that ASEAN petrochemical producers would then enjoy in the China market. This more parochial aspect of the ASEAN plus 1 agreement began to acutely focus minds in Taiwan on the need to address the increasingly irregular nature of Taiwan's trade relationship with China, Taiwan's largest trading partner. At the end of February 2009, President Ma announced that Taiwan would seek an ECFA with China that would at first normalize the trade relationship and then liberalize it.

The requirement to normalize Taiwan's trade relationship stems from legacy trade barriers put in place as far back as 1949 when Chiang Kai-shek's Nationalists fled the mainland. Chinese goods from within 2244 product categories have long been banned from being imported into Taiwan, and China has placed a priority on having those barriers lifted. As a presidential candidate, President Ma promised that he would not be removing any of the agricultural bans - numbering about 800 of the total list - and that commitment remains in place. Therefore, in the normalization phase of ECFA we can expect that Taiwan will agree to remove the import bans for approximately 1500 categories.

The liberalization phase is initially focused on what Taiwan typically refers to as the "early harvest". The term refers to the product categories which stand to benefit most from preferential market access, and includes textiles, petrochemicals, auto parts, and machine tools. The Chinese are focused on opening Taiwan up to investment, and want Taipei to consider providing access to property, equities, and other investment instruments. Taiwan is not reflexively opposed to domestic Chinese investment, but it is unlikely that China will receive blanket investment access to Taiwan.

At the 5th round of SEF-ARATS talks, tentatively scheduled for May/June 2010, both sides are focused on the goal of consummating the ECFA. The consummated deal will contain three main components: the

framework agreement, the early harvest agreement, and a timetable for the projected negotiation and completion of as yet unaddressed industry sectors. This approach is modeled on the ASEAN plus 1 agreement.

Lastly, Taiwan has recently undertaken several unilateral changes in its investment policies toward China in the semiconductor and Liquid Crystal Display (LCD) flat panel (TVs and monitors) sectors, where China investment guidelines for Taiwan companies had expired way back in December 2005. These recent changes were made under heavy pressure from Taiwan industry, which had been seeing its interests on the mainland marginalized year-on-year, given an inability to directly compete there. The changes also came about in reaction to the investment decisions of Taiwan's principal technology competitors and partners - the Korean government recently granted several of their largest LCD manufacturers licenses to invest in China. In the semiconductor realm, Intel's investment in a high-tech 300mm plant in the northern Chinese port of Dalian dropped the technology barrier for investments in China. With the decision to allow Intel to go ahead with the plant, the U.S. government signaled that it no longer had insurmountable security concerns over U.S. investments at that level of technology.

Taiwan's long-standing reluctance to allow its semiconductor and LCD industries competitive access to China has several root causes. First, it is entirely reasonable to credit Taiwan with looking to U.S. security concerns - and its own, of course - over providing China with access to high-technology research and production capabilities. In addition, Taiwan has concerns over companies potentially moving large chunks of production over to China if the door is opened too wide. This latter point has less credibility, given China's appalling intellectual property rights record and the unwillingness of Taiwan's top tech companies to risk their competitive edge. Taiwan Semiconductor Manufacturing Company (TSMC) recently triumphed in a California court against China's Semiconductor Manufacturing International Corporation (SMIC) for IPR theft. The case cost the Chinese company over US\$1 billion, and looks to have ultimately resulted in TSMC owning up to 10% of the business. It is a cautionary tale for all Taiwan businesses intent on doing business in China, as most of them do not have TSMC's muscle when it comes to fighting such battles.

With the new rules for tech investments, Taiwan's semiconductor and LCD industries are beginning to further expand their presence in China. But the Taiwan government remains very much in charge of the process, and they have a reactive - not proactive - approach to liberalization.

Overall, Taiwan and China have taken a three-pronged approach to cross-Strait engagements. 1) Incorporating these types of unilateral actions taken by Taipei. 2) Individual accords struck on issues such as tourism and logistics, agreed upon in an ad hoc manner or signed at SEF-ARATS meetings. 3) The ECFA, which will provide a platform for broader economic normalization and then liberalization.

What is Taiwan's Position in the World Trade Organization (WTO)?

Taiwan is a full member of the World Trade Organization (WTO), where it is listed as the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu (Chinese Taipei). Taiwan has been a member of the WTO since 1 January 2002.

On July 15, 2009, Taiwan became the 41st full member of the Agreement on Government Procurement (GPA) under the WTO. The GPA is designed to bring competition to domestic government procurement markets - for signatory countries - through the implementation of laws and regulations that create transparency and a level playing field.

Assess How the Recently Implemented China-ASEAN Free Trade Agreement Might Affect Taiwan

Asia is on a course of rapid integration through bilateral and multilateral trade agreements. Initially, many analysts and officials cast aspersions on the viability of these agreements, which were viewed as lacking both substance and ambition. This initial analysis is proving wrong, with the Asian Development Bank, among others, tracking the increasing gains that the agreements are reaping for their signatories. The

process is also having the added effect of accelerating China's emergence as a dominant Asian power, as it is using its economic muscle to draw its Asian neighbors deeper into its embrace.

The United States sits on the outside looking in. In the absence of a comprehensive trade liberalization policy, we have no Asia policy that can compete with the region's appetite for increased trade flows, foreign direct investment, and the associated rise in prosperity. This outsider's perspective is shared by Taiwan, although their lack of participation is not self-inflicted.

As discussed above, it was the China-ASEAN FTA accord on petrochemicals that highlighted for Taiwan the requirement to counter the agreement - with the proposed solution being Taiwan's own market access agreement with China. ECFA now provides a platform for trade normalization, but it will also provide improved access to the Chinese market. There is a possibility - indeed a probability - that Taiwan will gain better access to parts of China's market than what is offered by the ASEAN accord, with agricultural goods being an excellent example.

Lastly, ASEAN is also a pivotal trading partner for Taiwan. As you will note below, Taiwan has a strong requirement to turn the momentum of the ECFA with China into a Chinese willingness to drop its objections to additional Taiwan FTAs - or whatever its free trade accords end up being called. An ECFA with China can only be the first step in Taiwan's competitiveness plan. Other components must include significant domestic economic reform, infrastructure investment, and free trade agreements with its other main trading partners - like the United States, Japan, ASEAN, and the EU.

How likely is Closer Economic Integration between Mainland China and Taiwan to Lead to Political Integration?

President Ma's strategy toward China is designed to reap several important long-term benefits for the welfare of the Taiwan people. Approximately 74% of Taiwan GDP goes to export, and the economic strategy is designed primarily to increase Taiwan's access to the world's fastest growing large market. It is also designed to provide Taiwan-China relations with a more stable platform for engagement. Notionally, the economic gains will build increased prosperity on both sides of the Taiwan Strait, and will alleviate the long standing enmity enough to allow for pricklier issues - involving political, military and ultimately sovereignty issues - to be addressed.

But President Ma's government has had a rough time since May 2008. Ma's hands-off leadership style has led to several bungled issues - including the poor handling of relief operations after Typhoon Morakot (September 2009) and of the U.S. beef market-access protocol (October 2009). His rocky start has reopened the door to a resurgent political opposition, with the Democratic Progressive Party (DPP) tying together a series of local election victories that indicate improved voter support nationwide. The DPP are feeling increasingly confident, and see the defeat of the ECFA as an important tool in attempting to cripple the Ma presidency as the nation starts to evaluate whether Ma is worthy of re-election in March 2012.

The ECFA is now the most important issue in Taiwan's political narrative, and the outcome of the agreement will guide public opinion both about President Ma and his government and about the opposition DPP. The Ma presidency's fortunes are now inexorably intertwined with the fate of the ECFA, and a successful roll-out is critical to Ma's attempts to increase his domestic capital. He will need that goodwill to address future negotiations with China, including on political and military matters if he receives a second term in office.

However, while Ma is holding together the domestic coalition in favor of an ECFA - in the face of increasingly verbose opposition from the DPP - he has no such coalition of support behind engagement with China on political and military matters. On a recent trip to Taiwan, I visited the SEF. In my discussions there, it was pointed out that in poll after poll throughout the last decade, over 90% of Taiwan's citizens say that they support the "status quo", i.e. de facto independence. The SEF also noted that when Taiwan's people are asked what they would like to see beyond the status quo, they now favor

independence by over 70% - as opposed to indefinite status quo or moving from the status quo to unification. This trend has continued through the Ma government's term.

As a function of time and demographics, the Taiwan public's recollections of the General Chiang Kai-shek era are fading. Instead, there is an increased sense of what it means to be Taiwanese - with a unique culture, system of democratic government, and rule of law. Thus the appetite among the Taiwan populace for abdicating all of these gains to engage in political integration or unification with China is extremely low, and it is continuing to drop year-on-year.

This presents a major problem for President Ma, although few are considering China's reaction if Ma is unable to deliver on non-economic issues. China is vested in continuing their current policy of engagement through 2012 and the next presidential election, as long as Ma remains a viable candidate. But if President Ma is reelected, the pressure from China to transition to negotiations on political matters will increase dramatically. Also, if Ma is defeated and a DPP president takes office, we can expect China to have a dramatic and negative change in attitude toward Taiwan - with a commensurate rise in tensions. It is unlikely that the notional DPP president would undertake any provocative actions. Indeed, nor would he/she have to in order to precipitate such a rise in tensions. Instead, the problem would center on China's interpretation of a greater China of which Taiwan is a part, and the notion that that greater China is the People's Republic of China. In line with its party platform, the DPP would refuse to accept this interpretation and continuing negotiations under the "1992 Consensus" would be problematic.

The 1992 Consensus holds that there is only one-China of which Taiwan is a part however, both sides have different definitions of one-China. This allows for an ambiguity over Taiwan's sovereign status. Many in the DPP reject this formula as well as the notion that such an agreement was even made.

Assess the Economic and Political Impacts of Taiwan and Beijing Signing the Economic Cooperation Framework Agreement

For both sides, the short-term goal of the ECFA is to normalize and then liberalize the present bilateral trade relationship. In the longer term, however, Taiwan hopes to use the agreement to improve the competitiveness of its economy - for Taiwan the agreement is principally about economics. Meanwhile, China sees it as one component of its unification strategy - for China, the agreement is principally about politics.

In a coming study by Dr. Dan Rosen of the Peterson Institute for International Economics and Dr. Zhi Wang, they note that by 2020 Taiwan will see its GDP at least 4% higher by virtue of the ECFA (all other things being equal). It is a meaningful improvement, but that is not the only metric with which to view the impact of the agreement on Taiwan. Rosen and Wang's study points to six major issue areas where the economic benefit of the ECFA will be most profound for Taiwan's economy, should the agreement be successfully negotiated and executed and import bans removed:

1. The present import ban on 2244 categories of products from China means that in some cases Taiwan businesses only have access to the second most competitive product available in a given category, leading to a loss of welfare for Taiwan's consumers.
2. The import bans undermine Taiwan's competitiveness by restricting access to some products at a more competitive price, resulting in increased production costs and a less competitive industry.
3. The ban on Chinese investment flows into Taiwan deprives Taiwan businesses and equities of access to a major pool of capital that could be deployed to grow industries enjoying competitive advantages.
4. The present barriers to cross-Strait trade undermine the attractiveness of Taiwan as a global investment target. Again, the result is less capital for domestic investment.
5. The barriers create a disincentive even for Taiwan businesses to keep their money in Taiwan, as it reduces their flexibility and undermines the rationale of long-term investments in Taiwan.

6. The legacy approach to China has had a cumulative negative impact on Taiwan, where resources have been misallocated toward blocking trade flows instead of towards investing in areas of competitive advantage.

Another immensely important point made by Rosen and Wang pertains to the status quo. Taiwan is presently in a regional box on trade liberalization, and its own trade policies toward China are resulting in a decline in competitiveness in comparison with its trading partners. Taiwan must normalize and liberalize its relationship with China to adequately compete and attempt to more efficiently allocate precious resources. However, Rosen and Wang stress that ECFA is not enough for Taiwan - it simply establishes a level playing field. What Taiwan does with that level playing field is the critical follow-on question, and pertains principally to domestic economic reform¹.

I believe that Taiwan has a right to participate in regional liberalization efforts, despite China's objections to the contrary. However, Taiwan does not need China's permission to begin undertaking major domestic reforms that could have a long-term impact on the country's welfare.

Finally, it is highly instructive to note that in promoting the ECFA effort, President Ma has recently been focused on moving forward from the ECFA to signing FTAs with other regional players. It is likely that economies such as Singapore, Malaysia, and Thailand represent important initial targets, with larger markets such as the U.S., Japan, and the EU to follow. President Ma is astutely pointing out - to his fellow citizens as well as to the Chinese - that the welfare of Taiwan's citizens is his top priority, and that ECFA alone is not enough. If China continues to block Taiwan's efforts to engage in other FTAs, they are undermining the economic welfare of Taiwan. Therefore, the removal of this policy would show magnanimity on the part of Beijing as well as ongoing concern for the economic welfare of Taiwan's citizens. In addition, WTO-compliant FTAs do not have sovereignty connotations. However, it is still unclear how China will respond to this line of reasoning, and China continues to oppose Taiwan's participation in global bilateral and multilateral trade liberalization outside of the WTO.

The economic impact of the ECFA for China is minimal, with only the removal of the product barriers and access to Taiwan investment opportunities viewed as significant. As noted above, China's singular motivation is to draw Taiwan closer into its sphere of economic influence, and to thereby advance its unification policy. That does not mean that a wary Taiwan government should not pursue ECFA - quite the contrary. Taiwan's ability to fend off China's suffocating grasp can only come through muscular economic relevance and global market integration.

What Does Each Side Seek to Gain from Such an Agreement?

See above.

Are There Regional Impacts?

Initially, the regional impact of the ECFA would be positive. Right now, the Taiwan Strait is not the flash point it was from 2005-2008, as both sides are exercising rhetorical and actionable restraint in areas of disagreement, focusing instead on areas of bilateral engagement. Given that the region has numerous security challenges, a reduction - even short-term - in tensions across the Strait is viewed positively.

That said, China's attitude toward Taiwan can be put into the broader context of China's emergence as a regional - indeed global - power, and Asian countries are watching closely how the U.S. handles rapprochement. The United States has been Taiwan's closest ally for over 30 years, and the U.S. has equities that extend beyond mere maintenance of the status quo between Taiwan and China. Taiwan acts as a microcosm of a broader concern that in the face of China's emergence the U.S. is disengaging from

¹ Information from a pre-publication version of "*The Implications of China-Taiwan Economic Liberalization*", a study that will be published in 2010 by the Peterson Institute for International Economics. Used with permission.

its legacy responsibilities to underpin prosperity in Asia through proactive leadership on trade and security.

What Are The Risks And Opportunities For The United States In Light Of Closer Economic Integration Between Taiwan And The Mainland?

In the absence of a U.S. trade policy focused on liberalization, it is impossible for the United States to adequately respond to China's regional economic trade policies.

America is being marginalized daily by our inability to respond specifically to market access agreements, and this will be true in Taiwan as the ECFA starts to roll out. Our narrow commercial interests will be impacted by the preferential access that Chinese products will gain, and more broadly China's influence over Taiwan will increase at our expense.

Describe the Current Status of, and Recent Trends in, US-Taiwan Trade and Investment, to Include the Status of the US-Taiwan Trade and Investment Framework Agreement (TIFA)

As noted above, Taiwan's political and economic isolation remain a serious disincentive to U.S. investment in Taiwan. It is difficult to specifically quantify this issue, as companies typically do not announce when they have chosen *not* to invest somewhere - they only announce the location of actual investments. However, there are several important areas where U.S. companies have been deploying significant funds, and where the normalization of the cross-Strait trade relationship may encourage additional U.S. investment.

Investment

Contract Design & Production

Taiwan remains a key global strategic player in the technology sector, with contract manufacturers and IT integrators such as Hon Hai and Quanta dominating the consumer hardware sector. This results in multi-billion dollar procurement relationships with companies such as Hewlett Packard, Dell, and Apple, who look to Taiwan businesses to assist in the design and manufacturing of personal and notebook computers, mobile phones and smartphones, personal digital devices (PDAs), and myriad other productivity tools. The actual manufacturing of these devices is now typically done in China's coastal provinces.

Research & Development

Companies such as Intel and Microsoft have significant R&D facilities in Taiwan, working closely with product designers and manufacturers to ensure seamless hardware-to-hardware and hardware-to-software interface.

Hardware Investment

Other U.S. companies play a key role in the technology supply chain, and have a requirement to be near their primary customers (e.g Hon Hai and Quanta) or close to contract chip manufacturers (e.g. TSMC). These companies provide components, such as Micron's production of Dynamic Random Access Memory (DRAM) used in PCs, servers, video game consoles, and smartphones.

Facilities in these technology clusters - a tight geographic grouping of technology companies that produce components, located close to a product integrator such as Hon Hai - also require significant capital to build, and Taiwan is a top global market for many leading U.S. production equipment companies such as Applied Materials. Taiwan companies raise the bulk of their capital needs in U.S. financial markets, typically through the issuance of Global Depository Receipts (GDR).

Service Investment

U.S. financial institutions continue to take an active interest in the Taiwan market. Ownership in Taiwan's financial sector can result in long term profitability, with examples being Citibank's holding or AIG's soon-to-be-former investment in the insurance company Nan Shan Life. Both companies have done extremely

well in the market, and Taiwan's banking and insurance markets have benefited from quality products and global competition.

Taiwan's government has also undertaken an effort to sell distressed banks or to have foreign players assist in mergers and acquisitions activity to reduce the number of domestic banks. This effort too has reaped some reward, as companies such as GE Capital and The Carlyle Group have brought in capital and banking expertise to new institutions. The government has now slowed down the process of consolidation, but American companies remain well positioned to take advantage of further liberalization.

Finally, there's the aspect of a "Trojan Horse approach" to penetrating China's financial services market. As Taiwan and China liberalize the cross-Strait financial service market, American companies owning Taiwan banks and insurers could then achieve significant market access, thereby circumventing onerous legacy direct-investment barriers.

Trade

As with much of non-China Asia, America's legacy commercial relationship with Taiwan has undergone major changes over the past 2 decades, as global production switched to China. We are currently Taiwan's third largest market (behind China and Japan), with bilateral annual trade in 2008 at approximately US\$61.6 billion. They are our eleventh largest export market, and we export mostly machinery, raw materials and agriculture. Meanwhile, Taiwan sends IT and finished consumer goods back to us.

Taiwan remains a major market for technology equipment manufacturers such as Applied Materials, LAM and KLA Tenkor, who supply the country's chip, solar and LCD companies. In addition, companies that supply chips such as Intel, Micron, and Texas Instruments all have significant trade relationships with contract manufacturers such as TSMC or Nanya and with device integrators such as Hon Hai. Dell, Hewlett Packard and Apple manufacture the bulk of their hardware through their Taiwan partners with the manufacturing (component integration) taking place in China.

According to the U.S. Department of Agriculture, Taiwan will soon become America's largest agricultural export market on a per capita basis, with exports approaching US\$10 billion. American beef, pork and corn, as well as fruits such as apples, are all significant sellers in Taiwan. The market has continued to see steady growth after Taiwan's accession to the WTO.

Trade & Investment Framework Agreement (TIFA)

Twice in the past decade the United States has frozen its TIFA negotiations with Taiwan. In the 2003-2004 timeframe it was frozen over intellectual property rights (IPR), and the freeze was broadly viewed to have done considerably more damage than it offered help. Then again in 2008, the TIFA process was frozen over disagreements regarding beef imports. The Council is unaware of any other major U.S. trading partner being treated in a similar fashion.

This most recent impasse was to have been broken in October 2009, with the signing of a protocol offering American beef farmers additional market access for certain products. However, Taiwan's Legislative Yuan (parliament) overruled President Ma and nixed several peripheral aspects of the agreed-upon protocol. This took what was a win-win in bilateral ties and turned it into a major bilateral incident.

The Office of the United States Trade Representative (USTR) rightly points out that while the dollar value of the banned products are extremely small, the precedent that Taiwan set here for bilateral agreements might have broad and region-wide implications. If trading partners are able to use their legislative branches to undermine bilateral trade accords in such a fashion, the U.S. is compelled to respond seriously in order to deter similar actions by the Koreans, Japanese, etc. In addition, as Taiwan presses for additional protocols or agreements in areas such as investment or taxes, what assurances does the U.S. have that those too won't be changed after negotiations have been concluded? Still, the changes in the

protocol affect a very small portion of the overall value (<1% of the total) and U.S. beef exports continue to flow smoothly, and to grow, with the bulk of the October 2009 protocol being applied.

It is essential that both sides find a way around this present impasse. It was clearly a mistake for the United States to undertake such punitive actions against Taiwan, when previous similar attempts had proven unsuccessful. On the other hand, Taiwan's political class needs to pay closer attention to the implications of its actions when aggravating its most important strategic ally.

This line of reasoning leads us back to the ECFA. For ECFA to enjoy long-term domestic support in Taiwan it must be accompanied by balanced trade relations with America. Taiwan's people are most supportive when they view external relations to be in balance between with their two principal interlocutors – the U.S. and China. Therefore, as Taiwan and China look to spring 2010 to formalize the ECFA, the U.S. must also look re-launch TIFA talks during the same timeframe. This sets the appropriate balance for Taiwan, and impresses upon both Taiwan and China - as well as throughout the region - that America does have material and strategic equities on Taiwan, and will watch and respond to ongoing events.

What are the current bilateral differences that affect the possibility of a US-Taiwan FTA?

The principal major stumbling block to a US-Taiwan Free Trade Agreement is the lack of a U.S. trade liberalization policy. Taiwan remains committed to launching and negotiating an FTA with the U.S. as early as is possible.

How would China react to such an agreement?

China bristles at any U.S. support for Taiwan, and would likely look dimly on a US-Taiwan FTA. Its present trade policy, manifest in ECFA, is to draw Taiwan closer into China's sphere of influence. But as mentioned above, it is not clear if China will now show magnanimity and flexibility on other Taiwan bilateral agreements, including an FTA with the US but President Ma is now making a strong and public case for China to drop its objection.

China's present behavior on the world stage makes it difficult to gauge its response. However, it is worth noting that an FTA with the U.S. would come after China's own FTA with Taiwan (i.e. ECFA). In addition, as specified by the WTO it would not have any sovereign connotations. Frankly, China's own FTA with Taiwan dramatically reduces any argument that China might make to deny other Taiwan trading partners similar benefits.

What is Your Assessment of the Prospects for an EU-style Common Market and/or Common Currency in East Asia?

The likelihood of an EU style common market and common currency such as the Euro is low.

While the question focuses on a common-market and common currency, you cannot break out the evolution of the EU and the present post-Lisbon treaty environment. The relationship between European states since the signing of the Treaty of Rome has addressed both economic matters and political issues. This would certainly also be true for any Asian effort to create a common market, where issues such as human rights, sovereign boundaries, and law enforcement - to name but several - would cause major issues. However, it is not inconceivable that a free trade area (as defined by signatories) might emerge in the long-term, but it will likely look quite different from European economic integration.

Asian currency manipulation by myriad players makes it difficult to even consider the notion of a common Asian currency. In addition, the recent debt problems in Greece, along with likely coming issues in Italy, Spain and Portugal, are undermining the attractiveness of a single currency.

Is There a Logical Disconnect Between Taipei Moving to Improve Economic and Political Relations with Beijing while Continuing to Press for Arms Purchases from the United States?

China currently has a two-pronged strategy toward unification with Taiwan. In one hand China carries the economic carrot of ECFA, using its large market to draw Taiwan closer into its economic embrace. In the other hand China carries an ever-larger stick, with its ongoing military investment, modernization, and expansion continuing to increase the threat posed to Taiwan self-determination. Taiwan's present reality includes the threat of coercion, intimidation, and possible attack, and China has shown zero interest in scaling back such an expansion of capabilities during President Ma's term from 2008 to today. China maintains the right to use force to resolve what it terms the "Taiwan question".

Taiwan has a requirement to normalize and liberalize its commercial relationship with China. But this can not be a goal unto itself - it must occur hand-in-hand with domestic economic reform and inclusion in regional bilateral and multilateral initiatives. Therefore, Taiwan responds positively to China's ECFA while also demanding access to broader regional economic and trade opportunities.

In a similar way, Taiwan must also maintain a credible deterrent in the face of China's continued military expansion. That deterrent can help ensure that Taiwan is not backed into a corner where it is forced into agreeing to concessions. Instead, it allows Taiwan to negotiate outcomes as equals. It is essential that Taiwan field a modern military, giving it confidence in its engagement with China. It also helps China understand that a path forward of non-peaceful relations will come at a steep cost.

Finally, arms sales by the United States provide the entire process of engagement with a security guarantee that extends beyond Taiwan's reasonable military goals and capabilities:

1. It ensures that Taiwan has the military material it needs to match in quality what China can field in quantity.
2. It provides Taiwan with the confidence to know that its principal ally recognizes that it too has equities in the peaceful negotiation of cross-Strait relations. This confidence empowers it in negotiations with China, giving it the confidence to take calculated risks that may reap larger rewards.
3. A militarily weak Taiwan invites Chinese adventurism, which is inherently not in the interests of the U.S., and would destabilize the Asia-Pacific region.