USAWC STRATEGY RESEARCH PROJECT

UNITED STATES-CHINA-TAIWAN FOREIGN POLICY AND ECONOMIC GLOBALIZATION: AN ASSESSMENT

by

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This SRP is submitted in partial fulfillment of the requirements of the Master of Strategic Studies Degree. The views expressed in this student academic research paper are those of the author and do not reflect the official policy or position of the Department of the Army, Department of Defense, or the U.S. Government.

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ABSTRACT

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The peaceful resolution(s) of the issues that separate China and Taiwan, and conflict between China and the United States (U.S.) is essential for long-term regional stability and achievement of vital U.S. interests/objectives in the Asian-Pacific region. However, the dispute with Taiwan is no longer the key to conflict resolution, Chinese economic prosperity is now the center of gravity. Today, a nation's economic health is intrinsically linked to its' national interests and security and globalization has fostered economic growth and interdependence between countries. A key U.S. strategy for Asian-Pacific regional prosperity and stability is China's integration into the global market. The U.S. seeks to fully integrate China into the global, rules-based market system believing that China's participation in the global economy will accelerate economic reform(s) and increase China's stake in the stability and prosperity of the region.

This strategic research paper discusses/assesses the significance of China's continued global economic integration and interdependence as an underpinning of regional prosperity and stability. Effective foreign policy and engagement with China by the United States is assessed as key to Asian-Pacific regional stability. Accordingly, the implication(s) of China's accession into the global market, specifically entry into the World Trade Organization (WTO), and the corresponding implication(s) on China's relationship with Taiwan, and the implications for U.S. policy and strategies, as well as a risk assessment are discussed.

The US vision of an economically interdependent world that enhances stability and security while fostering economic prosperity and democracy is intrinsically linked to how the US and China choose to interact during this dynamic period. In the end China's future, and the future of U.S.-China relations, will be in a large part shaped by how China chooses to adapt, and comply, with the standards of the global economy. The U.S. must remain fully engaged, maintaining its regional strength and dynamism in this era of economic globalization, while encouraging China's own constructive engagement in the region.

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UNITED STATES-CHINA-TAIWAN FOREIGN POLICY AND ECONOMIC GLOBALIZATION: AN ASSESSMENT

> "We have our best chance since the rise of the nation-state in the 17th century to build a world where the great powers compete in peace instead of prepare for war."
>
> —President Bush
> West Point, New York
> June 1, 2002

A nation's economic health today is intrinsically linked to its national interests and security. Globalization has fostered economic growth and interdependence between countries. The United States (U.S.) policy of engagement to promote economic well being and global stability has been a consistent strategy. This policy is reinforced in the 2002 National Security Strategy (NSS) which states that "we will seek to establish political and economic freedom by igniting a new era of global economic growth through free markets and free trade" and "that we will promote economic growth and freedom beyond America's shores … and seize the global initiative." The NSS further states that a "strong world economy enhances our national security by advancing prosperity and freedom in the rest of the world".[1]

The United States has consistently stated that a stable and prosperous Asian-Pacific region is vital to its national security interests. Concerning China the NSS states; "The U.S. relationship with China is an important part of our strategy to promote a stable, peaceful, and prosperous Asia-Pacific region . . . The democratic development of China is crucial to that future."[2]

The peaceful resolution of issues that separate China and Taiwan, and of conflict between China and the U.S., is essential for long-term regional stability and achievement of vital U.S. interests in the Asian-Pacific region. However, the dispute with Taiwan is no longer the key to conflict resolution. Chinese economic prosperity is now the center of gravity. A key U.S. strategy for Asian-Pacific regional prosperity and stability is China's integration into the global economy. The U.S. seeks to fully integrate China into the global, rules-based market system believing that China's participation in the global economy will accelerate economic reform and increase China's stake in the stability and prosperity of the region. The U.S. vision of an economically interdependent world that enhances stability and security while fostering economic prosperity and democracy is intrinsically linked to how the U.S. and China choose to interact during this dynamic period.

This paper assesses the significance of China's global economic integration and interdependence as an underpinning of regional economic prosperity and stability. Effective

foreign policy and engagement with China by the United States is assessed as key to Asian-Pacific regional stability. Accordingly, the paper examines China's accession into the global economy, specifically its entry into the World Trade Organization (WTO), and the corresponding implications for China's relationship with Taiwan, and for U.S. policy and strategy.

BACKGROUND

> "We will actively work to bring the hope of democracy, development, free markets, and free trade to every corner of the world."
>
> —President Bush
> National Security Strategy 2002

One of the most complex bilateral strategic security relationships the United States has today is the one involving the U.S., China, and Taiwan. The peaceful resolution of the issues that separate China and Taiwan is essential for long-term regional stability and achievement of U.S. objectives. An awareness of the historical and cultural underpinnings of the issues is required to understand the U.S.-China-Taiwan relationship.

HISTORICAL PERSPECTIVE.

The modern history of China is a record of subjection, dismemberment, and humiliation by foreign powers. The origin and evolution of the current China-Taiwan relationship are linked with this history. The Chinese name for their country is the "Middle Kingdom", the kingdom between heaven and earth. The Chinese considered themselves above the peoples who lived outside their blessed country. Because of this attitude, it was particularly galling when Europeans exerted colonial influence in China.[3] From 1680 to 1895 China ruled Taiwan and supplanted the indigenous Taiwanese as the dominant population. In 1895 China ceded Taiwan to Japan after the first Sino-Japanese war, and from 1895-1945 Japan ruled the island. This period, from the late 1800's to the mid 1900's, when China was either ruled, or externally dominated, is commonly referred to as the "Century of Shame".[4]

From the 1930s a civil war was waged between Chiang Kai-shek's Kuomintang government (KMT) and the Chinese Communist Party (CCP) led by Mao Zedong. The current adversarial relationship between the U.S. and China began during this period when the U.S. supported the KMT in an attempt to block the spread of communism. Conversely, the Soviet Union supported the communist Chinese. After the defeat of Japan in WWII, Taiwan was given to the Republic of China (ROC). In 1949 the Communists won the civil war and the KMT fled to Taiwan. The Communists controlled the mainland and claimed rights over all of China as the

People's Republic of China (PRC). The Nationalists controlled only Taiwan and a few other islands, and proclaimed themselves the Republic of China. After the communists seized power the U.S. adopted a policy of isolation and containment towards China as a communist-dominated Taiwan was believed detrimental to U.S. vital interests.

In the 1970's Soviet Union expansionism concerned both the U.S. and China, setting the stage for normalization of relations as the United States felt that good relations with China was an effective counterweight to Soviet power. President Nixon's historic visit to China in 1972 set the stage for establishing formal diplomatic relations.[5]

In 1979 the U.S. formally recognized China in a U.S.-PRC Joint Communiqué. In this communiqué the U.S. recognized the PRC as the government of China and acknowledged the Chinese position that there is but 'One China' and that Taiwan is part of China. China acknowledged that the American people would continue to carry on traditional contacts with Taiwan. Also, in 1979 the US Congress passed the Taiwan Relations Act (TRA) establishing the framework for the United States' unique security relationship with Taiwan. The TRA states, "the policy of the US is to consider any effort to determine the future of Taiwan by other than peaceful means … to be of grave concern."[6] The TRA also provided for the continued sale of military equipment to Taiwan declaring that peace and stability in the region is a vital U.S. interest, solidifying future U.S.-Taiwan relations.[7] All subsequent U.S. administrations have adhered to the 'One China' principle.

In the 1980s Taiwan businesses began to set up factories in Mainland China and by the end of the decade the significant Taiwanese trade and investment in China satisfied Chinese leaders that progress was being made toward eventual reunification. By 1990, Taiwanese businessmen were investing one billion dollars annually in China. By 1993 this figure had grown to 2.5 billion annually. "Since the end of the Cold War, politics has been driven by economics instead of the other way around."[8]

Taiwan is closely associated with China's domestic legitimacy. With the return of Hong Kong in 1997 and Macau in 1999, Chinese leaders see Taiwan as the last step to completion of the communist revolution and restoration of the Chinese nation. National unification is identified as one of "the three historical tasks of the Chinese people in the new century."[9] China's actions when handling internal affairs, trade, and foreign policy all reflect its desire to prevent another "Century of Shame".

CURRENT PERSPECTIVE.

While extensive investment and trade relations have brought Taiwan and China economically closer, Taiwan's democratic evolution has strengthened its sentiment for an independent Taiwanese State. China views Taiwan's seeming drift toward independence as a threat.

Since the official recognition of China, Taiwan has changed dramatically. No longer a military dictatorship with minimum economic impact, it is now a democracy with a robust economy. This change has altered the dynamics of China's relationship with Taiwan, providing an impetus for a Taiwanese pro-independence movement.[10] As stated by Mao Zedong, "as long as Taiwan is not liberated, the Chinese people's historical humiliation is not washed away … responsibility is not fulfilled."[11] A Taiwanese move towards independence is perceived as a symbol of America's dominance and a testament to China's vulnerabilities.[12]

While China's leaders are focused on their country's internal issues, they also appear to be concerned by what they believe is the U.S. desire to restrain China's development. In China's viewpoint, Taiwan is a Chinese internal affair. Accordingly, China continually seeks to influence the Taiwanese political environment while simultaneously staking its claim towards Taiwan. For example, in 1996 China attempted to influence the Taiwanese presidential election by firing missiles near Taiwan. In response, the U.S. dispatched a Naval task force to the region to deter Chinese intervention. This response by the U.S. sent strong signals to the Chinese that the United States was serious about peaceful settlement of the Taiwan issue.

While tension between China and Taiwan continues, it has subsided as the level of economic interdependence between them has increased. For example, by 2001 China was Taiwan's third-largest trading partner, and Taiwan China's fourth. Taiwanese investment in Mainland China had reached nearly $60 billion, making Taiwan the third largest investor in China. According to PRC figures, cross-strait trade reached $19.6 billion in the first half of 2002 with PRC imports up 33 percent from the previous year, making Taiwan China's second largest source of imports.[13] Taiwan believes international economic growth and interdependence will provide protection from annexation that isolationism will not achieve.

POLICY DISCUSSION

Trade with China is not only good economic policy;
it is good national security policy."

—Colin Powell
U.S. Secretary of State
Texas A&M, 16 Feb 2004

FOREIGN & SECURITY POLICY.

Current U.S. foreign policy, as articulated in the NSS, states that the U.S. is to support democracies worldwide, and look for opportunities to expand liberty. The NSS also states that the U.S. will "promote freedom and support those who struggle non-violently for it, ensuring that nations moving towards democracy are rewarded for the steps they take." [14] The NSS advances the concept that a strong global economy will enable prosperity and freedom in the world and enhances U.S. national security.

Traditionally, the United States has called for a secure, stable, and economically viable Asia with which it could maintain strong trade relations.[15] The NSS calls for a mix of bilateral alliances and cooperation with regional institutions to manage change in a dynamic Southeast Asia.[16] The goals for regional cooperation include establishing a global balance of power that favors freedom, and ultimately creating a strategically stable Asia.[17] This must be done in an environment of both "competition and cooperation" with other countries, and in a region in which the *2001 Quadrennial Defense Review* (QDR 01) posits a military competitor may emerge.[18] QDR 01 called for a shift of defense focus from Europe to the Asia-Pacific Region. As a region, East Asia is the number one trading partner of the United States, has a healthy collective GDP, a large aggregate population,[19] and four of the world's six largest militaries.[20] Southeast Asia is crisscrossed with vital sea lanes of communication, and has an economic strength equal to that of the European Union in trade value for the United States.

Maintaining effective diplomatic relations with China, simultaneously with strong, unofficial relations with Taiwan, has been a consistent objective for six consecutive U.S. administrations. Three U.S.-PRC diplomatic communiqués and the 1979 Taiwan Relations Act (TRA) frame the current U.S.-Taiwan-China foreign policy which includes normalized relations with China and the Chinese position that there is but "One China".[21] The current policy also reassures Taiwan of U.S. resolve to secure peaceful reunification and a continuing commitment to the region. In 2001 President Bush vowed to protect Taiwan, and clarified U.S. policy by stating that "while the U.S. endorsed the 'One China' Policy it would not support Taiwan in a conflict caused by a move towards independence, nor an act of aggression by China."[22]

The United States economic objectives in Southeast Asia are to promote growth through expanded trade and investment and accelerated financial and economic reforms. The United States believes that a strong U.S.- Association of Southeast Asian Nations (ASEAN) relationship is a force for stability and development in the region. The goal is to create a network of bilateral Free Trade Agreements (FTAs) which will increase trade and investment, tying more closely together the U.S. and Asian economies and futures. Southeast Asia is

important to the United States, politically and economically. The region is home to some of the world's fastest-growing economies and a number of significant trading partners of the United States. Last year, the U.S. sold the region $57 billion in goods and services, almost twice as much as it sold to China and Hong Kong combined.[23] U.S. investment, totaling $53 billion in the ASEAN countries, has both strengthened U.S. economic ties in the region and expanded opportunities for American business. These economic ties are part of deep and long-enduring alliances and friendships in the region that are as critical to U.S. security as they are to economic prosperity.

China's goal is to become a strong, modernized, and unified nation that is recognized as a great power and regional hegemon. Accordingly, China sees the reunification of Taiwan as an objective that supports the attainment of these goals. China's foreign policy is based upon a belief that Taiwan as "an inalienable part of China"[24] and the concept of eventual reunification of Taiwan with China. China is concerned that a successful attempt by Taiwan to gain independence could encourage other regions of the country to secede. Another key objective is continued economic advancement. However, while attempting to accomplish these objectives the Chinese leadership is faced with a number of domestic problems, including unemployment, growing inequity between the urban and rural areas, a potential banking crisis, and corruption and public health issues. In order to address these problems China requires both a stable economic environment and a secure international environment. Therefore, it is reasonable to assume that China would want to avoid a clash in the Taiwan Strait, and would be willing to endure the status quo for the foreseeable future.

The Chinese are wary of U.S. intentions in Asia, labeling the U.S. "public enemy number one" of the People's Liberation Army's (PLA)[25] Also, China's 2002 Defense White Paper calls the ongoing U.S.-Japan research on Theater Missile Defense "detrimental to peace and stability in the Asia-Pacific Region" and further states that the United States is a serious obstacle to achieving the national goal of reunification with Taiwan.[26]

China has long encouraged nationalism and the desire to unify the motherland as a means of building unity and drawing attention away from internal problems.[27] This is especially true today as few Chinese are interested in communist ideology or believe in Marxism-Leninism or Mao Zedong philosophy. Chinese leaders also regard control over Taiwan as an important step in establishing Chinese influence in East Asia and blunting American influence. The loss of Taiwan to independence would be a critical blow to the Chinese regime.

Taiwan's position is equally clear. The Taiwanese government has stated that "the policy of the ROC has consistently been based on the respect for separate rule of the two sides of the

Taiwan Strait" and that "the ROC has always been an independent sovereign state."[28] Recent polls show the majority of Taiwanese citizens prefer independence.[29] With a capable military, a strong economy, and a true multi-party democracy, it is not likely the citizens of Taiwan will voluntarily subject themselves to Chinese rule.

ECONOMIC REFORM.

China is committed to economic reforms in order to become an effective participant in global markets. In 1992 the Chinese Congress stated that China's key task was to create a "socialist market economy." The 10-year plan to achieve this "socialist market economy" stressed continuity in the political system coupled with bolder reform of the economic system.[30] Accordingly, China began to take steps to decentralize its foreign trading system and integrate itself into the world trading system. In 1991 China joined the Asia Pacific Economic Cooperation (APEC) group, which promotes free trade and cooperation in the economic, trade, investment, and technology spheres. Despite China's impressive economic development during the past two decades, reforming the state-run business sector and banking system remain major obstacles to economic reform.

In 2001 China's accession into the World Trade Organization (WTO) marked a step toward the economic reforms that China has embarked upon to ensure survival, prosperity, and ultimately regional hegemonic status. A key factor is that the push for economic reform came from within China, and while the reforms are not completed, the belief in the need to reform has been embraced by the Chinese leadership. Accession into the WTO, symbolic of entry into the global economy, is one of China's primary economic reform initiatives.

Today's multilateral trading system, the WTO, traces its roots to post-WW II and the General Agreement on Tariffs and Trade (GATT). The WTO is the institutional and legal foundation for the world's multilateral trading system. Also, the WTO is the only global international organization that works with the rules of trade among nations. These rules exist primarily to create a predictable and liberal economic and legal framework for international trade. The WTO negotiates terms for membership, and these terms afforded China the ability to obtain economic reform timelines suitable to their deliberate, controlled approach to economic reforms.[31] China's WTO membership and accession commitments are in concert with key U.S. regional economic and security goals. The United States believes that an effective WTO can be a force that encourages economic reforms, prosperity, and stability of the region. Both China and the U.S. benefited from China's entry into the WTO. Two years after accession China is the United States third largest trading partner and the sixth largest market for U.S. exports. Over

the past three years U.S. exports to the rest of the world have decreased by 10 percent while U.S. exports to China have increased by 66 percent.[32]

China's membership and fulfillment of its WTO accession commitments are closely linked to key U.S. economic policy goals that include: 1) promoting China's continued economic reform and modernization; 2) ensuring that China becomes a responsible member of the rules-based global economic system; and 3) encouraging China's contribution to economic growth in the region and the world through market-oriented reform and development.

WTO membership provided China a venue to participate in the shaping of future regional economic and trade norms. China's rising economic power has made it a new presence in Southeast Asia as its integration into regional and global organizations and arrangements link it directly to trading partners, giving it a greater stake in the stability and prosperity of the region. Additionally, if China abides by WTO rules it will provide predictability to economic relations and disputes. For example, trade disputes can be resolved multilaterally rather than through bilateral negotiations which sometimes strained foreign relations. One of the underpinnings of China's rise to prominence is its healthy, vibrant economy. China has more than tripled the value of its trade with the U.S. since 1994. During this same period Taiwan's trade grew a more modest 10 percent.

The majority of China's economic growth is concentrated in the labor-intensive manufacturing sector which exploits the vast availability of cheap labor. There is tremendous economic disparity between the rural and urban populations of China. The statistics for 2002 indicate that the average increase in personal wealth was almost three times higher for urban workers than rural workers.

China's continued economic growth is largely dependent upon foreign investment and free trade. Activities which cause a drop in investor confidence, or disrupt free trade, will have a negative affect on China's economic health and security. Also, export growth continues to be a major component of China's rapid economic growth. To increase exports, China has enacted policies that encourage foreign investment in Chinese businesses. From 1994-2001 China was the second largest recipient of foreign direct investment (FDI), and today foreign investment in Chinese enterprises produce about 45 percent of China's exports. In 2002 China received nearly $53 billion in FDI, the most of any country in the world.[33] However, while investors and firms still see China as a vast market with untapped potential, the country still requires significant economic reforms to ensure a financially stable environment.

Mainland China requires both Taiwanese capital and expertise to achieve economic reform objectives. This dependence on Taiwanese resources and capabilities could provide the

impetus for political change. Already Taiwanese businesses are "invading" Mainland China politically and economically with both technical and managerial expertise. During the presidential election campaign, numerous Taiwanese managers working in Mainland China traveled home to vote, demonstrating to their Chinese employees the democratic system at work. The desire for economic prosperity to enable internal stability may cause China to make changes towards a more democratic, moderate regime while maintaining its sovereignty. China appears confident that its goal of absorbing Taiwan is best served by allowing economic reforms to proceed as part of a controlled, deliberate process.

However, China realizes that its move towards limited capitalism has some significant risks. For example, if the gap between the rich and poor grows too great, the masses may look for an alternate form of government. Therefore, China has invested significant amounts of capital into failing state business ventures in an effort to provide work for its citizens. Likewise, the government has embarked on a deficit spending program for costly public works projects to boost employment. More importantly there is a threat of growing discontent from a large section of the population in the central and western areas of the country, and regions with significant non-Chinese minorities. These groups pose a potential threat to the central government.[34] As one report observes: "China has serious problems. State-owned enterprises are hemorrhaging money, throwing more people out of work and contributing to a growing pool of migrants. Its financial markets are largely untamed, its banks broke and corruption rife. Looming over all of that is an environment straining under the pressures of breakneck economic growth."[35]

Taiwan, by comparison, has a vibrant economy with one of the highest standards of living in the world. Taiwan's economic health was demonstrated when it weathered the Asian economic downturn during the late-1990s relatively unscathed. Its Gross Domestic Product Per Capita is $22,559 as compared to only $4,329 for the PRC. In fact, much of China's economic growth is due to direct investment by Taiwanese businesses which increased 30 – 70 percent annually since 1993. In fact, there is some concern by the Taiwanese government that the level of Taiwanese investment in China has the potential to undermine Taiwan's economy, and limits to the amount and types of investment have been imposed.[36]

The combination of China's strong economic growth, increased market access linked with WTO membership, and U.S. trade pressure has produced some positive results in key trade areas. U.S exports to China are reaching new heights, increasing around 25 percent through November 2003 to $25 billion, after having already increased 15 percent in 2002. China is the United States fastest growing export market. The U.S. also enjoys a growing trade surplus in

services as U.S. investment banks, insurers and accounting firms continue to make inroads into the China market.[37]

Globalization has linked the futures of Taiwan, China, and the United States as all three become more economically integrated and interdependent daily. While several other significant concerns remain, such as human rights violations and the potential exportation of weapons of massed destruction, "economics has been overwhelmingly the most important basis of China-U.S. relations over the last 20 years, overriding military security and unresolved policy differences, and accounting for over 95 percent of official interaction between the two nations."[38]

IMPLICATIONS & RISKS

> "Once China becomes strong enough to stand alone, it might discard us. A little later it might even turn against us, if its perception of its interests requires it."
>
> —Henry Kissinger

Throughout the 21st century the U.S. will continue to have vital interests at stake in the Asian-Pacific Region. Since over half the world's maritime trade passes through the region, ensuring regional stability and security, while preventing the rise of a belligerent regional hegemon, is a vital U.S. interest. China is clearly positioning itself to be the dominant player in the region. To support this assessment, and its subsequent recommendations, some of the implications and risks related to the U.S.-China-Taiwan foreign policies and strategies are discussed.

IMPLICATIONS

China's improved economy has given it increased economic influence in Southeast Asia. In sharp contrast to its trade with the United States, China has operated with a significant trade deficit with emerging Asian economies, reflective of China's role as a processor of imported materials for sale to the United States. As China continues to import more, it is becoming one of the region's most important engines of economic growth. In that role, China's ongoing economic transformation can significantly enhance Asian and global economic growth and stability. While China has not moved aggressively to leverage the political advantage gained from its improved economic strength, there is no denying China's increased prominence on the Asian political stage. We need only to look as far as Taiwan -- where firms are lining up to move operations to China and are seeking increased access to the Chinese market -- to see how quickly economics can change the political landscape.

China's growing economic power has created competition for influence in the region, making it vital that the United States remain actively engaged with its Asian allies. Already China is beginning to assert itself in a leadership role in regional political and security matters/issues. The U.S. should attempt to co-opt these efforts to ensure that China is in cooperation, not in competition, with the U.S.

However, China's increased economic integration, or interdependence as is the case with Taiwan, may make China more of a constructive participant in global trade liberalization, and lead to stronger trade and investment ties between China and Taiwan. This cross-strait economic symbiotic relationship could contribute to a gradual reduction in tensions and serve as a deterrent of sorts towards future political or military confrontations as both countries focus on economic prosperity.

Therefore any increase in the Chinese military threat is more dependent on the actions of Taiwan than in the past. The dynamics of Taiwanese democracy, resulting, as it has, in no major political party publicly supporting reunification under the "one China" principle, indicate that return to the status quo of the 1980s is unlikely. A formal declaration of Taiwanese independence would likely provoke China to act militarily against Taiwan. Chinese leaders are increasingly concerned about Taiwan's "creeping separatism," and there is always a possibility of some kind of military response to an act the Chinese view as a bold step toward independence.

If China were to compel reunification with Taiwan it would be forced to attempt the tough task of integrating an angry, defiant population of Taiwan, while also contending with the associated long-term political, economic, and strategic costs. These costs would include a disruption of relations with the U.S. It is arguable that China simply does not posses a realistic military option in the near-term, and has adopted a long-term strategy of patience. Surely they recognize that any failure of the United States to come to the aid of Taiwan in case of a Chinese attack would destroy U.S. credibility and seriously damage U.S. alliances with other East Asian countries.[39]

Taiwan has been a staunch U.S. ally, is a valued trading partner (its eighth largest), and most importantly has transitioned from a military dictatorship to a truly democratic political system. In contrast China is the fourth largest trading partner of the U.S, and many U.S. companies have large capital investments and joint ventures in China. However, China is still a communist state with a long history of human rights abuses and is emerging as a competitor to the U.S. in the region. Therefore, it is unlikely that the U.S. would support a Chinese forced reunification of Taiwan.

Ironically, it may not be in the best interest of the U.S. for Taiwan and the PRC to reunify. A unified China would be an economic and military powerhouse and a strong threat to the U.S. Additionally, there is some concern that other Asian states might drift toward a unified China, especially a unified, democratic China. A resurgent Chinese-led Asia would offer a serious challenge to the U.S. and its vital regional interests.

Peaceful reunification would probably not occur unless China moves towards democracy and its economy dramatically improves. Failure to achieve both would probably discourage any agreement by Taiwan to reunify. It is inconceivable to think that the Taiwanese would agree to cede their political freedom and prosperity for a reunified China, particularly given their ethnicity. On the other hand, Taiwan may never seek reunification, even if the PRC conducts true democratic reform and makes dramatic economic improvements. Since most Taiwanese don't have particularly strong cultural ties to the Mainland, peaceful reconciliation is more probable than peaceful reunification.

RISKS.

There are varied risks for the United States, China, and Taiwan associated with regional security and stability based upon the belief that economic prosperity will drive political reforms. In this section some of these risks are discussed as country risks, and others as regional risks.

Economic reforms require China to take considerable political and economic risk. China's central government fears economic reforms will cause large unemployment, due to layoffs in state-owned enterprises (SOEs) attempting to compete globally. Today, millions of disgruntled workers with small pensions have already lost their jobs at SOEs. Additionally, WTO accession requires China to abide by international standards that could potentially reduce the flow of Chinese goods into foreign markets further increasing unemployment. Labor protests have become a common occurrence, creating economic and political instability. "In a crisis, Chinese labor could become as destabilizing a force for the world economy as oil prices."[40]

China is also exposed to political risk as economic reforms, the expected resultant formation of a middle class, and increased integration with the outside world may produce liberalizing effects in China. The advent of the Internet, satellite television, and mobile phones will improve the Chinese population's global awareness and may provide additional impetus for economic and political reforms.

Taiwan also faces risks in a fully integrated global economy. For example, when Taiwanese companies become dependent on China for their manufacturing, components, engineering, and markets, they also become more vulnerable to any Chinese political or

financial crisis. A Chinese financial crisis is certainly a possibility with China's banking system currently burdened with billions of dollars estimated in bad loans, and the effects of their artificial setting and control of currency exchange rates.

The U.S. also faces risks associated with economic globalization and interdependency. As the U.S. advances its economic relationship with China it should seek assurances that China satisfies its WTO obligations while not giving the perception that it is focused on protectionism and isolationism. The U.S. must guard against the perception of protectionism and isolationism both in the region and at home. One plausible scenario would be if the U.S. economy entered a recession and trade with China were perceived by the U.S. as imbalanced due to unfair Chinese trade procedures. This scenario could result in the U.S. enforcing trade policies that could negatively affect economic prosperity and regional stability.

Some risks are regional and apply to many countries. For example, if either the U.S. or China loses a WTO trade dispute, there could be a negative impact on that nation's economy. There is certainly a possibility that one, or both, countries will eventually lose a key economic dispute that is settled by the WTO. Therefore, both the U.S. and China need to recognize this aspect of economic globalization, and specifically WTO membership, and be prepared to react rationally.

Some regional risks are not associated with economic globalization. In fact, historically countries do not make decisions based solely on the economic merits of an issue. An example would be if China perceives a threat to its vital interests or security. The movement of PLA forces into Macao and Hong Kong is proof that China is not hesitant about protecting its interests. Additionally, any threat to China, or even a perceived loss of face on the international stage, may also override economic concerns. If China perceives that it faces a threat to its survival, or sovereignty, it would probably stir up nationalist sentiments in an attempt to distract attention from government inadequacies. China might also seek a military solution if it believes it has a window of opportunity to attack and that the U.S. will not go to war over Taiwan.

Another regional risk is if the Chinese deliberate pace for economic reform does not keep pace with changes in the global economy, causing an imbalance that could lead to domestic instability. This could result in a Chinese decision to invade Taiwan as a "smokescreen" solution, in an attempt to mask the real problem. Hence, while remote, the possibility of China invading Taiwan in the next five to eight years is real. In ten years the level of economic interdependence linked with the economic prosperity of the two nations would probably deter any military action. Hence, economic interdependency may yet prove to be the key incentive that leads to peaceful resolution of the issues.

China's growth into a global power and regional hegemon appears assured. Eagerness on their part to flex the military element of national power may cause the PRC to miscalculate U.S. resolve to protect its interests in the region. And failure by the U.S. to state its interests clearly could contribute to that potential misunderstanding. The most probable course of action is that the PRC will continue to tolerate the status quo as long as Taiwan behaves. In order to prevent a crisis, the U.S. must not allow the PRC to doubt our interest in peaceful resolution of the Taiwan issue. The U.S. must also ensure that Taiwan does not provoke China by any declaration of independence or similar provocative acts.

RECOMMENDATIONS AND CONCLUSION

> "On matters concerning security, defense and commerce, prudence and pragmatism should be the order of the day."
>
> —K. S. Balakrishnan

RECOMMENDATIONS

The United States engagement with China should treat China as an equal power, recognizing that it is a great power in Asia and someday will be a world power. Additionally, the U.S. policy of supporting Taiwan's self-defense, while acknowledging the "One China" principle, continues to pay dividends and should be maintained. The Bush Administration's China policy must be part of a larger Asian strategy that keeps America fully engaged, maintaining its regional strength and dynamism in this era of economic globalization, while encouraging China's own constructive engagement in the region.

Chinese economic prosperity is the strategic center of gravity, and economic prosperity requires positive relations with the United States. China needs Taiwan's capital and expertise and it is realizing that its goal of absorbing Taiwan is best served by letting the economic process proceed, and not by utilizing force. Therefore, it is imperative that we preserve the framework of our current policy toward Taiwan in return for an implied Chinese willingness to abide by the status quo. To preserve this framework, the U.S. should make it clear to both China and Taiwan that we will support Taiwan in the case of an unprovoked military attack by China, but we will not support Taiwanese provocative independence behavior. The U.S. should remind Taiwan that it has prospered under the status quo, and enjoyed relative independence, albeit without diplomatic stature.

The United States policy must engage both Taiwan and China with clarity and consistency, while recognizing the unique relationship that exists between the U.S. and Taiwan. A key to success in the region is constructive, cooperative engagement. Active diplomacy and

participation in alliances such as the U.S.-Japan Mutual Defense Treaty and the Republic of Korea-U.S. Alliance, coupled with economic alliances such as the WTO, will enable the U.S. to shape the environment. The U.S. should build on the stability provided by these alliances, as well as by institutions such as ASEAN and the Asia-Pacific Economic Cooperation forum, to develop a mix of regional and bilateral strategies to manage change in this dynamic region. The U.S. should attempt to leverage the inherent multi-national advantages that key economic organizations like the WTO, APEC, and ASEAN provide to foster economic and ultimately political reforms. Multilateral intervention limits the state-to-state relationships that can be so destructive to regional stability, while also limiting U.S. unilateral efforts that could be perceived as U.S. centric.

Economic reforms and increased global integration may drive political changes in China. U.S. policy must require China to adhere to reasonable international standards, while striking a balance between demanding total WTO compliance and allowing no compliance at all. America should encourage China to embrace the concept that the "democratization of Taiwan can empower reform on the Mainland and lay the groundwork for meaningful political harmonization between Beijing and Taipei over the long-term."[41]

The United States commercial engagement with China must be one that provides prosperity to both countries. As the U.S. advances its economic relationship with China it must avoid giving the impression that it is focused on protectionism and isolationism. The U.S. must further its commitment to free trade in order to promote the goal of stability and prosperity through global economic interdependence and the subsequent growth of democracy.

A coherent, consistent long-term strategy that seeks to leverage the elements of U.S. national power in conjunction with allies in the region will ultimately yield the best results. A policy of constructive engagement with China, coupled with a credible military capability if engagement fails, offers the best chance of success.

CONCLUSION

China's rise as a regional power is the greatest challenge facing the U.S. and its allies in East Asia. China clearly intends to return to what it believes is its rightful place as the leading power in the region. The U.S. must remain fully engaged, maintaining its regional strength and dynamism in this era of economic globalization, while encouraging China's own constructive engagement in the region.

The U.S. must stay focused on the long-term strategy of integrating China into the global community as a constructive force for stability and prosperity. "To look only at China in the

present is to see a nation beset with human rights abuses, municipal corruption and inefficiency. To look at China over the span of twenty years, or even five years, is to see a dynamic nation moving inexorably toward a market oriented economy and genuine reform. With economic change will come prosperity, and with this broader prosperity the people will demand political change."[42]

Finally, for U.S. policy-makers, the status quo should be acceptable over the next 15 years. Current conditions preserve U.S. regional influence and allow time for the impact of globalization and free-market forces to hasten the democratization of China. Today Taiwan, enabled by the U.S., infuses the principles of both the free market system and democratic values into China. This should promote regional stability until China and Taiwan can peacefully resolve their issues. Until then the current U.S. policy of supporting Taiwan while simultaneously acknowledging the PRC's "One China" policy appears to be the prudent approach.

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