



TRANSCRIPT

The Taiwan Presidential Elections: Political, Economic, & Security Implications

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PANEL I: TRADE AND ECONOMICS

DR. BUSH: If you could please take your seats, we will get started with our panel on Trade and Economics. My name is Richard Bush. I am with the Brookings Institution and the Center for Northeast Asian Policy Studies. I would like to thank CSIS and the US-Taiwan Business Council for their outstanding support and hard work in this.

I would like to introduce the three panelists we have this morning to talk about trade and economics: Nicholas Lardy, a former colleague at Brookings, now a Senior Fellow at the Institute for International Economics; Mignonne Chan, who is the Director of the Division of International Affairs at the Taiwan Institute of Economic Research; and Chang Yi Wang, who is President and CEO of United Biomedical, Incorporated.

The purpose of this conference today is to look forward. We have had a very exciting election, a horse race that somebody won by a nose. Still some people think that it is unclear. But with a horse race, the horses go back to the barn and you wait until next year. In this case, somebody will have to govern Taiwan and somebody will have to fashion policies that provide benefits for the people of Taiwan. So that is our focus today, first of all on trade and economics, and then politics and security.

We have three outstanding presenters. Some of this is PowerPoint presentations, I see. Some we may do conversationally and work to have as much time for question and answer.

Without further ado, I'd like to turn to Nick Lardy.

DR. LARDY: Thank you. I am going to inflict some pictures on you, so I am going to stand up here near the machine. I want to talk about what I see as the critical aspects of the economic relationship across the Strait and I think the key message is that there continues to be a severe disjuncture between the political relationship and the economic relationship, a complete discontinuity. If anything, it has gotten more severe in recent—last year or two as political friction has increased and economic relations have continued to move ahead. I am going to just review basically a few simple things on trade and investment flows across the Straits.

The first diagram just shows what's happening in terms of two-way trade. You can see particularly, the top is exports to the mainland, the bottom line is Taiwan imports from the mainland, and you can see the top line is pretty steep, particularly the last two years as export growth has been extremely rapid from Taiwan across the Straits, and it is very close to tied, and as I will explain in a minute, to the pattern of investment that we have seen.

It is also useful to look at this in terms of how big is the mainland in terms of a share of trade for Taiwan, and as you can see, by last year, Taiwan was selling about 25 percent of its exports were going to the mainland. A smaller share of its imports was coming from the mainland, just a little bit under ten percent. But for the last two years, the mainland has been Taiwan's largest export market, and I believe last year overall, China became Taiwan's largest trading partner.

There is a little bit of a, as you can see from this diagram, the imports coming from the mainland are still relatively small. This, of course, is a function of the fact that, to some degree, Taiwan still restricts imports from the mainland. About 25 percent of all the lines in the tariff schedule have a prohibition on goods coming from the mainland.

If you look at the U.S., the share of exports going to the U.S. is about 18 percent, so significantly less than the 25 percent going to the mainland, and the share of imports, Taiwan imports coming from the U.S., is about 13 percent. So the U.S. is still slightly bigger on the import side in Taiwan.

The mainland is much, much bigger on the export side. So the mainland is now the biggest trading partner of Taiwan.

The next diagram is simply showing foreign direct investment flows from Taiwan to the mainland. There are three different sets of numbers. The pink line is the numbers released by the Taiwan Ministry of Economic Affairs. The blue line is the numbers that come from the Chinese MOFCOM, as it is currently called. The two green dots are two single estimates that have been released by the central bank in Taiwan on cross-Strait investment flows from Taiwan to the mainland.

My view is that the green dots are a more accurate indicator of what is going on. But in the year 2002, I think they put the number at something like about \$65 billion U.S. dollars as cumulative foreign direct investment by Taiwanese companies in the mainland.

I mean, the key thing here, of course, that Taiwanese investment in the mainland—the mainland is the single most important source or most important destination for cross-Strait economic relations, and I would say further that the foreign direct investment is really the driver of the trade relationship because the big export boom that I showed you in the first diagram, if I can get my thing hooked back up here, is basically—it is mostly intra-firm trade. It is Taiwanese companies selling—buying parts and components from traditional suppliers in the mainland and sending them to the mainland where they are assembled into final products, and this is obviously concentrated in an area such as electronics, IT hardware, and so forth.

IT hardware is probably the most interesting sector, and this is a diagram that shows you how rapidly the migration of these production from Taiwan to the mainland. As you can see in 2001, if you take the total value of IT hardware production by Taiwanese companies, about \$43 billion, almost 50 percent of it was still being produced in Taiwan and the share on the mainland was under 40 percent.

Two years later, as you can see on the right-hand side, the mainland share is over 60 percent and the share being produced in Taiwan is just a little over 20 percent. So there is a very, very dramatic migration of the production of Taiwanese companies from Taiwan to the mainland.

The other interesting thing is, of course, that the so-called other share is pretty much unchanged. This is Singapore and other production sites in East Asia. Those have a fairly constant share. The dramatic change is the migration from Taiwan itself to the mainland.

One of my key themes, of course, is the growing interdependence that these patterns imply, and on the growth side, this is a diagram that shows you what is happening in China domestically in terms of production of a fairly broad range of products that I am calling here electronics and information products. This includes IT hardware, consumer electronics and communications products, and as you can see, by last year, we are closing in on \$2.5 trillion R&D in terms of the production value of these commodities in China. It is a very, very important segment now, perhaps the single most important segment in Chinese manufacturing. Two-point-five trillion is a significant share of total production in manufacturing in China.

And closely following, indeed, driving this, is the exports of these products, which you can see in this diagram have gone from about \$20 billion in 1995 to something like \$120--excuse me, \$142 billion U.S. dollars last year. So the first diagram was showing you total production. This diagram is showing you exports measured in dollars.

Just to put a context on it, about 13--exports in 1995 that are shown in this diagram represented about 13 percent of total output that I showed you on the previous diagram. The \$142 billion in exports for 2003 represents about 50 percent of production. So this has been a driver for economic growth in China. It is a very important sector, growing extremely rapidly, and the

share of the product that is being exported has increased dramatically in a relatively short period of time. Roughly speaking, it has gone from ten percent of production to about 50 percent of production in the last eight years.

And Taiwan companies have been a very, very big part of this story. If you restrict yourself, of course, to the IT hardware sector alone, about two-thirds, which is a big chunk of this, about two-thirds of all the production on the mainland is by Taiwanese companies.

I will just take one more subject and make one more point here, and that is that although many people in the United States and some other countries are thinking that China is moving up the technology ladder very rapidly, they are no longer just selling us tennis shoes and sporting goods and footwear. They are selling us computers and other kinds of sophisticated products that, in fact, these goods are being simply assembled in China and all the key parts and components are coming from the rest of Asia, and Taiwan, of course, is the single biggest supplier.

So against the exports of electronic information products, I now add in, in the red line, the imports, and I think this shows you pretty clearly, China did not even become a net exporter of these kinds of products until 2001. If you look at 2002 and 2003, the margin between China's imports of these products, which is mostly parts and components, and the exports, which is mostly finished goods, is relatively small.

In 2002, the net exports of these products were only \$7.5 billion. That is out of total exports of \$92.5 billion, so that net exports represented about eight percent of total exports of these products. Or to put it another way, the import content of these products, on average, was over 90 percent. So that simply shows you that what is happening on the mainland is the assembly of these products and this is the same exercise of China's comparative advantage in labor-intensive products, and it doesn't really matter whether it is footwear, on the one hand, or laptop computers, on the other, in terms of the production process in China. The production of laptop computers does not represent a much more sophisticated level of manufacturing.

By 2003, the net exports have increased significantly to almost \$15 billion. But as you can see, the margin is still fairly small. Exports, net exports, are only about ten percent of total exports.

So the picture here is obviously one of dramatically increased integration and the two economies are particularly intertwined in the electronics and IT hardware sectors, which is clearly Taiwan's strongest comparative advantage on a global basis. Those companies have moved to the mainland to take advantage of lower-cost labor. The parts and components for those products are still sourced overwhelmingly elsewhere in Asia, including in Taiwan.

That is one of the reasons in the first diagram there is such a huge difference between Taiwan exports to the mainland and Taiwan's imports from the mainland. So you have these economies increasingly integrated, both in terms of investment flows and trade flows, even though the politics is moving in an unfavorable direction.

Well, that's a quick overview and I'll stop there to save time for questions.

DR. BUSH: Thank you very much, Nick.

We now turn to Dr. Chan. Dr. Chan, thank you so much for coming so far to be with us. Thank you to Chairman Chang King-yuh and FICS for making that possible.

Dr. Lardy presents, I think, a picture of China posing a great challenge economically to Taiwan, and I think globalization as a whole presents a great challenge for Taiwan. Tell us a little bit about how you think Taiwan is responding to this challenge and how it should.

DR. CHAN: Thank you very much. It's great to be here. Regarding Nicholas's statistics, I would not repeat them. Stronger trade and economic ties are growing. On the bilateral front across the Strait, actually, President Chen's government has been very keen on promoting cross-Strait relations - if not in public - but our legislation in the making has all pointed to the fact to promote cross-trade investment as well as labor mobility.

I would like today just to point out to you some different views regarding the cross-trade economic issues. On the one hand, we have strong supporters, mainly from the business sector, promoting the reduction of business transaction costs, but the concerns from the opponents' element mainly focus in three areas.

One of the issues is the so-called Trojan Horse. The hypothesis is that with direct links there could really be Chinese soldiers hidden as passengers and coming to Taiwan, just like the Greek warriors hiding in the Trojan horse. They would then pose a great security issue.

And the second hypothesis is the so-called hollowing out hypothesis, mainly that direct links would really promote more of the industrial exodus to China.

And the third hypothesis is the so-called immigration flooding hypothesis, that once it is open, there may be quite a lot of traitors and saboteurs coming to Taiwan. Interesting, but this data traces some of Taiwan's concerns regarding issues of concern that cross-trade relations and economic upscale communication would pose.

Therefore, I think once the bilateral dialogue is in place, this kind of issue of concern will have to be addressed, and perhaps the U.S. could facilitate some of the capacity building and training program to dissipate some of those concerns.

I would also like to say a few things about what you mentioned about the global front. On the one hand, we see the failure of the Doha Development Round, not proceeding quite well since the last Cancun ministerial meetings and with the proliferation of FTA and RTAs, free trade agreements and regional trade arrangements, Taiwan certainly would not like to be marginalized by being excluded from all these RTA and FTA schemes.

Therefore, on the one hand, in WTO we continue to fulfill our obligations as a global player. On the regional and sub-regional plane, we also try to forge RTAs, and at the same time, China is also proposing a so-called Taiwan-China CEPA, Closer Economic Partnership Arrangement.

Of course, we have quite diverse views, as I pointed out earlier to you. On the one hand, we have these debates about the China threat vis-a-vis the China opportunity. On the other hand, we have tremendous activities related to China's trade and investment across the Strait.

So I think the challenge ahead is for the government, first of all, to have very consistent economic leadership and to build up the business confidence. And on the other hand, we will continue to explore the potential of other setback approach, if you wish, to forget FTA partnerships with our potential trade partners, whether it is with the U.S. or Japan or the Philippines or Singapore. These are all under discussion.

I do believe that China will have to be more relaxed in terms of initiating communication across the Strait, not to focus so much on the political issue, but focus on actual confidence building via economic activities.

And finally, I would just like to pay tribute to DR. BUSH by citing some of his distinctive insight. In one of his articles, he made a distinction about the Confucian belief in clarity, and Taoist views on the virtue of ambiguity—

[Laughter.]

DR. CHAN: --and the approach, the U.S. approach of being Confucian and Taoist at the same time at the dawn of the 21st century. I happen to appreciate wholeheartedly his contention that, quote, "The U.S. best protects Taiwan by being clear about the military intervention but ambiguous on sensitive political issues," and that, quote, "Too much straight talk on political matters undermines Taiwan's security and other U.S. interests, as well."

With this, ladies and gentlemen, I submit to you for further elaboration.

DR. BUSH: Thank you. Thank you for reminding me that I was so articulate at one time.

[Laughter.]

DR. BUSH: Let me ask you to follow up a little bit on the hollowing out concern that people have. Jobs will migrate. That is a sort of natural law of economics and this is something the United States has experienced and we have had to find new competitive niches where we can employ people at high wages, high-quality jobs. Is this a challenge that Taiwan is facing? How do you think the Chen administration in the second term will face it?

DR. CHAN: Right. In terms of business mobility, actually, under the scheme of IAPs, I-A-P, Individual Action Plan, that is one of the yearly progress that we have to report to, and then also this year is when Chile is hosting the IAP summit in August, I believe, that Taiwan is going to submit an IAP for review and the U.S. businessmen, as many other countries' businessmen, will be able to exert that peer review pressure monitoring system, raise some of the bilateral trade issues, including business mobility that you just mentioned.

In terms of hollowing out, actually, it all depends on which industrial sectors we are talking about. Now, the government in 2002 has launched a six-year plan. We call it Challenge 2008, and the main focus is to develop Taiwan as a green silicon valley. That is to say, we would need quite a lot of structure readjustment by shifting our service industry as the main base from the—used to be 45 percent of our GDP. That would increase to 68 percent of our GDP and slowly away from the manufacturing base.

Of course, in the services industry, including the financial sectors, I think the challenge for the government is to secure the business base in Taiwan, not necessarily—actually, ironically, it was the direct links. Personally, my analysis is that it will further prevent the hollowing out effect.

DR. BUSH: Thank you very much.

I think Dr. Lardy and Dr. Chan have given us a good general framework for the current situation. We are now privileged to have a concrete example of U.S.-Taiwan economic interaction in Chang Yi Wang. Your company has a strategic alliance with MLEA. You have to examine every day the investment climate in Taiwan and how much you want to commit there. We welcome your observations about your situation. I understand you have a PowerPoint, as well?

DR. WANG: I do, but I just realized that there's somehow a conflict that the PowerPoint cannot be shown on this computer.

DR. BUSH: Oh really? Oh, that's too bad.

DR. WANG: I can speak without the PowerPoint—

DR. BUSH: Okay. Thank you.

DR. WANG: --and you just have to bear with me when I share this example with you.

DR. BUSH: Can everybody hear okay? Okay. Thank you. Please.

DR. WANG: I will now share with you our story of how UBI Asia came to be in partnership with UBI and the advantages for a high-tech enterprise of being in Taiwan.

UBI is an international biopharmaceutical firm with cutting-edge technology with headquarters located in Long Island, New York. We at UBI are committed to treating and preventing diseases by directing the immunosystem.

Our operational systems are UBI China in Beijing and Shanghai. UBI Asia in Taiwan serves as our R&D center of Asia and also provides CGMP manufacturing facilities, both of which position us for growth in Asian and global markets.

At UBI, we have combined elements of genomics and protein and modeling information with our expertise in immunology, synthetic chemistry, vaccine formulation, and antibody engineering to create our platform technologies in functional intergenics. The company has used these proprietary technologies to develop a new class of peptide-based immunotherapeutics, antibodies, and diagnostic products for both human and animal health. We have used our unique technologies to develop a pipeline of blockbuster products for Alzheimer's disease, prostate cancer, AIDS, and allergy, with over 120 patents issued in the U.S. and worldwide and over 40 scientific publications and established product development and commercialization collaboration through government sponsorships by both U.S. and Taiwan governments and global business alliances with major players in both animal and human health products.

With co-investment from the development fund of Executive Yuan and the Ministry of Economic Affairs of the Taiwan government, UBI was able to establish a Taiwan-based company, UBI Asia, in 1998. In 1999 and 2001, UBI Asia, after close consideration and business evaluation, acquired two international CGMP pharmaceutical manufacturing operations in Taiwan from Roche and Glaxo Smith-Kline and used these bases as its base for operations.

With the CGMP systems and the framework lease already existing worldwide facilities provide, UBI Asia is able to break through the barriers of process development, manufacturing QC, and other product development-related activities. These acquisitions accelerate what otherwise would have been a prolonged process in obtaining regulatory approvals for the commercial productions of pharmaceuticals and our proprietary bio-pharmaceutical products.

For example, by already having an internationally-oriented corporate culture, we are able to readily set up for production of specialty injectibles, drugs, and the FDA guideline. Marketing of products in North America will generate additional near-term sales with bottom-line revenue to sustain the growth of a fully integrated company and fuel the development of our proprietary blockbuster products derived from our platform technologies.

These are the types of synergies UBI and UBI Asia are constantly striving for. These advantages allow UBI and UBI Asia to operate with low costs, lower cost, and more rapid time to market, as well as creating stable revenue opportunities for both UBI and UBI Asia.

Another example illustrating the cost effectiveness of operations. With UBI and UBI Asia's management know-how in U.S. FDA-guide requirements for biologic manufacturing, such as documentation, validation systems, and the factory and engineering expertise, that is abundant in Taiwan combination of two. We were able to build a pilot multi-kilogram peptide manufacturing plant and a pilot monoclonal antibody manufacturing plant for the production of our key biologic ingredients. This was done at a fraction of the cost it would have taken to build in the Western world, with the quality far surpassing that we could build in China.

Also, as our companies grow, UBI Asia's engineering and manufacturing teams stand ready to assist in the establishment of even more facilities as needs dictate.

From an R&D point of view, our bio-R&D team we built at UBI Asia together with the up-to-date institutions and facilities that are to be found on Taiwan demonstrate world-class capabilities. UBI Asia received several exclusive panel licenses from UBI that have great market potential in Asia. These include, first, foot and mouth disease and [indiscernible] vaccines for swine. These products have recently received regulatory approvals for marketing in China.

China, with 450 million pigs, is the world's largest market for swine health care. The pen/field swine studies for the development of our vaccines for foot and mouth disease were conducted by UBI Asia in Taiwan in collaboration with the Pig Research Institute in Taiwan and Taiwan's National Animal Health Research Institute. Follow-up studies of these two institutes have led to the first-ever commercialization of a peptide-based vaccine for foot and mouth disease, with a goal to replace the decades old virilized base vaccines in five years. I am talking about billions of doses for the worldwide market.

Our state of art FMD diagnostic test, capable of differentiating infected from vaccinated animals, has been validated extensively through a collaboration between UBI Asia and the two above-mentioned institutes in Taiwan. Taiwan leads the world in the use of such advanced technology tests to survey its pig population for FMD status in the island. The scientific data generated through the close UBI Asia Council of Agriculture and UBI collaboration has led Taiwan being declared as the first country in the world to be an FMD-free country in the presence of FMD vaccination.

Again, I want to emphasize that this revolution in change in international disease control was the result of the friendly atmosphere for high tech that is fostered by the Taiwan government.

UBI Asia also has been the beneficiary of supports and grants from Taiwan government programs, such as the Industrial Technology Development program of MOEA. A major industry technology development program has enabled UBI Asia to set up the first GMP production plant in Taiwan dedicated to the manufacture of engineered therapeutic antibody. This facility will allow UBI Asia to commercialize its platform technologies for human therapeutic model co-antibodies based on antibody demonization, with a product already under the sponsorship by the Division of AIDS, U.S. NIH, for clinical trials. Again, I am talking about close collaboration between U.S. and Taiwan governments and companies, in this case, between UBI Asia and UBI.

The young scientists of UBI Asia's bio-R&D team are the foundation of this success. It was they who successfully established the technology platform for development and manufacturing of immunized monoclonal antibodies with the guidance and support from UBI and with performance ahead of the schedule and beyond our expectation.

With superb world-class production facilities, a highly qualified R&D team, and an experienced management team, we expect UBI Asia to become a premium provider of innovative biologic and pharmaceuticals in Asia.

With its international relationships, UBI Asia's unique products will be extending into global markets. UBI Asia has become the strategic partner in Asia for the UBI group.

Aided by the excess of information technologies during this age of quote, "this is at a speed of thought," we have benefited from the 12-hour time difference between New York and Taipei. It has given us a highly efficient around-the-clock mode of operations.

Despite all this, you may still be asking, why Taiwan? While searching for an Asian base of operation for UBI, my native Taiwan was a natural choice. However, I have to convince our board of directors and shareholders of the rationale for such a choice.

Taiwan's up and downstream industrial chain is compact, complete, and connected to an excellent electronic communications network. Taiwan's ability to commercialize R&D breakthroughs is strong, and as experienced global competitors, Taiwan's enterprises are clearly attuned to the latest trends in world markets.

Already in place in Taiwan are research institutes and biotech companies to carry out all stages of biotech and formal product development activities which make it a great place to accelerate product development efforts.

And then the Taiwan government provides, as I said, co-investment incentives, R&D grants, and establish, quote, "one-stop shopping organization" to promote our industry. These are all the reasons that gave us to set up a base in Taipei, Taiwan.

The term "Made in Taiwan" is U.S.'s most common recognition of Taiwan. The country is synonymous with high-tech goods. The Taiwanese people, however, are not defined by what they make, but rather what they have been made from.

We are all too familiar with the history of Taiwan. However, it took a strong spirit and perseverance to bring Taiwan to its current economic state. Taiwan's economic structure changes instituted in the '50s has led to consistent rapid growth which continues now, some 50 years later. Taiwan has a dynamic capitalist economy, an export-based trade surplus funding industrialization, has a healthy edge regarding high-tech capital-intensive goods, has a stable political infrastructure that includes strong democratic institutions, well-enforced commercial laws and regulations, at least when compared with countries in that region. And the high value placed on its long history of friendship with the United States.

Taiwan's greatest investment may be, you know, may still lie in the investment in human capital through education, which created a strong foundation of the workforce that is highly educated, diligent, and committed to hard work and quality. Taiwan's highly educated workforce produced high-tech goods, in turn, high Taiwanese profits. Taiwan's almost monopolistic hold of semiconductor production is just an illustration of a firm base producing huge accomplishments, a common trend in Taiwan's success independent of any one product or industry.

I said Taiwan's cash crop still remains its people. As the country's investment in highly-educated people endures, Taiwan should enjoy continued growth, economic growth, in the future, despite China's tremendous surge in its economic power. At UBI Asia, we have been able to enjoy the fruits of the best and the brightest Taiwan has to offer.

In summary, Taiwan is the place to establish bio-pharma firms with international links to create synergistic alliances and to achieve win-win business relationships. The paradigm shift from Silicon Valley to Hsinchu Valley occurred more than a decade ago for electronics and IT and it may happen again for biotech and pharma.

Taiwan has government policies to promote biotech and pharma industry. It also has diligent entrepreneurial and well-educated human resources and the strong democratic and legal institutions. Operations can be cost effective. It is a place where fast-breaking and first-hand business information can be easily accessed. It offers access to the huge China market due to similarities in language and cultural background and to markets worldwide due to its extensive connections to the Western world.

So join us, and welcome to industry. Thank you.

DR. BUSH: Thank you. Thank you very much for that—

[Applause.]

DR. BUSH: Thank you for that impressive success story. I, for one, wish you further success, particularly on your anti-Alzheimer drug.

DR. WANG: Yes. We are working with a major player on that.

DR. BUSH: Hurry up, please.

[Laughter.]

Questions from the Audience

DR. BUSH: The floor is now open to questions. There are people holding mikes. If you just raise your hand, somebody with a mike will come to you. Identify yourself and who you are with and who you would like to ask the question to. Joyce?

MS. LIN: My name is Joyce Lin, visiting researcher in Asia studies, Georgetown University, from Taiwan and last year's Visiting Fellow at the Brookings Institution.

I would like to make some comments on the question to the three panelists. In recent developments, I think the United States' economic power around the world is being reduced. It is facing competition in Europe and East Asia. In Europe, you can see although the European Union is growing to 25 nations and also France and Germany will be very strongest partners who want to be independent from the U.S. political and economic influence.

Also, in Asia, China becomes a more multi-power and Japan would like to be recover its economy through invest and tech advantage from China market. And also, similarity, and this is also is, South Korea promotes their goods and products more to China than to the U.S. And also Southeast Asia, ten member countries, they would like to sign ASEAN Plus 1 free trade agreement with China. China also [indiscernible] ASEAN Plus 3 and ASEAN Plus 5 so-called China, South Korea, and Japan, so-called New Zealand and Australia, so—

DR. BUSH: Maybe—what's the question?

MS. LIN: Only that Taiwan would like to enhance our relations. I have two questions. Number one, should Taiwan sign a CEPA with mainland China? And my second question is, shouldn't the United States enter into a bilateral FTA with Taiwan? Thank you.

DR. BUSH: Okay. CEPA and Taiwan FTA. Does anyone have any views on that? Nick?

DR. LARDY: Well, I think the main challenge, as I think DR. CHAN mentioned, is that it's very important that Taiwan be a part of the increasing economic integration that occurs in Asia, and Taiwan already has a role in fostering global multilateral integration through the WTO and the question is, what are the mechanisms that Taiwan has available to participate in regional integration in Asia.

As you mentioned, many of the proposals and some of the deals that have been done, whether they are bilateral or regional, would leave Taiwan out, and this would have very adverse repercussions for Taiwan because Taiwan is, in certain respects, very competitive vis-a-vis similar neighboring economies, say, for example, South Korea.

So if South Korea goes into a free trade agreement or regional free trade agreement and gets preferred access to other markets in the region, they will be able to displace perhaps in some areas lower-cost production by Taiwanese countries, and that is what we call trade displacement, when a higher-cost producer takes the market away from a lower-cost producer by virtue of preferred access to the market through an either bilateral or regional free trade arrangement.

So the challenge is, I think, particularly for those of us who are really ultimately interested in multilateral global liberalization is how do you try to minimize the regional potential trade displacement?

So I think the ultimate goal is clear. I'm less clear about how to achieve the goal, and it's not—I don't know enough about exactly what China has proposed with a CEPA to know whether it is a solution. But if a CEPA would provide a relationship across the Straits for relatively unrestricted trade and by virtue of that relationship Taiwan would not then be excluded from other regional agreements, such as ASEAN Plus 3, I would think it would offer certain substantial advantages. But I don't know the details enough about what a CEPA would be.

Of course, the other problem is we are a long way, it seems to me, politically from being able to even initiate such a set of discussions. So I think there is a question of how do you get from here to there.

DR. BUSH: Dr. Chan, do you have a comment?

DR. CHAN: Yes. Also, basically just like any FTA and RTA, it has to be negotiated. It has to be mutually beneficial, either by the form of single undertaking or as a comprehensive package that both sides can make out a wish list and see where the common interests are, and they, of course, have to be negotiated.

What's the other question? U.S.-Taiwan FTAs. Actually, two years ago, ITC came out with a feasibility study that showed the indication of economic benefits of forging a bilateral FTA. However, there is some difference in terms of how to proceed there, and since the U.S. has different priorities in terms of their FTA partners at the time, I do not foresee any difficulty for both sides to come up with a realistic assessment about how to proceed further.

On an FTA, on the one hand, you have to assess the economic benefit. But on the other hand, U.S. in practice also rewards FTA's partners, either to encourage the democratic process or as a reward as other military strategic partners, as well, and the cases in point include U.S.-Jordan FTA as well as finalizing the U.S.-Australia FTA, I believe.

So I think strategically, if U.S.-Taiwan continues further, going beyond the economic beneficiary sides, there will be quite a lot of strategic points, I believe, that the U.S. can showcase as their continuous moral support for Taiwan as a democracy in transformation as well as forging a strategy of partnership.

DR. BUSH: Thank you. Dr. Wang, do you have a comment on this?

DR. WANG: Yes. In my industry, I think industry needs U.S., America more than ever. Rupert had written an article recently in the Asian Wall Street Journal talking about that.

Biotech and pharmaceutical industry is highly regulated industry. Now, Taiwan, it's a small island. It goes R&D as extension of U.S. base and have close interactions. That's important. But the product ultimately has to reach the world market, go through the U.S. and reach the whole market. You go into China, you have to go to the U.S. to be routed there.

One example, foot and mouth disease product. We have recently gotten China government approval, which is unprecedented in this field. We got into the field because Taiwan had an FMD outbreak and we thought our technology can have an application and that's why we got into the product. And we developed the product with close collaboration with the USDA Plum Island Animal Disease Center and Taiwan Research Institute and Council.

So together, scientifically and product development effort, you cannot see the difference between UBI and Asia. They are very closely intertwined together. The product can never be shipped—

[Break between sides of recorded tape.]

DR. WANG: --China would not allow any foreign company to sell foot and mouth vaccines in China. What we did was, because of this close collaboration, we have demonstrated our scientific and technology advancement, and for a product which China needs very badly. It's a billion-dollar market, those markets. They need it because they need to control their animals to have good health, animal health care control.

In this case, by being a U.S. company, we work with the Ministry of Agriculture, form some type of alliances, and with very high-level approval, we were—and also because we have a strong Chinese background in the founding of the company and we were able to have a special approval to participate, to build this product or produce this product in China or the supply of China.

This is one example of close interaction between Taiwan and the U.S. in R&D in the product development area where we, together, we can still find a way to open a door of China. In this case, a major player, our competitors, Marille [ph.], a joint venture between Merck Adventis. They tried to open the door for ten years, couldn't do it. We did it.

I think many other areas, too. I think biotech and pharmaceuticals industry, we were talking about in the later product creating solutions for a problem to deal with and the problems, and together we become stronger and we can influence China. I think we had a win-win-win relationship. So it's a little different from industries.

DR. BUSH: Thank you. I have a question here, and then we'll come over here. Right there.

MR. MARSHALL: I'm Dana Marshall, and the question for any of the panelists, I was struck by those very interesting numbers that Nick Lardy put up, especially that very thin margin between the import and export value of electronics and IT, growing but still very thin.

I wonder if any of the panelists might, in light of that kind of an economic dynamic going on over there, comment a bit on what China's reaction might be to a closer economic relationship between Taiwan and the U.S., let's say through an FTA. Would there be some impact on China's exports to the United States, maybe through a trade displacement sort of a mechanism that Nick was talking about, or in some other way to that end, or might there be at the same time in some other sectors some advantages to China, should there be a U.S.-Taiwan FTA?

DR. BUSH: Nick?

DR. LARDY: Well, in this sector, I don't think there would be very many direct effects from a U.S.-Taiwan FTA, and the reason I say that is, of course, that China allows—all of this activity in China is taking part under their processing, export processing regime, if you will, which allows Taiwanese companies or American companies or Japanese companies or whatever to bring in all their parts and components on a completely duty-free basis as long as they are then re-exported into the global market.

So essentially, we already have entirely free trade in those commodities and their related components, so adding in a U.S.-Taiwan FTA or even adding in a CEPA between Taiwan and the mainland, I don't think is going to have any direct effect on this growing concentration of assembly activity for these products in the mainland.

The economic basis for it is already there. Direct shipping would help a little bit in terms of reducing the cost. As has already been mentioned, the transactions cost would help. But an FTA, I don't think is going to change the fundamental underlying dynamic of this process, which is very strong, as you can see from the diagrams, and already very well underway.

DR. BUSH: The gentleman over here.

MR. DILLON: Ken Dillon, Spectrum Bioscience. This is a question for Dr. Wang, but also for the other two panelists.

Dr. Wang, you are the lead inventor of some 80-plus patents and that raises the very interesting issue in Taiwan and China of intellectual property rights. Taiwan has done splendidly over the past recent years in improving its protection of intellectual property rights and in generating an awful lot of new inventions, patents and so on.

But China's role or position on intellectual property rights, as you know, I guess we could best characterize it as being remarkable, and I'm wondering, that causes a real problem for foreign companies, for instance American companies, dealing with Taiwan if they find that actually what they're dealing with with Taiwan is showing up in China, too. You understand the problem. Do you see a solution?

DR. WANG: Well, that's why we have presence in both Taiwan and China. I have to say, Taiwan government has made a tremendous effort to respect the IP, and for us to be able to establish a basis in Taiwan, the Taiwan government, when we formed this partnership, was able to give us credit. Actually, we call intangible in terms of the—intangibles for our valuation, and that's good. That's just a direct recognition of our contribution in this field and our patents, our proprietary product rights, licensing. It's all come together. They recognize that.

In China, we do have a presence and you know—for China at this moment, we're still thinking it's a market where our products can provide solutions and we cannot ignore that market, and particularly in some of our products that uniquely fit them. For example, in the swine industry, it's just huge. We can't ignore that. So we are there.

Now, I must say it is much tougher to deal with Chinese in this area, but by being there and filing patents there and having hopefully a strong presence there, or getting strong, it will protect your proprietary products from being copied.

Again, not just the patent, you know, patent environment. Anything with a product, you have many, many parts associated with the know-how. So you're protecting those by the IPs and also—the patents, but also by the know-how. So I think that's the way we do it.

DR. BUSH: Dr. Chan for a brief comment.

DR. CHAN: Yes. To promote foreign investment, of course, any country has to promote IPR, and I think Taiwan is fully aware of the fact. You know, as investors in China, we also need to be protected, our IPR issue. The implementation, of course there is room for further enforcement. But overall, Taiwan's keen awareness about the promoting IPR protection is there.

And if I may, Mr. Chairman, if I can come back to an earlier question about U.S.-China FTA, I would just like to add one thing. The underlying rationale of establishing FTA actually is the so-called competitive liberalization, which emphasizes the simultaneous preferential and universal treatment for MFA at the same pace.

So the question best is that cross-trade relations and U.S.-Taiwan FTA, are they compatible? Actually, they're mutually stimulating to sort of hatch forward further global liberalization. So I don't think one has to play off the other. Of course, U.S. is the master of the art in this regard.

DR. BUSH: Thank you. A question over here, Jay Chen?

MR. CHEN: Jay Chen, Central News Agency of Taiwan. I'm wondering whether DR. CHAN could elaborate on the government's plan to increase the percentage of service industry in the GDP, I think to nearly 70 percent, you said, and how would that be a factor in the future development of cross-trade and economic ties? Thank you.

DR. CHAN: So far, the 65 percent of GDP is already in place in the service industry, as opposed to a decade ago, the statistics I mentioned earlier. Now, the plans of the Challenge 2008 is basically is focused more on the e-generation manpower cultivation, as well as international innovation on R&D base, da lu tourist arrival plan, e-Taiwan construction plan, operation headquarters development plan, water and green construction plan, new home community development plan, inland truck transportation plan.

DR. BUSH: David Laux?

MR. LAUX: My question is for Nick. Nick, can you say something about where can laymen get a hold of the statistics in this area of trade between the two, something there.

Secondly, looking ahead at the next five years, what do you see ahead, just a continued extrapolation of the curves on your charts, or do you see problems developing, or do you see it accelerating? I think if you look back, nobody would have predicted the degree to which this has grown. It's just incredible. Is that going to continue, or do you see problems ahead or going to accelerate?

DR. LARDY: On this first question on the data, on trade flows, I rely primarily on the data released from the Taiwan side. They have two different data sets. The coverage has varied over time.

The more difficult question is how do you measure investment because of the restrictions that exist in Taiwan on outward investment to the mainland. Most of this is not recorded in the data of the Ministry of Economic Affairs. The central bank has this independent methodology for estimating what these flows are. But they haven't made available a consistent time series. The central bank governor has just, at a press conference on a couple of occasions, said what the central bank believes these numbers to be.

So you can see in the diagram their numbers are very substantially higher, but we don't have a time series. But I think the orders of magnitude for most of these variables, we can measure without too much difficulty.

In terms of the speed, I think we will see—I am basically of the view that we will see continuity and, if anything, an acceleration. If you look at how fast—I had one more diagram I didn't actually put up, but if you look at what happens in these very competitive industries, for example, notebook computer production, as recently as 2000--and, of course, Taiwanese companies are the world's dominant producers of notebook computers—as recently as 2000, they were produced 100 percent in Taiwan. In 2001, it was about five percent.

The key thing is when one producer starts to move and gain some small cost advantage, most of the rest are, for competitive reasons, forced to follow. By the year 2002, we had about 35 percent of all the notebook computers being made in the mainland, and by last year, it jumped up to about 75 percent.

So in a three-year period, we went five percent, 35 percent, to 75 percent. And that happens in other products. It's also happening in LCD monitors.

So as commodities become commoditized and very price sensitive and no longer had a leading edge, it makes sense economically to shift the production, and this is very consistent with the longer-term strategy for Taiwan of moving to an increasingly service-based economy and what Dr. Wang was saying. You do your R&D in Taiwan. You have your labor-intensive manufacturing on the mainland. And the markets are in North America.

Some people think of this as just a Taiwan, a cross-Straits story between Taiwan and China, but it deeply involves the United States and Europe and other advanced industrial economies, as well,

because the final markets for all these products, you know, \$142 billion of exports of communications and electronics and IT hardware, Taiwan can't absorb more than one or two percent of that. It's not big enough in terms of population, per capita income, et cetera.

So the markets have to be global. So you have this increasingly dynamic pattern of trade that involves not only Taiwan, but also to a considerable extent Southeast Asian countries, Korea and even Japan, where a lot of parts and components are going to the mainland for assembly and then the final goods are purchased in, let's say, North America and Europe.

And that's part of why you have increasingly a pattern of, say, Taiwan has a gigantic surplus in its trade with the mainland. The same thing is now true for Korea and perhaps it will eventually be true to a greater extent for Japan. And then China, of course, has a huge surplus in its trade with the United States because that's the biggest market for the final products and most of the parts and components are coming from other countries in Asia rather than the United States. So you have a triangular kind of pattern of trade, if you will, that involves basically the whole globe. It's not just a cross-Straits story.

So I think the economics of this are very compelling. China is a very efficient site for the assembly of a growing range of products, and if you look at the EMS companies, these assembly companies like Flextronics and so forth, they are building huge additional amounts of capacity in China to produce a very, very broad range of, you know, servers, computers, et cetera, et cetera. The list is endless. I think this is accelerating, not at a plateau.

DR. BUSH: Okay. Other questions? Anybody else?

I'd like to ask Dr. Wang a question, and the question is, what could the Taiwan government do more to create even a better environment for your company? You talked about the importance of IP protection. You talked about the importance of continuing to educate a very talented populous. Is there anything else?

DR. WANG: Again, put even more incentives in the area of capital investment, not just VC but a higher level for lower-risk companies and then companies will be into further stage. When you emphasize R&D for a company in Taiwan, the accounting laws still record all R&Ds as negative, as loss. And so they have to adjust or change, you know, somehow, that part for that R&D expenses to be recognized in some way not as—in [indiscernible].

And then also further need to encourage investment outside of Taiwan, and there is currently no restriction in Taiwan. Taiwan alone cannot make a successful biotech and pharmaceutical company, no way, because of the current political and other situation. If it ties closely with the U.S., for example, it will be a win-win situation, and so the government has to have a broader mind in terms of that and we're trying to ask them to think in that way. Think global, and that's key.

DR. BUSH: Okay. Thank you. We have time for one more question if anybody—Nadia?

MS. TSAO: Nadia Tsao with the Liberty Times. I have a question for Dr. Lardy. I know in your presentation, you didn't really endorse the theory of a hollowing out for Taiwan's industry to mainland China and we know that the present chain is facing a difficult problem, as you said, because the political and economic trains are going in opposite questions. So if you have an opportunity to give a suggestion, what would you suggest Taiwanese government to handle their economic policies towards China? Thank you.

DR. LARDY: Well, I think, quite frankly, the economic future of Taiwan will rely increasingly on manufacturing in the mainland, and if you look at the big successful Taiwanese companies, they are gaining global market share by moving to the mainland and taking advantage of the lower

cost there. This is very clear in notebook computers. The global market share of these companies has gone up significantly over the last three or four years as they have moved their operations to the mainland.

So these companies can get a larger global market share if they try to—if the government had implemented a policy of trying to force all this production to stay in Taiwan, these companies would have shrunk, and so I think what the government should be doing is facilitating the natural evolution of the economy to more R&D, service-oriented economy with the labor-intensive assembly activities moving offshore. That's what's happening in the United States and has happened over a period of decades and I think that's the inevitable trend for a successful long-term pattern of economic growth, and I think Taiwan's very well poised position, if you will, to follow that strategy.

I think the government has not facilitated that by and large. It's been happening to a considerable degree as a result of private sector decisions, but I think the government has to create an environment where there's complete freedom for these companies to move wherever they want to go, because that's how they're going to be globally competitive.

And you can see from the huge increase in exports of parts and components going to the mainland, Taiwan—from the point of view, you can't just look at the final product and say, okay, now 75 percent of the computers are made in the mainland instead of being made in Taiwan and that's hollowing out. It is true, if you look at Quanta or Compel, they have these gigantic factories that are turning out a million notebooks a month in a single facility. They're extraordinarily impressive.

But there's still a tremendous demand for the parts and components, so the long-term strategy has to be to allow the companies to move their operations and various aspects of their operations to wherever they can be most competitive globally, because there are lots of other firms out there that would like to take their market share.

DR. BUSH: Thank you very much Nick. Oh, one more question quickly?

AUDIENCE MEMBER: Your analogy of the U.S. evolution of the economy to that of Taiwan, does that suggest, then, that you see in the heavy industry side the same kind of erosion in Taiwan as occurred in the United States?

DR. LARDY: Say what you mean by heavy industry.

AUDIENCE MEMBER: Shipbuilding, steel, cars—

DR. LARDY: Well, I think in some of those sectors, there's been a lot of erosion already in Taiwan. Taiwan is not a very competitive producer of, say, automobiles, for example. But I think my basic point is the same. If you adopt policies that try to kind of freeze your industrial structure, I mean, think of what the U.S. economy would be today if we had tried to freeze the industrial structure the way it was a century ago or the way it was after World War II through various impediments to trade. We would have suffered enormous losses of real economic growth and welfare and living standards.

So I think the lesson is the same for Taiwan. If they become noncompetitive in certain areas, you have to gradually move out of those areas.

Now, I don't know enough about the competitive position of steel or shipbuilding, for example, in Taiwan, but clearly in—because there's more sophisticated technology involved in some of those sectors. But in the area of electronics, where the final stage assembly is relatively labor intensive,

I don't think Taiwan has an advantage, or if it has it, it's subject to very significant erosion over the last few years.

DR. BUSH: Okay. We're out of time. Thank you very much, Nick. Thank you, Dr. Chan. Thank you, Dr. Wang. I think you'll agree this was a terrific panel. The next panel is terrific, too, so don't go anywhere.

[Applause.]

[Break.]

PANEL II: POLITICAL AND SECURITY ISSUES

DR. GILL: We'll start our next session at this point, then. Let me again extend my warm appreciation to our co-organizers, the Center for Northeast Asian Policy Studies at the Brookings Institution, the U.S.-Taiwan Business Council, and the Foundation for International and Cross-Straits Studies. We are very grateful and it's been a wonderful collaboration. I want to thank all of you, as well, for taking your time today to join us for this important discussion.

In this next session, which will last through until lunch, we will be discussing political and security factors affecting the cross-Strait relationship, but especially in the context of the recent presidential elections in Taiwan and the prospects as we go forward with the next Chen administration for political insecurity questions.

* * * *

So without further ado, I do want to turn the floor over then immediately to Bonnie Glaser, a Senior Associate at the Center for Strategic and International Studies, a colleague there, and also a well-known and longtime consultant on East Asian security affairs.

MS. GLASER: Thank you, Bates, and thank you to our three sponsoring organizations for hosting this conference today, rather timely, although we have had many events and conferences on this subject over the last few weeks. As we get closer to the inauguration in Taiwan, there's obviously a lot of attention being paid to the security and the political implications of Taiwan's presidential elections, and that is what I will speak about today.

On the surface, it appears that China, Taiwan, and the United States all share basically the same objective of preserving the status quo in the Taiwan Strait. Of course, the PRC has a national objective of reunification, but I think it's really quite willing to be patient and accept the status quo, or at least of a de facto independent Taiwan, not a de jure independent Taiwan, for quite some time. And the people of Taiwan, as polls consistently show us, the vast majority favor the maintenance of the status quo.

And as President Bush reminded us all last December when he met with Wen Jiabao, he warned both China and Taiwan to not take unilateral steps to change the status quo. So the United States also favors maintaining the status quo.

Of course, the problem is that all three have different definitions of the status quo. Beijing insists that Taiwan is part of China and the legitimacy of its regime is closely intertwined with preventing Taiwan from gaining a juridical stature as a sovereign country.

Taipei, of course, views itself as an independent sovereign nation and is seeking to make that status irreversible, except by a referendum by the people on the island.

The United States has a one China policy, which we consistently differentiate from China's one China principle, and the U.S. insists the differences between the two sides of the Strait be worked

out peacefully less America be compelled to become involved militarily under its obligations stipulated in the Taiwan Relations Act.

Thus, the status quo is in dispute and it is unstable. The danger of military conflict is present and I would add that it may be increasing.

Since being reelected for a second term, President Chen Shui-bian has reaffirmed his pledge to hold a referendum in 2006 on a new constitution that would then later be enacted two years later in 2008. Washington is not likely to object to a new Taiwan constitution that promotes more effective governance, as long as it is formulated and adopted through legal mechanisms and does not seek to unilaterally resolve the dispute over sovereignty. So U.S. concerns include both process and content.

China, of course, as we, I think, have heard from many of us—I was just in Beijing last week and continued to hear concerns that are expressed by Chinese officials and experts, and continued opposition to the creation of a new constitution for Taiwan because it is viewed as breaking the continuity of the Republic of China and is viewed as representing the founding of a new Taiwanese state.

I would underscore the point that Beijing's red lines are not unalterable. They are changing. They really have always been fungible. So I would not take this as China's bottom line. I think that China might not react to the enactment of a new constitution, even one that is approved by a referendum of the people, if the preface and the articles one through six of the current constitution are left largely intact. I believe, indeed, that China's concerns focus more on content than process.

Or if convinced that the international community would not recognize Taiwan's existence as an independent sovereign state once that were enshrined in a new constitution, Beijing might choose to punish Taiwan through non-military means, but only if its leaders were confident that domestic stability would not be jeopardized and their rule would not be threatened, and I think those are important caveats.

Nonetheless, frustration on the mainland is rising with a policy toward Taiwan that many Chinese view as too soft, and China has indeed showed considerable restraint in the past year in the face of what it has viewed as repeated provocations, including, of course, the passage of the referendum law by Taiwan's legislature and then the holding of Taiwan's first referendum simultaneous with the recent presidential election.

But Beijing's relatively relaxed approach was premised on the expectation, I think, that Chen Shui-bian would be ousted and the Pan-Blue forces would come to power, and this would then restore a longstanding squabble over whether it is the ROC or the PRC that has sovereignty over Taiwan.

Chen's reelection for another four-year term has alarmed Beijing and it has stoked really a fierce debate in China over what mix of policies will prevent Taiwan from permanently severing its ties with the mainland.

I have found in my recent trip to China that voices favoring the use of military force to compel Taipei to halt its forward movement toward juridical independence are growing louder. Advocates of employing military power say that doing so is imperative to disprove Taiwan's claim that China is a paper tiger that doesn't dare to use force because it would risk all-out war with the United States.

Some Chinese even believe that there is sufficient concern in Washington about Chen's actions so far and about his future agenda that the United States might even acquiesce in a limited use of

force by the PLA, for example, to seize an offshore island, temporarily impose a limited blockade, or fire a lone missile at a military target on Taiwan. Some say that would have a sobering effect on Taipei's behavior and that, therefore, that would serve U.S. and Chinese interests.

Those in China who question the advisability of relying on military means to warn Taipei of the dangers of going too far may be losing ground in the debate in Beijing. I think proponents of using economic levers to attract Taiwan toward political integration with the mainland have lost credibility as cross-Strait trade has flourished but has failed to bridge the political divide. Even though over a half-million Taiwan businessmen have established residences on the mainland, this has not stemmed the growth of Taiwan consciousness.

Now that over half of Taiwan's electorate has cast votes in favor of President Chen, who ran his campaign primarily on an anti-China platform, there is growing doubt about the efficacy of pinning hopes on the people of Taiwan and on the Taiwan business community to preserve a political link with the Chinese motherland. Indeed, Beijing now worries that in the wake of its astonishing loss, the Pan-Blue opposition may splinter and lose its majority in the legislative year-end elections slated for December.

So as China's confidence in Taiwan's internal checks wane, these checks that might curb momentum toward a de jure independence, Beijing is increasingly looking toward the United States to rein in President Chen. The Chinese hope that Washington will not only pressure Taipei to back down from its plan to create a new constitution, they also seek really to create a broader understanding with the Bush administration on what steps by Taipei would constitute a provocation, and then if Taiwan were to take those steps, how the U.S. and China might respond separately or even jointly if those agreed-upon red lines were crossed.

So the question is, is Washington likely to cooperate with Beijing to avert a crisis in the Taiwan Strait, and I would say surely this will not be the Bush administration's preferred option. Siding with a communist country against a democracy would no doubt draw fire from Republicans and Democrats alike.

Although President Bush, I am sure, is quite peeved at President Chen for disregarding his calls last December to back down from the referendum and to move more judiciously, I think that Bush would probably find distasteful the notion of collaborating with the nation that he once termed America's strategic competitor against the 23 million people on Taiwan, whom he promised early in his Presidency that he would do whatever it took to help defend themselves against a mainland attack.

Instead, I see the United States pretty much working on its own, to some extent with other countries and specifically Japan, to compel Taiwan to refrain from actions that will further incite cross-Strait tensions. Washington expects Chen to enunciate a clear vision of Taiwan's future relationship with the mainland in his May 20 inaugural address and offer a road map for realizing that goal.

Rhetorically, the Bush administration is adopting a fairly even-handed approach that discourages both sides of the Strait from taking destabilizing actions to change the status quo while urging Beijing and Taipei to make positive gestures toward the other to create an atmosphere that is conducive to the resumption of cross-Strait dialogue.

But the message to Taiwan to cool it, I think has become clearer and louder in recent weeks. James Kelly in testimony to Congress a few weeks ago noted that it would be irresponsible for Taiwan to treat Chinese statements on the possible use of force as empty threats. He also noted that there are limits on what the United States will support as Taiwan considers changing its constitution. And Assistant Secretary Kelly called on President Chen to be responsible,

democratic, and restrained, and he reminded Taiwan that U.S. support is not a blank check to resist dialogue with the mainland, and I think these are very important and very clear statements.

Of course, while admonishing Taipei, the U.S. is simultaneously taking steps to reassure Beijing that it will oppose efforts by Taiwan to unilaterally sever the island from the mainland and reassuring China that it will not recognize Taiwan as an independent country.

At the same time, Washington regularly reiterates, publicly and privately, that the use of force under any circumstances by China will not be countenanced. U.S. officials are continuing to prod China to take steps to reduce its military threat to Taiwan, including a pullback or reduction of its more than 500 short-range ballistic missiles deployed on China's coast, and calls for implementing military confidence building measures to reduce the likelihood of miscalculation or misunderstanding leading to conflict, which has not been heard from U.S. officials, I think since the late '90s, are once again invoked.

The new hands-on approach to managing cross-Strait relations is a significant shift, I think, from the laissez-faire attitude that marked the first two-and-a-half years of the Bush administration's policy towards cross-Strait relation, and in my view, that shift is both welcome and necessary. The U.S. must be more actively engaged in preventive diplomacy in the Taiwan Strait. The stakes are high.

As U.S. forces continue to be mired in Iraq and Afghanistan and as U.S. policy makers are really fixated on Southwest Asia and on a global war on terrorism, Washington simply cannot afford a clash in the Taiwan Strait. Thank you.

DR. GILL: Thank you very much, Bonnie.

Let me just probe a little bit on some of the issue you have raised there very briefly, and then we will turn it over to Dr. Lin and Colonel Kamphausen.

We were just in China a brief time ago, and as is often the case during those sorts of visits, at least in more public settings, a lot of very clear messages and signals being delivered to us, I felt. Most strongly, I sensed a deepening sort of pessimism and an even disappointment and unhappiness on the Chinese part about the way this seemed to be devolving, in their view, with the Taiwan situation.

If you had an opportunity, though, to sort of try to paint the bright side of all of this, I mean, how would you structure the next five to six years in a way that would sort of reinstall confidence in our friends in China, maybe even strengthen the hand of those who look over the longer term and hope that through some form of economic integration a resolution can be achieved, or is it just nothing but bad news?

MS. GLASER: Well, I certainly don't think it's nothing but bad news, but it is obviously not completely up to the United States to reinforce that confidence that the Chinese have. It is really largely up to Taiwan, and I think that Taiwan is going to take those steps.

We will see the beginning of that effort on May 20 when Chen delivers his inaugural address and explains to the Taiwan people, first and foremost, and to the mainland and the United States and people around the world what the components are of his cross-Strait peace instability framework and perhaps explain certain red lines that he will not cross or reassure China that Taiwan does not have the intention of creating a juridical separate state and will not walk away from one China in its constitution, even though rhetorically they may continue to say that they are an independent and sovereign state.

And the United States has a role to play, as well. I think we have to be consistent in our policy. We have to try to speak, I think, a little bit more with one voice. That is always difficult for a democracy. But we have to state our interests quite clearly to both Taiwan and China.

I think we do have to play a more proactive role. I think that the Bush administration has done quite well in that regard over the last few months and I think will continue to pay more attention to this issue in the future and talk, I think, very bluntly, directly, to officials and counterparts in Beijing as well as in Taipei and hopefully begin the process of getting them to talk to each other, which is ultimately, I think, what is in the interests of both sides.

DR. GILL: There lies the solution. Thanks very much.

I am struck in today's discussions, I suppose, as we come day by day closer to May 20, the degree of sort of weight and expectations being placed upon President Chen's words on May 20. I fear, I fear to a degree and would love to be corrected, that we don't stake our expectations too high, but nevertheless, we can be hopeful, I think, that this will be, as you put it, a good step in the right direction when he does give that address.

But I think this is a perfect segue, then, to hear from one of our friends from Taiwan, Senior Advisor to the National Security Council of Taiwan. We are very grateful that you have taken time out of your busy schedule to fly all the way over to the United States and have an opportunity to share some views with us on this question. We look forward to your remarks, Dr. Lin.

DR. LIN: Thank you, Dr. Gill. I am very honored to have this opportunity to share with you my observations on cross-Strait relations. My job in the National Security Council is mainly to provide advice to the presidents on cross-Strait relations and sometimes foreign affairs. But before I make my presentation, I would like to emphasize that the points I make in my presentation are my own. They do not necessarily represent the position of National Security Council.

I think Taiwan and China have a very unique relationship. On the one hand, the two countries have very close economic ties and work in terms of people-to-people exchanges. Dr. Lardy already gave us a very clear picture about the close economic ties between the two sides of the Taiwan Strait. I will give you some examples of to U.S. trade, how close are the economic ties between the two sides of Taiwan's trade.

Two-way trade between the two sides of the Taiwan Strait amounts to more than U.S.\$50 billion. That is per year. And Taiwan's investment has accumulated to more than U.S.\$100 billion. The official figure provided by China is over U.S.\$65 billion. Unofficial estimates of the figure are more than U.S.\$100 billion.

Taiwan people have made more than 30 million trips to mainland China since 1987. I myself have contributed 12 times when I was allowed to make trips to mainland China. About 500,000 to 800,000 Taiwanese people live in the greater Shanghai area.

On the other hand, as everybody knows, there is no official contact between the two sides of the Taiwan Strait. Cross-Strait dialogue was unilaterally discontinued by China in 1995 to protest Lee Teng-hui's trip to the United States. Although we have urged again and again to resume cross-trade dialogues, China continues to turn a deaf ear to Taiwan.

The Taiwan Strait is regarded as one of the three flash points in Eastern Asia, so China has increased its military threat to Taiwan in recent years and China outlined three conditions to use force against Taiwan. Number one, if Taiwan declares independence. Number two, if foreign

powers intervene in Taiwanese affairs. And number three, if Taiwan rejects for a long period of time to negotiate for the unification with China.

Recently, China gave us another condition for the use of force against Taiwan. If domestic chaos occurs in Taiwan, China would not sit idly by. It implied that China might use force against Taiwan if domestic unrest develops in Taiwan.

China as a nation has increased its threat to Taiwan. More than 500 short-range missiles are deployed by China toward Taiwan, and according to a report by the Pentagon, the number increases by 75 every year. China's defense budget has increased every year by double-digits since 1989, except the last year, 2003.

And China has imported a lot of elements of weapons, many from Russia. Ninety percent of China's weapons are from Russia and ten percent are from Israel. Those imports of advanced weapons deployed in the southeast region and [indiscernible], are at least possible for military operations against Taiwan.

But I will argue that the possibility for China to use force against Taiwan is not high for two reasons. China wouldn't ruin the chance to develop its economy. And number two, China is still not strong enough to take over Taiwan by military means. And, of course, China will not be strong enough to challenge the United States for at least two decades.

But we cannot ignore the possibility that China might use force against Taiwan. We take China's threat very seriously. We've don't take as an empty paper. China's [indiscernible] export, we take very seriously.

Cross-Strait relations in the coming four years may still be deadlocked. President Chen's victory in the presidential election this year is another setback to China. China might still refuse to come to the negotiating table to talk with us in the coming four years. China will continue to isolate Taiwan in the international community. That is their strategy. And China will increase its military threat against Taiwan in the coming years.

But I will argue that cross-Strait relations in the future will be affected by three groups of factors. Number one, political and economic development in Taiwan. Number two, political and economic development in China. And number three, changes in international situation.

Taiwan has no intention to provoke China and we have no intention to change the status quo. But our definition of the status quo is that there is one country on each side of the Taiwan Strait. Taiwan is not a part of the People's Republic of China.

I think we have no attempt to cross the red line. Bonnie mentioned several times that Taiwan shouldn't cross China's redline and indicated concern about whether Taiwan would cross the red line or not. I think we have no intention to cross the red line. But I would like to remind everyone that we should not give China the privilege to define where the red line is. I think we should have dialogue between the two sides of the Taiwan Strait or to have a trilateral dialogue among the United States, Taiwan, and China to decide where is the red line.

Of course, we would like to write a new constitution in the future, but it has nothing to do with Taiwan independence. The purpose of the new constitution is to make the government more effective. President Chen has said again and again that a new constitution has nothing to do with Taiwan independence.

I think we are ready to negotiate with mainland China and President Chen has urged again and again that the two sides of the Taiwan Strait should sit down and talk. We have already amended

the law on people-to-people relations across the Taiwan Strait and now we can authorize and enter or to negotiate with China on Taiwan's behalf.

And recently, President Chen proposed to establish a peace and stability framework for cross-trade interactions to work on the following four issues. Number one, to establish a mechanism for the negotiation. And number two, to conduct the negotiation based on equality and reciprocity. And number three, to establish political relations between the two sides of the Taiwan Strait. And number four, to prevent any kind of military conflict in the Taiwan Strait.

I personally do not believe that China will come to the negotiating table in this year for two reasons. The first one, China is still upset by President Chen's victory in the presidential election in March.

Number two, we are going to have legislative elections in the end of this year and China has no intention to have President Chen to win these elections. So I personally believe that China will not sit down and talk with us in this year.

But I hope that China can make use of the opportunity next year. I personally believe there is a window of opportunity for the two sides of the Taiwan Strait to sit down and talk next year, and I hope that China can make use of this opportunity to talk with us next year. But, you know, it's up to China. But the international community can encourage China to talk with us. It will help the promotion of peace in the Taiwan Strait.

Thank you for your attention. Thank you.

DR. GILL: Thank you very much, Dr. Lin, for your remarks.

I was most intrigued by some of your comments towards the end in which you were trying to analyze precisely how the mainland might be reacting to the four-point set of proposals, if you will, for some reopening of dialogue. I think I would agree with you that over the course of this calendar year, it will be difficult to see any responsiveness for the reasons that you presented.

But I question still whether or not even following the legislative year-end elections, even if there is some sort of legislative defeat for President Chen, that this would open up the kind of ground that would allow—that the mainland would feel confident enough to work with the Chen administration.

I wonder if you wouldn't mind just taking a minute or two to explain a little more in detail why you think the mainland is prepared to accept this mechanism, say, in 2005, when it is pretty clear that there's been no responsiveness really for the past several years.

DR. LIN: Well, as I mentioned in my presentation, I said that it is up to China, whether China will come to negotiate with us or not, and I have reservations. I said maybe in the coming four years, there would be a deadlock in cross-Strait relations, but I hope that China can make use of this opportunity because in the past four years, Beijing declined to deal with the DPP government. They believe this trend is to promote economic integration between the two sides of the Taiwan Strait and they expect that, you know, this strategy can work and those economic information can steer over the critical areas.

But, you know, it proves that China's strategy is not effective because a result, you know, there is an increase of economic ties between the Taiwan Strait, but politically, Taiwan has moved further away from China. So, you know, China already wasted four years and China seems unclear whether they want to waste another four years or not. If they waste another four years, Taiwan might move further away politically. So China should think of that twice.

DR. GILL: Yes. I take your point. I think it is probably not a question of wasting four years, it is probably even a more narrow window than that, that China will want to take some measures one way or the other. So I think we can all be hopeful that the mechanism, the four points that you've suggested, could be even more sort of boldly outlined in the coming months in a way that would perhaps offer the kinds of incentives you'd like to see given to the mainland. But maybe in the questions and answers, we can probe a little even deeper on how that might be structured.

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I think given time considerations as we have about 15 more minutes or so, I'd like to be able to turn it open to the floor prior to lunch. So let me ask persons when they have their hands up to identify themselves, and maybe you could just wait for the person with the microphone also to come by so everyone can hear your remarks.

I recognize you, Chris, please.

Questions from the Audience

MR. NELSON: Chris Nelson, Nelson Report. Thanks very much. Interesting presentations. Bonnie, I really appreciate your paper, but I'm furious because you stole the theme I have been working on in my head for the last week and I should have written it, so there we go.

I think the concern many of us have in watching this dynamic is perhaps not even so much the rise of anger and frustration in Beijing and a sense of can we or can we not trust President Chen to be truly sensible about power realities versus emotional and political ones, but having watched the development of the role of ideology in this country, can we trust Taiwan's friends in this country to give Taiwan really sensible advice about what is doable and what is sustainable.

[Break between sides of recorded tape.]

MR. NELSON: --little theme I was playing with in my head last week was if Kerry is elected, the chances for war go up, not because of anything that Kerry will do but because people like Tom DeLay and Bill Kristol and others will feel absolutely free to not support the White House and to encourage Taiwan to formally declare independence, if you believe what they say, if you take it at face value.

I'm wondering if it would be useful to talk a little bit about the role of Congress and Taiwan's friends over the next few years, given the concerns that we've raised today.

MS. GLASER: Well, that was a mouthful, Chris. I think domestic politics are important in all three of these capitals that we are talking about. At least we can say that domestic politics in our country are extremely transparent, and I would say that to be true in Taiwan, as well.

In fact, I think one of the perhaps uncertain factors is what is going on in terms of domestic politics in the leadership in China. We really do—we do not know to what extent there are differences between Jiang and Hu on policy toward Taiwan or as the transition takes place and Hu Jintao is on firmer footing than he is today, whether China will move toward a tougher or more moderate policy toward Taiwan. So that is one of the really uncertain factors.

But in terms of domestic politics in the United States, I think it is certainly an important factor. Right now, we have a Republican President and a Republican-controlled Congress. The latter seem to be somewhat restrained, unwilling to really confront the President, although there are individuals who have voiced some different points of view. But we have not really had a major split at all between the President and the Congress on this issue, and as you point out, that could become more visible if we have a Democratic President.

But I would leave it up to the president of Taiwan in that case to still make the correct decision as to what is in Taiwan's best national interest. There are always various voices in the United States. We speak through Congress and the President and sometimes even people in the administration have different points of view, and then we have lots of people in think tanks. But I think that our friends in Taiwan are smart enough to be able to know what the really right message is that's coming from the President. They should listen to the other messages and ultimately draw for themselves the conclusion of what is in the best interests of the people of Taiwan.

DR. GILL: Thank you very much, Bonnie.

Yes, sir, please.

MR. WANG: Vincent Wang, University of Richmond. I'd like to ask a question about the issue of the declining Taiwan defense budget. Many analysts have talked about this. The prevailing explanation seems to be that Taiwan is not serious about its own defense and is willing to free ride on the United States.

I'd like to invite some alternative hypotheses, maybe. One is that if you look at the percentage of defense budget on GNP, it has declined. But, of course, in 1950, 90 percent of the central government budget was allocated toward defense and Taiwan at that time had a per capita GNP of \$50. Today, Taiwan has a per capita GNP of over \$14,000. So the pie has expanded. I haven't looked, but I think that the absolute number has increased, but the relative share has declined. So this is an issue about different numbers to look at.

Alternative hypothesis number two is as Taiwan is becoming more and more a welfare state, we have this classic debate between gun and butter. Taiwan, by the way, has a universal health care system and this country doesn't. So as the country is devoting—it's devoting more and more money toward educational health care expenses rather than toward guns, whether we should also consider that.

Three, there is a cliché. Defense is much more expensive than offense, probably nine times as expensive for missile defense, which still is an unproven technology. One reason Taiwan is facing this budgetary shortfall is because the money needed for effective defense against PRC-preferred weapons of coercion, namely missiles, have skyrocketed. So I wonder if there's any way that Taiwan can actually keep up with this arms race.

In this context, the proverbial cliché that the best defense is actually offense and whether Taiwan should consider some—in order to make the deterrence more credible, whether Taiwan should consider more—some offensive options.

DR. GILL: I might just make a couple of quick comments in response to that, if I may. On the first set of questions, you raise some interesting hypotheses and I understand that those are strong arguments in Taiwan on these issues and I think they do make some sense.

The one place I might differ with you, and it would be interesting, maybe at another time we could have a longer conversation on this, is that those hypotheses appear to dwell largely on the question of hardware acquisition. They tend to be the most high-profile. They seem to be the most expensive, and they certainly grab the most headlines, and so it's understandable why a lot of attention would be attracted to building one's defense on the basis of hardware and weapons acquisition.

But I think it's the case, and I would invite others here on the panel to respond, as well, that where there are very, very serious issues regarding Taiwan's defense have nothing to do with hardware and have a lot to do with the way the military is organized, issues you might want to call software questions, and I think we heard some remarks on that earlier. Those aren't as

expensive, presumably, difficult to implement perhaps, but maybe that's just an indicator of just how important they truly are.

In that sense, without massive expenditure in the several tens of billions, you can probably get some significant improvement in Taiwan's defense capacity through these other software and organizational reforms. I think that's one reason why the United States is so interested in devoting as much time as they have in trying to get that side of the Taiwan defensive house in order.

Would anyone else want to chime in on these questions at all?

DR. LIN: Of course, we always are facing criticism from American friends is that our defense budget decreased in recent years. Of course, President Chen already announced we are going to allocate a special budget about \$20 billion U.S. to purchase weapons from the United States. But Taiwan is a democratic country already. We need to get the support of the opposition party in congress. So sometimes it takes time. The process might be very slow because the opposition party is a minority party in the congress. So it takes time to persuade the opposition that is there to support the government to increase the defense budget.

But in recent years, of course, we try to restructure the [indiscernible], but as everybody knows, the ministry is right across organization, you know, is [indiscernible] organization. It is a cause [indiscernible] transitions. It takes time to change it. The culture or transition [indiscernible] is good or not. It takes time.

But I think we are going in the right direction to reform our defense and our ministry. Thank you.

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DR. GILL: The lady behind you, Phil, and then we will go to you, Phil.

MS. WEI: Thanks, Dr. Gill. Wei Jing from Phoenix TV of Hong Kong.

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The gentleman beside you, Mr. Advisor, has just said—

DR. GILL: Dr. Lin.

MS. WEI: Sorry. The definition for Taiwan's status quo is one country on each side. He just said that rather clearly. Is that in line really with your commitment to the three communiqués in which you said Taiwan is part of China? Thank you.

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DR. LIN: I said that Taiwan's definition of the status quo is that there is one country on both sides of the Taiwan Strait and Taiwan is not a part of the People's Republic of China. I use the People's Republic of China because the People's Republic of China was established in 1949 and the Beijing regime has never governed Taiwan in the past five decades and so we don't think that Taiwan is a part of the People's Republic of China.

But in the three communiqués, the United States only recognizes that the people on both sides of the Taiwan Strait argue that there is only one China and Taiwan is a part of China. The United States does not recognize that Taiwan is a part of China. We have discussions with American scholars about what is the status quo, because [indiscernible] to carry means that the status quo [indiscernible] defined, as the United States has defined it.

We would debate what the space is called. Americans [indiscernible] means that the status quo by the United States that Taiwan's state is undetermined. So I simply note every party here has

their own definition of the status quo. Of course, China has its own definition. China's definition is that Taiwan is a part of China.

President Chen made his statement in August of 2002 that there is one country on each side of the Taiwan Strait. But maybe because we have special ties between the two sides of Taiwan Strait, as President Lee mentioned in 1999, we can have a special relationship with mainland China. Actually, we have special relations with mainland China.

So we have our own definition. Of course, the United States has its own definition. So that's why I said maybe we can have discussions. Our position is that one China should be an issue for discussion, not be a precondition for negotiation. Thank you.

DR. GILL: Thanks very much, Dr. Lin.

Phil, did you want to raise a question?

MR. SAUNDERS: Sure. Phil Saunders, National Defense University. This is a question for both Bonnie Glaser and Dr. Lin. Of course, for President Chen, the legislative elections are absolutely critical. He has not had a working majority in the LY for his last four years. He needs that to make progress on both a domestic and an international agenda.

But given the kind of campaign that was run in the presidential election, which Bonnie characterized, or I'll characterize it as a fairly divisive one run on the issue of who loves Taiwan more and who will stand up to China, given those domestic political incentives, how is that going to affect those electoral incentives, the need to try to get a working majority? How is that likely to affect President Chen's policies toward the mainland, which seem to me to be run—likely to reflect those electoral imperatives? So I would like both of you to address that question.

MS. GLASER: I would say in general, the kind of issues that people vote on in local elections in Taiwan are really quite different from those that are prominent in the presidential campaign. I would doubt if there would be many candidates at the local level who are going to be putting at the forefront of their campaign issues of what kind of future relationship Taiwan would have with China. So I just don't think that they are going to be that prominent.

But having said that, what we have, of course, is the fallout from what you accurately describe as a divisive, rather rancorous election campaign outcome than followed by charges by the opposition that the election was not fair, and indeed, I believe the recount is going to begin on May 10.

And so there the aftermath, I think, will continue to affect the ability of, on the one hand, President Chen to bring about some kind of national unity, and on the other hand, the ability of perhaps the Pan-Blue forces to work together in order to run the right number of candidates so that they can be successful in their elections, because I think, indeed, the Pan-Blue forces need to move, of course, assuming that the recount does reconfirm the election results, that they need to move away from now the presidential election and the opposition in the whole judicial process toward now paying their attention, shifting their focus to the local elections, which I agree with you will be very important in determining what President Chen and the DPP are going to be able to accomplish in the next four years on the islands in terms of political reform and economic reform and improving, you know, just basic good governance on the island, not to mention, obviously, the effort to pass a new constitution.

DR. GILL: Thanks. Dr. Lin, would you like to make some comments?

DR. LIN: I think, as I mentioned, domestic politics always affects our policy toward mainland China, and President [indiscernible] was that he got them in there this year because he got 50.1

percent of the popular vote in the elections. It's a majority of the board that supported President Chen.

But when we make a decision in Taiwan, we are all realists. We cannot be true believers. We cannot be idealists. We need to take into consideration the concerns of the United States, the concerns of the PRC. Of course, President Chen is really a pragmatic person. He is waiting to compromise. He realizes his duty as the president of 23 million people in Taiwan and he needs to make Taiwan a more secure country. We understand our obligations as a member in the international community, that we have the obligation to maintain peace and stability in the Taiwan Strait.

President Chen, of course, you know, is a person who is for Taiwanese independence. But when it comes to reality, he needed to compromise, and so I think that's why he urged again and again that we would like to have dialogue with mainland China and again and again that he's not going to declare independence or to write a new constitution is nothing to do with Taiwan's independence.

That is the reality. We realize what the reality is and we are waiting for compromise. Thank you.

DR. GILL: Thanks, Dr. Lin. We have time for one more question and then we'll break for lunch. Sheldon?

MR. RAY: Sheldon Ray, UBS. How much do the Hong Kong political developments impact the situation over the next, say, five years?

DR. GILL: Bonnie, do you care to speak to that, or—why don't you make a quick comment and I'll ask Dr. Lin.

MS. GLASER: I think it's hard to say. I mean, to some extent, people in Taiwan watch developments in Hong Kong quite closely. It is a lesson, I think, that most people in Taiwan have drawn that one country, two systems wasn't right for Taiwan anyway, but recent developments in Hong Kong really confirm for the people in Taiwan that this is not a model.

I think the implications of what transpire in Hong Kong, perhaps they have the greatest implication for China and the way that the world views China and how it's going to manage its future relations, how it's going to manage its own people, its relationship with Hong Kong, certainly its relationship with Hong Kong.

But if Hong Kong goes well, I'm not so sure that that necessarily has positive implications for Taiwan. I think Taiwan will emphasize that it's different from Hong Kong and I'm not so sure that the people of Taiwan will look to the Hong Kong model and say, well, things are going well. We want the same thing. I think that the Taiwan people have kind of a different set of concerns and demands. So I think it would have more of an impact on the negative side, in my view, than it would have on the positive side.

DR. GILL: Thank you, Bonnie, and Dr. Lin, would you care to chime in on this?

DR. LIN: Yes. As Bonnie mentioned, Taiwan watches very carefully what happens in Hong Kong. My job in the National Security Council includes the study of Hong Kong. Our observation is that China has already given up one country two systems in Hong Kong. China now emphasizes only one country because China already suggests that Hong Kong can never have a real democracy. China cannot allow the Hong Kong to become a [indiscernible] city. China can only allow the Hong Kong to be an economic city.

The practice of one country, two systems in Hong Kong is used as a model to encourage Taiwan to accept this model for unification. But China's policy toward Hong Kong recently has shown that

one country, two systems model cannot work in Hong Kong and it cannot work in Taiwan, either. It strengthened our position to reject the one country, two systems model for unification between the two sides of the Taiwan Strait. Thank you.

DR. GILL: I might have just a slightly different take on that. I think the one country, two systems does work in Hong Kong. Hong Kong is clearly a different place than mainland China, but it's not a model to be applied, and as soon as we can, while paying our respects to the great Deng Xiaoping, set aside this notion of one country, two systems and think of something more grand and flexible, the sooner we can do that, the better off I think we'll all be.

Just one more administrative remark. I'm going to come off the dais and no one in the press is going to want to talk to me because I've obviously been so difficult with them already. But just two more requests for of all of you. Recall our ground rules on the off-the-record remarks which have been made today.

And secondly, we are pleased to be as over-subscribed as we are today for our lunch and we look forward to that very much. We have to ask that those who are sort of non-press participants, those persons who are here in their capacity as observers and listeners and participants, we ask them to be allowed to take their place at lunch first and then we'll have to see. We hope we'll have room for the press, but I don't think we necessarily will. In any event, I'm sure you are all so busy you have to run back and file your reports.

[Laughter.]

DR. GILL: With that, I hope you'll join me, please, in thanking today's speakers.

[Applause.]

DR. GILL: Our lunch is in the next room. Just pass out and go right to the next room over here. Thank you very much.

[Luncheon recess.]

LUNCHEON KEYNOTE ADDRESS

MR. HAMMOND-CHAMBERS: Ladies and gentlemen, if I could have your attention, please. Ladies and gentlemen—thank you all very much, indeed.

We've had a very successful morning, I believe, and to round it all off, we're going to come back to the economic relationship, one which I believe doesn't get as quite a robust a profile here in Washington, D.C., in respect to Taiwan, given the focus on political-military matters, and yet clearly a very significant dynamic in the U.S.-Taiwan relationship. Taiwan is a very significant trading partner for us and that belies its importance in the global supply chain, particularly in technology.

With all that said and done, over the last 16 to 18 months, we've had some challenging times in U.S.-Taiwan economic relations and find ourselves with a number of bilateral economic issues that our trade negotiators have—America's trade negotiators have been in discussions with their counterparts in Taiwan from the Board of Foreign Trade and the Ministry of Economic Affairs dealing with issues such as intellectual property rights, market access for rice, pharmaceuticals, and telecom services.

As President Chen enters his second term, he has a new economic team shaping up at the moment and a resurgent hope here in the United States that this will result in the resolution of these outstanding issues and the return to a more forward-looking economic relationship.



Here to make sense of all of this is Assistant United States Trade Representative for China, Taiwan, Hong Kong, Macao, and Mongolia, Charles Freeman. Ladies and gentlemen, Charles Freeman.

[Applause.]

MR. FREEMAN: Thank you for that. It's a real pleasure to be here today, and a pleasure to actually be talking about Taiwan for a change. I spent the last I don't know how many months focused on another economy in my portfolio and so it's great to actually be addressing issues that are very close to my heart.

Let me first thank CSIS and the U.S.-Taiwan Business Council. I do want to say, for those that don't realize it, the Council has a tremendous asset in Rupert, and he's not just an asset for the Council, he's really an asset for U.S.-Taiwan relations. He is dogged in his pursuit of interests of the relationship, not only economic but otherwise, and I just can't say enough about what a great job he does for all of you.

[Applause.]

MR. FREEMAN: And the bill is in the mail.

[Laughter.]

MR. FREEMAN: Let me just say with respect to U.S.-Taiwan relations, I think the last time someone from our office addressed this issue was in 2002, and as I was putting my remarks together, I looked at her remarks. I'm referring to Wendy Cutler, at that time the Assistant USTR for North Asia and my boss until a couple of weeks ago. I was going through the notes that she put together for those remarks and I was trying to find something new and creative and interesting and different to say, and I really, unfortunately, had a hard time finding it.

That's, I think, really kind of the really difficult thing about the U.S.-Taiwan economic relationship, is that many of the issues on which we all spend so much time have been the same for the past five, six, maybe more, years. And really, I think there's a great interest, at least within the U.S. government, the administration, in trying to move the relationship forward. And we've, frankly, been scratching our heads and trying to make a go of this and figure out what we can do to push the relationship in an appropriately forward-looking way, and it hasn't been easy. It hasn't been easy.

If you look at the issues, and Rupert has ticked them off, you know, IPR, pharmaceuticals, telecom, and rice, these are not difficult issues to solve except that they impact some very important constituencies in Taiwan, and unfortunately, they impact some very important constituencies here in the United States.

It's very difficult for us at USTR, and frankly, for the U.S. government. Our constituencies are, frankly, the business interests. They really drive the agenda for us. We are not driven by political or other issues at all. So for us, really what we're looking at is are the business constituents, are they interested in moving the ball forward, as it were? Are they interested in pushing us towards a closer relationship? And right now, frankly, there is not that interest.

On the IPR side, we spent a lot of time agonizing over the last few months about our Special 301 decision. We have a decision which is due every April 30 or so looking at the intellectual property rights enforcement in various economies, and a lot of us have been really anxious to move Taiwan off of an area that Taiwan doesn't belong, frankly, for economic reasons. That's the priority watch list.

Taiwan is too important an economy, too advanced an economy, too mature an economy to be on the priority watch list. Yet the level of IPR piracy and counterfeiting in Taiwan is absolutely rampant, and it's very difficult for us as a government to tell our industries, who put Taiwan as one of the top priorities to change as an IPR, or as an IPR problem, it's very difficult for us to say, no, no, no. We want to help move them away from this, or we need to find some way to get them off the priority watch list.

That said, let me say a couple things about IPR in Taiwan. We know how hard the government has worked to change IPR enforcement patterns and levels and we cannot say enough good things about the work that the Intellectual Property Office has done to really make some really quite dramatic improvements in the level of attention to IPR problems.

We still have some work to do, and I think, ultimately, with respect to some of the key issues that our business constituents see as really problematic, and we can't but agree, there has to be some movement on the legislative side and we really need to see some final copyright legislation that actually is effective.

Right now, the level of enforcement activities in Taiwan is quite—is really, on one level, very impressive. On the other hand, pirates and counterfeiters and, frankly, the Taiwanese people are extraordinarily resourceful and have discovered a few ways around the enforcement patterns in ways that really has made the business losses in Taiwan due to IPR piracy to be, frankly, unacceptable.

So again, I mean, as someone who's studied Taiwan's economy and who has spent a certain amount of time in Taiwan, it is frustrating, and I'm sure it's frustrating for many of you who know how advanced Taiwan is and how important to Taiwan, how the continued high-tech development and the creative industries and innovation is to its economic advancement, why the intellectual property is still such a major problem. It's not in the interests of the Taiwanese people for the level of piracy and counterfeiting to be as high as it is, and really, ultimately, it is a question of political will and that's what it comes down to.

There are some other issues. We can talk about them, and I will be happy to answer questions with respect to them on the pharmaceuticals, telecom, and rice. They tend to be fairly technical in nature, and for those of you that aren't trade policy fanatics, I won't bore you with them.

But I will say with respect to some of the moves forward that we've seen on the Taiwan side in response to, I think, a real give and take between the two governments, we think that we're just about ready to try to reconvene what we've sort of been putting off for a while. We have a trade investment framework agreement with Taiwan under which we're supposed to have trade negotiations of some level and we think, I think, that we're at the point now where we'd like to press ahead and have a high-level team go to Taiwan to reconvene those talks, I think largely because the areas that we need to finish on IPR, pharmaceuticals, and the other issues, we really need to get that final push to get it done, we believe, and I hope we'll be successful.

I think before we do send someone out, I'm looking forward—I just started this new hat a couple weeks ago and I haven't been to Taiwan in a couple of years, so my first order of business was to start booking tickets to Taipei and I'm looking forward to going, hopefully at some point next month, which, if anybody will see me there, would be great, and to start planning for, I think, what should be a continued robust engagement between our two sides to start nailing down these issues.

On some other areas, I know that I can respond to questions about some of the cross-Straits issues that might be coming up. Certainly, it's a factor in the relationship and certainly it's become a factor in Geneva, whether we like it or not. The cross-Straits relationship has become

a complicating issue recently. We know that Taiwan sought to become a third party in a WTO dispute that we have ongoing with China and was denied for a couple of times.

We certainly hope, and I think one of the main reasons that we wanted to get Taiwan and China into the WTO at the same time was that we thought that this would be a really powerful arena for the two sides to come together to discuss substance, and the fact that issues of politics have intervened and are playing a part in the WTO is really unfortunate.

The WTO is not a group of sovereign countries discussing issues of politics. It's a group of economies discussing issues of economic substance. And the fact that these issues that have nothing to do with WTO are a major issue in Geneva is a source of great frustration to the United States government.

That said, I will be happy to take questions. I probably am forgetting something, but since I am talking off the cuff largely—

Questions from the Audience

DR. MIGNONNE CHAN: Regarding the IP issue that you just mentioned earlier, last year, I was supposed to meet with Mr. Vincent Siew on the mission here to the U.S. My understanding is that it is not the fact that we don't have the political will to pursue the FTA. On the other hand, the feeling is that the high threshold that was established in terms of setting the issue, the unresolved issue, as a precondition to discuss FTA is very different from being part and parcel of the content of FTA negotiations.

So with that, I would submit for your response. Thank you.

MR. FREEMAN: That's sort of like the question, when did I stop beating my wife?

[Laughter.]

MR. FREEMAN: There have been no preconditions to FTA discussions. In fact, the FTA concept has been floated but never formally raised by either government. So there is no precondition set on discussions of that.

We have had a series of meetings under the Trade Investment Framework Agreement, which have been, frankly, frustrating and haven't gone very far. The issue for us is we've taken this as far—some of the issues that we've been discussing—as far as we can, and unless there's some willingness to make some changes and to follow through on some of the commitments that Taiwan has made, there really hasn't been a great desire in the government to move forward with the TIFA talks, which is very different, as you know, from FTA talks.

Again, we think that there have been some very positive movements and we certainly are looking now at exploring reconvening the TIFA discussions. But again, the relationship of those discussions to broader or closer economic relations is yet to be determined.

I didn't realize my friends from the press are here.

MR. KASPEROWICZ: You should have known better than that. Pete Kasperowicz from "Inside U.S. Trade." Some of the business, representatives of the business community have said it's really important to get an FTA with Taiwan because China's busy trying to isolate Taiwan economically and if we don't move quickly, then I guess China can succeed.

MR. FREEMAN: Is that the U.S. business community or the Taiwanese-

MR. KASPEROWICZ: Yes, U.S. business, yes.

MR. FREEMAN: Do you have names, because they haven't come to me with that.

MR. KASPEROWICZ: I'll point them out later when there's mingling.

MR. FREEMAN: Raise your hands.

[Laughter.]

MR. KASPEROWICZ: Is that a real tension in your office, and if so, is that an idea that you float with Taiwan officials, and if so, again, how do they react to that? Is that—

MR. FREEMAN: I'm sorry, can you clarify? You're saying that—say it again.

MR. KASPEROWICZ: If it's a real priority of the U.S. business community to pressure you guys to get an FTA done, how does that translate? Do you go to Taiwan and say, you have to help us—

MR. FREEMAN: Well—

MR. KASPEROWICZ: --outstanding issues because then the door is open and we can do an FTA and it's over.

MR. FREEMAN: In the last two years, there has been not one U.S. business group that has come to me with any pressure to do a Taiwan FTA, not one. So if people want to come and discuss anything with me, my door is generally open.

People say—people have a lot of reasons why we haven't pursued an FTA and there's a lot of rumor and innuendo out there. People say, well, you know, there's that elephant across the Strait and there's no way that politically—that's nonsense. I mean, we have a very strong and separate economic relationship with Taiwan. We have a very strong and separate economic relationship with the mainland.

Politics doesn't enter into the discussions on the economic side, and we keep those two sides very separate. So there's a significant amount of rumor about why we haven't done something. I will tell you, the reason that we have not begun these negotiations, aside from the fact that we have limited resources at USTR, is that the U.S. business community and the constituencies that would really ultimately need to support an FTA through Congress have not been supportive, and in fact, quite the opposite.

I have had people from the business community come in and specifically say, don't pursue an FTA with Taiwan, not because of concerns about across the Strait, but because of concerns within Taiwan.

MR. Rugaber: Hi. Chris Rugaber, BNA Publications. Just a quick follow-up on your comments about reconvening the TIFA and so forth. I mean, can you update us on some of the progress that Taiwan has made that has led to this decision?

MR. FREEMAN: Sure. I mean, I think largely, we recognize there's a difference between the standards that with which we're looking at the Special 301 and that which we're looking at the TIFA discussions, and I think some of the movements on IPR on the enforcement side and particularly some of the really strong work of the Intellectual Property Office and the BOFT really does suggest that there is a good reason to try to close the gap between what we see as optimal IPR enforcement and the current largely unacceptable level of enforcement.

There has been movement on some other areas, whether it's telecom and pharmaceuticals, and certainly we sell an awful lot of rice to Taiwan, so there are reasons to keep going.

MR. FU: I'm Norman Fu with the China Times. Mr. Freeman, you referred to the fact the cross-Strait relationship has affected the working relationship between the Taiwan delegation and the mainland Chinese delegation within the WTO. I know for a fact that China has been trying to

downgrade the status of the Taiwan office in the WTO. I don't know if this issue has been resolved yet, but the Secretary General of WTO has been under intense pressure from Beijing to downgrade the status of the representative Taiwan office and they don't want Taiwan to use— apparently, they use the word “mission” instead of the office or something.

I think you must be privy to this thing. Can you share with us some of the inside stories that you know about?

MR. FREEMAN: At the end of the day, this is an issue for the parties that are directly involved to resolve with the WTO. I will say that one of the reasons that we are particularly frustrated about this issue is that this issue, the question of how the office, Taiwan's office in Geneva will be designated has interrupted the publication of the WTO phone book for some six months. It's a laughing matter, but it is a major source of frustration in Geneva because there are all these new faces at the WTO and nobody knows how to reach them or who they are.

I think, ultimately, believe it or not, that's what the issue is about - how the Taiwan office's representation in Geneva will be designated within this phone book, and I don't think it's more than that. And this doesn't seem to me to be much of an issue that the United States or others should really be actively engaged in. This seems to me a fairly simple issue that the two sides should work out.

AUDIENCE MEMBER: [Inaudible.]

MR. FREEMAN: Well, I mean—

AUDIENCE MEMBER: [Inaudible.]

MR. FREEMAN: Here's the issue. The issue is whether or not the use of certain terminologies, certain nomenclature, conveys sovereignty, and the issue is whether or not the use of the term “permanent mission” conveys a notion of sovereignty.

As the U.S. has made clear to the WTO and to all those concerned, sovereignty issues, as I've said before, have no place in the WTO. I mean, we could call ourselves the “Empire of the Moon,” the “United States Delegation from the Moon.” It wouldn't mean anything because the notion of sovereignty doesn't have any designation, or any utility in the WTO context. So we think this is a non-issue and we wish both sides would grow up, ultimately.

AUDIENCE MEMBER: [Inaudible.]

[Laughter.]

MR. FREEMAN: The United States is delighted to deal with our Taiwan friends in Geneva whether they call themselves mission, permanent mission, representative office, Office of the Planet of Taiwan. It doesn't really matter to us.

[Laughter.]

MR. FREEMAN: This is a substantive dialogue, a substantive body. This is not about politics, and that's the maddening thing. And that's exactly what we were trying to avoid by bringing China and Taiwan into the WTO at the same time, to avoid this nonsense.

AUDIENCE MEMBER: [Inaudible.]

MR. FREEMAN: I'm not telling you what my portfolio is, either.

[Laughter.]

MR. FREEMAN: I am not qualified to answer that question and that's probably—there are people in Wall Street who get paid a lot more than I do to answer that question.

AUDIENCE MEMBER: [Inaudible.]

MR. FREEMAN: Probably not. As you can probably tell, I'm not exactly politically correct and I'm probably going to get in some trouble. But I will say that, you know, the election was fascinating to watch and I think a lot of us, up until some of the dramatic events at the end, really enjoyed watching it.

I used to work at one point for Senator Murkowski from Alaska, who is now the Governor, and he called me last night. He's on his way to take part in the inauguration on the 20th and he asked me what I should say and I said, say "Ni hao."

So the election as an economic issue, as far as the U.S.-Taiwan trade relationship, has not been a major thing, as far as I can tell.

MR. CHENG: T.J. Cheng from William and Mary. Would you care to compare Taiwan with South Korea or Mexico or other countries regarding the enforcing of the IPR provisions? I know that China is probably not a good benchmark, but other countries probably are.

MR. FREEMAN: The problem that we have is when we hear from our constituents about their biggest concerns, they tend to say China, Taiwan, et cetera. I mean, and so again, the notion that China and Taiwan, as far as intellectual property protection are even in the same sentence, is absolutely scandalous. It's absolutely unacceptable. I mean, Taiwan is so much more advanced in terms of its structure than China, the fact that this is even on the same page with China is maddening.

I'm not really qualified to compare Taiwan with South Korea in terms of intellectual property enforcement or Mexico. I will say that it's high time that Taiwan take the next step and really advance the process.

MR. LIN: Oliver Lin with the Central News Agency from Taiwan. I would like to make a follow-up question on FTA. You mentioned that the question or the problem lies within Taiwan. Could you elaborate on—

MR. FREEMAN: No, I—

MR. LIN: --IPR issue or others?

MR. FREEMAN: Let me say this. The issue of an FTA with Taiwan has never been formally raised. There is no notional FTA with Taiwan. The U.S. side would like very much to advance our economic relationship with Taiwan. We have some preliminary steps that we need to get through in order to do that. We would like to begin discussing some of our current trade issues under the Trade Investment Framework Agreement. I think for right now, that's enough. We need to take that step before we talk about the broader issues.

Rupert, how much time do I have? Okay. Last question?

MS. TSAO: Nadia Tsao with the Liberty Times. Just for a reporter, I'm interested to know, when you mentioned a high-level delegation is going to Taiwan, can you tell us what kind of level would that be? And also, you mentioned—

MR. FREEMAN: Nadia, I'm going to interrupt you because I always get in trouble with the Taiwan press when I say—I mentioned a high-level delegation. We are thinking about that. We'd like to take some steps. I would like to go to Taiwan as early as next month to see whether a high-level

delegation makes some sense. That's where we are. So I hope I'm not going to read in the Liberty Times that a high-level delegation is on its way to Taiwan because we're not there yet.

MS. TSAO: No, yes, so that's—

MR. FREEMAN: I'll get in trouble, so—

MS. TSAO: That's what I want to confirm with you. You're thinking about it, right? It's not formally proposed or somebody's not—you don't have—

MR. FREEMAN: We've been talking for some time about the need to reconvene the TIFA. We believe that some of the steps that Taiwan has made have been very encouraging. We would like to take the next steps. We will go see—I mean, I would like to personally go see whether those next steps, in other words, a high-level discussion, high-level delegation, make logical and substantive sense. If there is something to discuss, something substantive to discuss, I will certainly recommend that a high-level delegation take place.

MS. TSAO: My question is that you mentioned the basic problem between the U.S. and Taiwan in the past five or eight years still remain the same and you didn't really see progress. Can you tell us, what's the key points from your perspective, what Taiwan needs to do? We talk about rice, pharmaceutical, and IPR, the same question again and again.

MR. FREEMAN: I'm not going to go through the technical issues with what Taiwan has to do. I will say if somebody from TECRO was here, they probably can tell me, Jason or Francis, you can say better than I can what the U.S. and Taiwan sides have been discussing for many years.

But roughly speaking, we've had similar issues with respect to IPR, rice trade, telecom and pharmaceuticals, and all of these are, on the face of it, minor irritants. The fact of the matter is these are major economic concerns of the United States and really have been a tremendous impediment to the economic dialogue.

So we think—we really believe—that the Taiwan side has made some important progress and we'd like to take the next steps. We'll see where we go. Thanks.

[Applause.]

MR. HAMMOND-CHAMBERS: Well, thank you all very, very much indeed for joining us today. I do hope you felt it was valuable, and I thank you again, Charles, for joining us and we look forward to seeing you at any one of CSIS, Brookings, or Council events in the future. Good day.

[The proceedings were adjourned.]