

Tackling Cross-Strait Paradox: Economic Dependence, Foreign Policy, and Domestic Split

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This study addresses “Asia’s paradox,” where deepening economic interdependence has not led to sustained political harmony in East Asia. It argues that domestic splits, non-violent conflicts between antagonized social groups with significant political and economic power, can disrupt the pacifying effect of economic dependence. Using an in-depth case study of Taiwan’s relations with the People’s Republic of China from the late 1980s to the late 2000s, this paper underscores the limitations of economic constraints on political relations across the Taiwan Strait, suggesting that despite economic interdependence, individuals’ political preferences may be swayed when identity agendas emerge at the center of politics. This research predicts that Beijing’s recent utilization of economic coercion for political purposes is likely to prove counterproductive, as it can provoke nationalist sentiments among the target country’s population and neutralize China’s economic leverages. For the same reason, the U.S.-ROK alliance won’t be hindered by South Korea’s economic ties with China.

Keywords: Asia’s Paradox, Cross-Strait relations, economic coercion, the capitalist peace, ethnic cleavages

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Introduction

At the end of the eighteenth century, Immanuel Kant argued that the power of money impels states to try to avert war.¹ Since then, the proposition that economic dependence results in a conciliatory foreign policy, also known as the capitalist peace, has remained a prominent theory in the field of international relations (IR). In academia, this proposition was developed into a more sophisticated model by several theoretical endeavors, especially by liberal IR scholars, and supported by a large number of empirical studies.² In the political realm, this theory has been accepted by numerous policymakers and became a theoretical foundation for many significant policy initiatives, such as Willy Brandt's Ostpolitik, Richard Nixon's détente, and the rapprochement with the People's Republic of China (PRC).³

However, not all IR scholars agree with this proposition. Realist skeptics argue that economic interdependence can provoke tensions between states by increasing strategic vulnerability.⁴ Empirically, the proposition has been challenged by many counterexamples, most notably World War I, where heavy economic interdependence among European powers could not prevent an all-out war in Europe. Moreover, East Asia has recently witnessed a phenomenon called Asia's paradox that is quite

1 Immanuel Kant, *The Philosophy of Kant*. (New York: Modern Library, 1994), 454-455.

2 Erik Gartzke, "The capitalist peace." *American Journal of Political Science* 51, no. 1 (2007): 166-191; Edward D. Mansfield and Brian M. Pollins, "The Study of Interdependence and Conflict," *Journal of Conflict Resolution* 45 no. 6 (2001): 834 -859; Bruce Russett and John Oneal, *Triangulating Peace: Democracy, Interdependence, and International Organizations*, (New York: W. W. Norton & Company, 2001).

3 Mansfield and Pollins, "The Study of Interdependence and Conflict," 834.

4 Dale Copeland, *Economic Interdependence and War* (Princeton: Princeton University Press, 2015). Avery Goldstein and Edward D. Mansfield, *The nexus of economics, security, and international relations in East Asia* (Stanford: Stanford University Press, 2012); T. J. Pempel, *The Economy-Security Nexus in Northeast Asia* (New York: Routledge, 2013).

puzzling from the capitalist peace's perspective. Despite the deepening economic interdependence among East Asian countries in the 21st century, the relationship between them has been marred by recurring political tensions. How can we explain this puzzling behavior? What is the condition under which economic dependence does and does not contribute to a peaceful relationship between states?

This article posits that a domestic split has the potential to disrupt the relationship between economic and political ties among states. A domestic split is defined as a non-violent political conflict between antagonized groups with comparable and robust domestic support. Given that domestic splits commonly arise from enduring social divisions such as ethnic, religious, or class issues, they can profoundly influence individuals' political preferences, steering them toward supporting policies aligned with their social causes rather than economic interests. Consequently, a domestic split has the capacity to nullify the pacifying influence of economic dependence, at least temporarily. To assess this argument, the research delves into an in-depth case study examining Taiwan's relationship with the People's Republic of China from the late 1980s to late 2000s, a period often considered an anomaly within the capitalist peace framework.

This research aims to contribute to the theory of the capitalist peace by introducing a new variable, domestic split, that may undermine the connection between economic and political relations between countries.⁵ By testing this variable against anomaly of extant theories, the Cross-Strait relations, this paper also intends to extend empirical coverage of the capitalist peace research program. Furthermore, conducting an in-depth case study is not only useful to examine the causal relations that connect economic interdependence to political relations, but also contributes to the methodological diversity in the current research on the capitalist peace, which is heavily driven by quantitative research.⁶

5 Gartzke, "The capitalist peace."

6 Mansfield and Pollins, "The Study of Interdependence and Conflict," 837.

In terms of policy-relevant contribution, this research underscores the limitations of economic constraints on political relations across the Taiwan Strait. The case study indicates that, despite the growing economic dependence on China, Taiwanese people at times did not necessarily support Taipei's mainland policy pleasing Beijing. Specifically, this research predicts that while individuals in Taiwan may lean toward supporting an amicable relationship with Beijing, they may not be unswervingly influenced by the pacifying impact attributed to economic connections with China, particularly when their identity is under threat. This explains why Beijing's recent assertive stance towards Taiwan could be counterproductive.⁷ A confrontational policy is likely to mobilize Taiwanese individuals who would have otherwise favored the status quo in the Taiwan Strait for economic reasons to rally behind more provocative mainland policies. That is to say, the mitigating influence of commerce may not suffice to offset openly aggressive behavior.

This research also holds relevance for the future U.S.-Republic of Korea (ROK) relations. South Korea, maintaining robust ties with both the U.S. and China in terms of security and the economy, has adopted a hedging strategy between the two powers.⁸ This approach has occasionally raised questions about Seoul's allegiance to the United States.⁹ However, considering China's deployment of its commercial relationship as a coercive tool during diplomatic tensions over THAAD, it appears improbable that South Korea would be significantly restrained by its economic links with Beijing. In essence, the U.S.-ROK alliance is unlikely to be impeded by South Korea's economic engagement with China.

7 Kathy Huang, "China Is Locked Into Xi Jinping's Aggressive Diplomacy," *Foreign Policy*, December 2, 2022, <https://foreignpolicy.com/2022/12/02/china-xi-jinping-aggressive-diplomacy/>.

8 Ellen Kim and Victor Cha, "Between a Rock and a Hard Place: South Korea's Strategic Dilemmas with China and the United States," *Asia Policy*, no. 21 (2016): 101–22.

9 Tong Kim, "Scholars call for stronger ROK-US alliance," *Korea Times*, November 1, 2015, https://www.koreatimes.co.kr/www/nation/2023/09/113_189901.html.

Literature Review

Large numbers of existing studies deal with the influence of economic dependence on foreign policy. Many scholars who follow the liberal tradition argue that economic dependence promotes a conciliatory foreign policy.¹⁰ Some focus on the influence of domestic interest groups in the policymaking process. Specifically, they argue that as a state's commercial relations with other states grow, the number of people who prefer a peaceful relationship with those countries also grows, forming a powerful interest group. Faced with large numbers of citizens who favor a good relationship with their trade partners, policymakers in the government are more likely to adopt a moderate foreign policy toward those countries.¹¹

Other liberal scholars emphasize the impact of the increased interaction between countries due to economic relations. They maintain that as commercial relations with other countries intensify, a complex interdependence between non-governmental actors can emerge.¹² Due to frequent contact with people from other countries, individuals are more exposed to the values and culture of others. The population of one country would understand other countries better and might develop a shared identity. Therefore, they are more likely to support a more benign foreign policy toward each other.¹³ In a nutshell, the proponents of the capitalist peace argue that when a conflict breaks out between economically

10 Norman Angell, *The Great Illusion: A Study of the Relation of Military Power in Nations to Their Economic and Social Advantage* (Garland Pub, 1972); William K. Domke, *War and the Changing Global System* (New Haven: Yale University Press 1988); Edward D. Mansfield, *Power, Trade, and War* (Princeton: Princeton University Press, 1995); Solomon William Polachek, "Conflict and Trade," *Journal of Conflict Resolution* 24, no. 1 (1980): 55 -78.

11 Russett and John Oneal, *Triangulating Peace*, 130.

12 Robert O. Keohane and Joseph S. Nye Jr. "Power and interdependence," *Survival* 15, no. 4 (1973): 158-165.

13 Karl Wolfgang Deutsch, Sidney A. Burrell, and Robert A. Kann, *Political Community and the North Atlantic Area: International Organization in the Light of Historical Experience* (Westport: Greenwood Press, 1969).

interdependent countries, the population within these countries will pressure their respective governments for a speedy resolution for fear of losing the economic gains as well as the friendship associated with the trading relationship.

On the other hand, some scholars, including realists and mercantilists, counter the liberal view.¹⁴ They maintain that a state becomes more vulnerable when economically dependent on others because the state will be more likely to become entangled in other states' affairs.¹⁵ In addition, some scholars contend that asymmetric economic dependence can be utilized as a coercive power of strong states.¹⁶ Although the neo-realists and mercantilists are opposed to liberals, they implicitly agree that economic dependence constrains a state's behavior.

One glaring problem of these studies is that they are based on restrictive assumptions. The second group of scholars treats a state as a unitary actor. As many critics have pointed out, by "black boxing" a state, they fail to consider a nuanced domestic process that influences its foreign policy.¹⁷ On the other hand, while liberal scholars embrace domestic political processes in their theories, they suffer from a restrictive assumption on people's preferences. They assume that domestic politics are primarily driven by people's economic interests. However, as a plethora of studies has demonstrated, people often follow motives other than economic interests, including moral values, political ideologies, and emotions, which may trump their rational calculation related to economic gains.¹⁸ This problem is related to an important methodological issue.

14 Richard Rosecrance, *The Rise of the Trading State: Commerce and Conquest in the Modern World* (New York: Basic Books, 1987).

15 Kenneth Waltz, *Theory of International Politics* (New York: McGraw-Hill Humanities/Social Sciences/Languages, 1979), 138-139.

16 Albert O. Hirschman, *National Power and the Structure of Foreign Trade* (Berkeley: University of California Press, 1981).

17 Steven E. Lobell, Norrin M. Ripsman, and Jeffrey W. Taliaferro, *Neoclassical Realism, the State, and Foreign Policy* (Cambridge: Cambridge University Press, 2009); Randall L. Schweller, "Bandwagoning for Profit: Bringing the Revisionist State Back In," *International Security* 19, no. 1 (1994): 72-107.

Because most widely cited studies on the relationship between economic dependence and foreign policy employed quantitative analyses, which have a disadvantage in examining the causal process.¹⁹

Argument

Here, it is hypothesized that domestic splits prevent a state from adopting a conciliatory policy towards other states it economically depends upon. It is in partial agreement with the capitalist peace proposition that when a state's economy becomes more dependent on other states, people will generally be more inclined toward cooperation for economic gains. This private economic interest influences a state's foreign policy through domestic political processes, such as political parties, pressure groups, and lobbying. When there is a domestic split, however, this process can be reversed; instead of being influenced by their supporters, politicians adopt policies that polarize the population to maximize their factional interests.

As stated above, existing literature virtually assumes a theoretical conveyor belt, which automatically delivers a state's economic interest into its foreign policy. However, there are complex dynamics of domestic politics that these literatures neglect. While private actors are the main players in the economic arena, a state's foreign policy is determined by politicians. And under certain conditions, this conveyor belt malfunctions, and a state's foreign policy fails to reflect its overall economic interests. This research argues that domestic splits may prevent economic dependence from resulting in a conciliatory foreign policy.

In a normal political process, economic dependence affects a state's foreign policy. Suppose that there are two states: A and B. When state A's economy becomes more dependent on state B, people in A will hope for

18 Stanley Feldman, "Economic self-interest and political behavior," *American Journal of Political Science* (1982): 446-466.

19 Mansfield and Pollins, "The Study of Interdependence and Conflict," 837.

their government to build good relations with B because many of them have stronger economic ties with the state than they did before. To secure their gains from economic activities with B, they will prefer more harmonious relations with the country, supporting a cooperative policy. If conflicts break out between states A and B, many of the population of A will be concerned that such conflicts may negatively affect economic relations with B. If state B damages its economic relations with A by imposing an economic sanction or trade barrier, many citizens of state A will have to suffer economic losses. Thus, they will expect their government to resolve the conflict and avoid taking an action that will further jeopardize its relationship with B.

This private economic interest will influence a state's foreign policy through domestic politics. Taxpayers in state A will support the party that pursued a more conciliatory policy towards state B. To maximize the opportunity to win, parties will develop policies that reflect the economic interest of the majority or avoid policies that contradict with people's interests at least. Politicians who hold power will also maintain a more cooperative policy towards state B to increase the chance of getting reelected.

When a state suffers from a domestic split, conversely, its foreign policy may not reflect private economic interests. There are three attributes to the notion of domestic split. The first attribute is an *antagonism*; domestic split occurs when there is an antagonism between groups within a country. The causes of these antagonisms, such as religious, ethnic, or class conflict issues, often are long-standing issues within society and emerge into the center of politics when there are changes in external conditions, such as an outbreak of war, military threats, or global economic recession, or internal conditions, including changes in political system and economic hardship. When emerged, this antagonism can be strong so that there is a small room for compromise among groups.

The second attribute is the *balance of power* among groups. If there is an overwhelmingly strong group, an antagonism among groups may not

affect domestic politics, as the dominant group will easily take control of the country. However, it is when antagonized groups have comparable power, in terms of the political and economic power as well as the number of populations, that a domestic split occurs. As each group has a chance to win the competition by outnumbering the opponents, all of them have strong incentives to mobilize their respective constituencies.

The third attribute is *peace*, or lack of armed violence. This attribute distinguishes domestic splits from militarized internal conflict such as civil wars or insurgencies. The antagonism among domestic groups has the potential to develop into violent conflict, but they compete with each other by using peaceful means at this stage. If an armed conflict breaks out, it will be outside the scope of this research. Conversely, a state may suffer from a domestic split when it has finished a long-lasting violent conflict or civil war and is about to implement a normal political process.

When there is a domestic split, each group will be firmly united against one another and domestic politics will be factionalized. People will identify their interest with their faction's causes or interests and oppose other faction's interests. There will be limited vote mobility because voters who belong to one faction will not support the parties of other factions. Domestic splits hinder each political party implementing a policy that deliberates economic interest of the majority. Each party will follow a policy that clearly reflects the identity of the population it belongs to and distinguishes its factional interest from others. Sometimes, parties use aggressive strategies towards other factions simply to mobilize loyalty within their own factions. By doing so, parties can promote solidarity among the factions they belong to and eventually attract stronger support from their own factions. These policies may reflect the economic interest of the majority or not, but mobilized voters will not be much concerned about it for a while.

Case Selection, Measurement, and Methods

To assess the argument, this research examines the case of Taiwan's mainland policy spanning from 1986 to 2010, which is often recognized as an anomaly within existing theories addressing the nexus between a state's economic dependence and foreign policy.²⁰ Despite the continuous growth in Taiwan's economic ties with the PRC during this timeframe, its policy toward Mainland China fluctuated from conciliatory to provocative. If the hypothesis of this research effectively explains this case, it will extend the empirical scope of the capitalist peace research program.

Furthermore, this analysis specifically concentrates on this timeframe to mitigate the influence of other factors that could potentially have impacted Cross-Strait relations, such as Sino-American relations, U.S.-Taiwan relations, and Chinese domestic politics. During this timeframe, the United States adhered to what some describe as an engagement policy toward China, fostering deepened economic, social, and cultural ties while managing potential diplomatic and military tensions.²¹ This contrasts sharply with the post-2011 Sino-American relations, marked by Washington's shift toward great power competition with China, now the world's second-largest economy with advanced military capabilities.²² Furthermore, in tandem with its evolving approach to China after 2010, the United States also adjusted its position on Taiwan, transitioning from its traditional "strategic ambiguity" to a more robust commitment.²³ Additionally, this timeframe predates Xi Jinping's

20 Scott Kastner, *Political Conflict and Economic Interdependence Across the Taiwan Strait and Beyond* (Stanford: Stanford University Press, 2009).

21 Aaron L. Friedberg, *Getting China Wrong* (Cambridge: Polity Press 2022), 24-25.

22 "China uneasy over US troop deal in Australia," *The Guardian*, November 16, 2011, <https://www.theguardian.com/world/2011/nov/16/china-us-troops-australia>; Hillary Clinton, "America's Pacific Century," *Foreign Policy* 189 (2011): 56-63; Donald J. Trump, *National security strategy of the United States of America* (Washington: White House, 2017), 27.

23 David Brunnstrom and Trevor Hunnicutt, "Biden says U.S. forces would defend

ascension to the leadership of China in 2012, whose assertive foreign policy differed starkly from that of his predecessors.²⁴

Using qualitative methods, this research aims to capture within-case variation to avoid the risk of an indeterminate research design.²⁵ Based on the values of the hypothesis's independent variable, domestic split, the Taiwanese case is disaggregated into three periods: a period of democratization (1986-1993), ethnic factionalism (1994-2004), and normal politics (2005-2009).²⁶ As ethnic cleavages among Taiwanese spiked between 1994 and 2004, the argument of this research predicts a less conciliatory policy towards the PRC during the second period compared to the first and third periods. With these three observations, the analysis first examines the correlation between the independent and dependent variables and observes whether the Taiwanese government changes its mainland policy as the hypothesis predicts for each period. After that, the analysis proceeds to trace the link between the independent and dependent variable to observe whether the causal process suggested by the hypothesis is evident in the Taiwan case.²⁷

Alternative Explanation

While conducting a case study, the main hypothesis's explanatory

Taiwan in the event of a Chinese invasion," *Reuters*, September 19, 2022, <https://www.reuters.com/world/biden-says-us-forces-would-defend-taiwan-event-chinese-invasion-2022-09-18/>.

24 Kathy Huang, "China Is Locked Into Xi Jinping's Aggressive Diplomacy."

25 Gary King, Robert O. Keohane, and Sidney Verba, *Designing Social Inquiry* (Princeton: Princeton University Press, 1994), 118.

26 To measure a domestic split, I examine the three attributes of the variable. I determine that Taiwan politics experienced a domestic split when there was significant antagonism between ethnic groups, when the economic and political capabilities of those groups were comparable, and when the groups were opposed to each other in a peaceful manner.

27 Alexander L. George and Andrew Bennett, *Case Studies and Theory Development in the Social Sciences* (Cambridge: MIT Press, 2005), Chapter 10.

power is tested against one alternative explanation: the balance of power across the Taiwan Strait. From the balance of power perspective, Taiwan is more likely to become more conciliatory to the mainland as the PRC's relative power grows. In general, IR realists consider an accommodation strategy irrational since it is likely to make a rival more dangerous,²⁸ yet in the case of the Cross-Strait relations, Taiwan had quite a limited policy option. When its rival's power grows, a state will balance against its rival externally and internally.²⁹ However, the military and diplomatic support from the United States were obscure at best, and despite its constant growth in national power, Taiwan was no match for China's rapid rise as a great power. If it could not secure external support and its relative power declined, Taiwan is expected to adopt a more conciliatory policy toward the mainland or, at least, avoid provocative action to guarantee its survival.³⁰ Examining the Taiwan case is a crucial case study for the balance of power theory.³¹ As the military gap across the Taiwan Strait significantly grew throughout these periods, it was a clear case for the balance of power theories to predict a continued conciliatory policy toward mainland China.

Case Study

I. Democratization (1986–1993)

Economic Dependence

After the 1980s, the Taiwanese economy faced various difficulties. Due to past economic development, Taiwanese firms suffered from high

28 John J. Mearsheimer, *The Tragedy of Great Power Politics* (New York: W. W. Norton & Company, 2001), 164.

29 Waltz, *Theory of International Politics*, 168.

30 Stephen M. Walt, *The Origins of Alliances* (Ithaca: Cornell University Press, 1990), 28-33.

31 Harry Eckstein, "Case Study and Theory in Political Science," In *Handbook of Political Science, Vol. 7: strategies of Inquiry*, ed. Fred I. Greenstein and Nelson W. Polsby. (Boston: Addison-Wesley Educational Publishers Inc, 1975), 118-119.

wage levels. Taiwan's small and medium-sized enterprises sought to lower labor costs.³² Additionally, the advent of newly industrialized neighboring countries, such as members of ASEAN, caused greater international competition. Taiwanese enterprises were also concerned about growing shipping expenses. Under such unfavorable circumstances, mainland China emerged as an excellent solution, providing cheap and plentiful labor, raw materials, and a huge export market.

The incentive to develop economic relations with the mainland increased further by the PRC's creation of a legal framework for investment from Taiwan. China offered preferential treatment toward investments from Taiwan and endured a sizeable trade deficit with the Taiwanese for this political objective.³³ PRC leaders, including Yang Sang-Kun, openly revealed their intention to use economic ties for political purposes.³⁴ The PRC State Council enacted the "Regulations for Encouraging Investment by Taiwan Compatriots" in 1988, followed by the designation of two special investment zones for Taiwanese enterprises in Fujian Province.³⁵ Thus, many Taiwanese companies started to trade with the mainland and invest considerable amounts of money.

From 1986 to 1993, Taiwanese economic dependence on the mainland grew considerably. Trade across the strait significantly increased. According to estimates from the Mainland Affairs Council, trade with the mainland formed 1.49 percent of total trade in 1986, which increased to 9.19 percent in 1993.³⁶ In addition, the total Taiwanese investment in mainland China by 1993 was at least 5,032 million dollars.³⁷

32 T. J. Cheng, "China-Taiwan Economic Linkage: Between Insulation and Superconductivity," In *Dangerous Strait: The U.S.-Taiwan-China Crisis*, ed. Nancy Bernkopf Tucker, 93-130 (New York: Columbia University Press, 2005), 97.

33 Suisheng Zhao, *Across the Taiwan Strait: Mainland China, Taiwan and the 1995-1996 Crisis* (New York: Routledge, 1999), 27.

34 Cheng, "China-Taiwan Economic Linkage," 104.

35 Karen M. Sutter, "Business Dynamism across the Taiwan Strait: The Implications for Cross-Strait Relations," *Asian Survey* 42, no. 3 (2002), 524.

36 Mainland Affairs Council, *Cross-Strait Economic Statistics Monthly*, no. 197 (Taipei: Mainland Affairs Council, 2009), 26.

Domestic Politics

During the first period, Taiwan underwent rapid democratization. Recognizing public demands for direct elections and an end to the Kuomintang (KMT) one-party authoritarian rule, President Chiang Ching-kuo, the son of the first ROC President Chian Kai-shek, allowed the formation of opposition parties and the rejuvenation of the Legislative Yuan in 1986. In that year, the first opposition party, the Democratic Progressive Party (DPP), was founded, and the inaugural multi-party Legislative Yuan election was held. The president also terminated a half-century of martial law in 1987. Lee Teng-hui, who became the next president after the unexpected death of Chiang Ching-kuo, accelerated democratization. He abolished the “Temporary Provisions Effective During the Period of Communist Rebellion” imposed in 1948, which suspended the democratic constitution and granted extraordinary power to the president that normally belonged to other branches of government.³⁸

Quite a few Taiwan experts argue that democratization increased the political influence of entrepreneurs.³⁹ During the authoritarian era, businesses had marginal representation within the KMT regime, so economic bureaucrats had limited influence compared to their counterparts from other agencies.⁴⁰ After the mid-1980s, however, private business owners could gain expanded political influence through several changes. Influence-buying was permitted in some elections, including the Legislative Yuan election.⁴¹ Also, thanks to democratization, entrepreneurs themselves were able to participate in politics.

37 Mainland Affairs Council, *Cross-Strait Economic Statistics Monthly*, no. 197, 28.

38 Denny Roy, *Taiwan: A Political History* (Ithaca: Cornell University Press, 2003), 83–84.

39 Kastner, *Political Conflict and Economic Interdependence*, 49.

40 Yun-han Chu, The Realignment of Business-Government Relations and Regime Transition in Taiwan, In *Business and Government in Industrialising Asia*, ed. Andrew MacIntyre (Ithaca: Cornell University Press, 1995), 116–17.

41 Kastner, *Political Conflict and Economic Interdependence*, 50.

Taiwanese domestic politics maintained unity. The DPP created a stir in Taiwan. In the process of a hegemonic struggle between internal factions of the DPP, independence emerged as a plank. The DPP's independence plank, however, was unable to make a strong impact on Taiwanese politics. Although the DPP won a small number of seats in the Legislative Yuan, it possessed only marginal political power. According to one estimate, the DPP had approximately 7,000 members in 1988; some estimates say they had only 2,500 members.⁴² During this period, the DPP did not yet have enough power to mobilize large numbers of people. Moreover, Taiwan was still under strong KMT rule; although martial law had been lifted, there was a new national security law that retained the substance of the martial law.⁴³ The DPP opposed the enactment of this law, the was supported by the public.

Mainland Policy

From 1985 to 1994, Taiwan's mainland policy became more conciliatory. After 1979, when the mainland isolated Taiwan from the world by establishing official relations with the United States, the PRC government pursued a peaceful unification strategy. Faced with the PRC's reunification policy, the Taiwanese government maintained the Three No's" policy: no contact, no negotiation, and no compromise with the mainland. The Taiwanese government, however, eventually adjusted its policy toward the PRC. Taipei began to recognize Beijing as its counterpart, not as *gongfei* (Communist bandits).⁴⁴ In 1986, the Taiwanese government eased restrictions on contact with the mainland. In 1987, Taipei allowed trade, investment, and visits to the mainland to some degree. Taiwan permitted indirect importation of goods from the PRC and indirect

42 John F. Copper, "Taiwan: A Nation in Transition," In *The Republic of China on Taiwan today: View from Abroad* (Taipei: Kwang Hwa Pub. Co, 1990), 42.

43 Selig S. Harrison, "Taiwan After Chiang Ching-kuo," In *The Republic of China on Taiwan today: View from Abroad* (Taipei: Kwang Hwa Pub. Co, 1990), 24.

44 Zhao, *Across the Taiwan Strait*, 22.

investment and technological cooperation in 1989 and 1990, respectively. In 1991, the Taiwanese government revealed its intention of peaceful coexistence with the mainland by announcing the Guidelines for National Unification. In addition, Taiwan and the PRC established some quasi-official organizations: the Straits Exchange Foundation (SEF) on the Taiwan side, and the Association for Relations Across the Taiwan Strait (ARATS) on the mainland.⁴⁵ At the preliminary meeting of the talk between the agencies, the SEF agreed to accept one Chinese principle, although it also added that there might be a different interpretation of what that meant.⁴⁶ This “1992 consensus” reveals Taiwan government’s eagerness to develop its relations with the PRC. In sum, Taiwan’s mainland policy became more conciliatory as economic ties across the Strait strengthened.

II. Domestic split (1994–2004)

Economic Dependence

During the second period, the Taiwanese economy was rapidly integrated into the mainland economy. After Taiwan and mainland China entered the WTO, markets on both sides became more open, and mutual trade tariffs were reduced. In addition, the PRC government’s efforts to promote strong economic ties with Taiwan were even more successful than in the earlier period.⁴⁷ The National People’s Congress enacted the Investment Protection Law, which was designed to protect Taiwanese investments in China.⁴⁸ In 1999, the State Council proposed the Implemented Regulations for this law.⁴⁹ The Asian financial crises, which devastated alternative investment markets (especially those in Southeast

45 Bates Gill and Chin-hao Huang, “More Strait Talk: Ten Years After the Taiwan Missile Crisis,” *China Brief* 5, no. 22 (2005), 2.

46 John Q. Tian, *Government, Business, and the Politics of Interdependence and Conflict across the Taiwan Strait* (New York: Palgrave Macmillan, 2006), 21.

47 Cheng, “China-Taiwan Economic Linkage,” 102.

48 Sutter, “Business Dynamism across the Taiwan Strait,” 52.

49 Cheng, “China-Taiwan Economic Linkage,” 102.

Asian countries), and economic hardship in Taiwan also affected Taiwanese entrepreneurs' decision to increase investment to China.⁵⁰

Trade levels across the strait tripled. From 1994 to 2004, the amount of trade with the mainland jumped from 17,881 million dollars to 65,722 million dollars.⁵¹ During the same time, the mainland's share of total foreign trade went up from 9.93 percent to 18.72 percent.⁵² In addition, the amount of Taiwanese-approved investment in mainland China increased from 962 million dollars to 6,940 million dollars.⁵³

Domestic Politics

From 1994 to 2004, Taiwan's domestic politics suffered from a serious domestic split. Taiwan established procedural democracy; the first direct Presidential election was held in 1996. Repressed grievances of the native Taiwanese finally erupted in this period. Many native Taiwanese, who once were alienated from politics under KMT's authoritarian rule, gained political influence thanks to democratization.⁵⁴ Some of them adopted an aggressive posture toward the mainlanders, who were believed to be the dominant power during the past period; they even eagerly strived to dilute the remaining Chinese legacy through the revision of education programs.⁵⁵ Some of them were also strong champions of Taiwan's external sovereignty and independence, which was regarded as a highly unrealistic policy from others' perspective.⁵⁶

50 Sutter, "Business Dynamism across the Taiwan Strait," 56–57.

51 Mainland Affairs Council, *Cross-Strait Economic Statistics Monthly*, no. 197, 23.

52 Mainland Affairs Council, *Cross-Strait Economic Statistics Monthly*, no. 197, 26.

53 Mainland Affairs Council, *Cross-Strait Economic Statistics Monthly*, no. 197, 28.

54 Tian, *Government, Business, and the Politics of Interdependence and Conflict*, 32.

55 Tian, *Government, Business, and the Politics of Interdependence and Conflict*, 36.

56 Shelley Rigger, *From Opposition to Power: Taiwan's Democratic Progressive Party* (Boulder: Lynne Rienner Publishers, 2001), 135.

Ethnic problems between native Taiwanese and mainlanders emerged as a central issue of domestic politics.⁵⁷ Native Taiwanese, who gained the rights for full participation in the politics for the first time, took an initiative. By setting a political agenda, they were able to modify the political landscape in their favor. President Lee openly advocated a state-to-state relationship between the PRC and Taiwan in an interview with a German radio broadcast in 1999. Lee's interview was so strong that it made DPP candidate Chen Sui-bien's posture, which also was quite radical, seemed relatively moderate.⁵⁸ In addition, ethnic rivalry seemed to have trumped regular party politics. Lee, who was a leader of the KMT, expressed his support for Chen Sui-bien before he left the party. After his withdrawal from the KMT, Lee's followers established the Taiwan Solidarity Union (TSU), which would form the Pan-Green Coalition with the DPP after the 2000 presidential election.

In contrast, the KMT adopted a passive posture. First, the KMT did not have a strong political agenda that could inspire loyalty among its members, as independence did in the native faction. The KMT politicians criticized the native Taiwanese faction's pro-independence policy as unrealistic or reckless but did not have their own strong counter-initiative. In addition, the party suffered from a lack of cohesiveness. As the KMT had served as a vehicle for one-party rule, it included members with various political spectrums.⁵⁹ In other words, the KMT had much to lose but nothing to gain during the process of democratization. For example, Lee Teng-hui was a charismatic figure of the conservative KMT, but he was, in fact, a pro-democratic and pro-independence individual. When Lee was removed from the party due to his dubious loyalty, it was a huge blow to the KMT. Therefore, the party failed to find a charismatic candidate for

57 Some commentators even refer to this political trend as a "cultural populism." Olwen Bedford and Hwang Kwang-Kuo, *Taiwanese Identity and Democracy: The Social Psychology of Taiwan's 2004 Elections* (New York: Palgrave Macmillan, 2006), 10.

58 Bedford and Hwang, *Taiwanese Identity and Democracy*, 20.

59 Rigger, *From Opposition to Power*, 123.

president despite its strong factional power. The KMT eventually divided into two political parties, with a group of former KMT members, including James Soong, establishing the People's First Party. Such division contributed to the DPP's victory in the 2000 presidential election, in spite of the relatively small power of the progressives.

The success of the native Taiwanese was not limited to the administration. The DPP's relative vote share in the Legislative Yuan also substantially grew. In 1995, the KMT polled 46.1 percent of the total votes but won 28.6 percent in 2001, while the DPP maintained its share of around 33 percent of the votes during the same time period.⁶⁰ In the 2004 Legislative Yuan election, the Pan-Blue Coalition won against the Pan-Green Coalition, but it was a narrow victory, with 49.81 percent of total votes to 46.26 percent. Also at this time, the DPP became the largest party.⁶¹

Mainland Policy

During the second period, the Taiwanese government did not pursue a conciliatory policy towards the mainland. Instead, Taipei often maintained a provocative posture. The Republic of China (ROC) White Paper, published in 1994, exposes a huge departure of Taiwan's mainland policy from earlier periods.⁶² The paper claimed equal status of the ROC with PRC over its own territory and in the international sphere. In 1995, President Lee Teng-hui responded to Beijing's Eight Points, quite a conciliatory gesture for China, with a demand for acceptance.⁶³ In addition, Lee Teng-hui enforced a visit to his alma mater, Cornell University, despite Beijing's open displeasure. Such action frustrated the PRC leaders and galvanized aggressive reaction; the People's Liberation Army did a series of missile exercises toward the Taiwan Strait in 1995 and

60 John Fuh-sheng Hsieh, "Ethnicity, National Identity, and Domestic Politics in Taiwan," *Journal of Asian and African Studies* 40, no. 1-2 (2005), 23.

61 Kastner, *Political Conflict and Economic Interdependence*, 72.

62 Tian, *Government, Business, and the Politics of Interdependence and Conflict*, 30.

63 Roy, *Taiwan: A Political History*, 196.

1996. Again, in a 1999 interview with a German radio station, Lee mentioned the Cross-Strait relations as a state-to-state relationship and provoked a sharp reaction from the PRC.⁶⁴ Negotiation between the SEF and ARATS stopped immediately after the interview and did not continue until 2008.

Chen Sui-bian, Lee's successor, also frequently took provocative actions toward the mainland. He had continuously pursued an independence policy during his candidacy for president. Although he proclaimed that his administration would not pursue independence, he occasionally revealed his pro-independence ideas, which strained the Cross-Strait relations. In 2002, Chen antagonized the PRC by describing the Cross-Strait relations as "one country on each side of the Strait".⁶⁵ Further, his regime decided to put the *de jure* independence issue to the referendum vote alongside the 2004 presidential election. Chen also refused to recognize the very existence of the 1992 consensus over the "one China" principle.⁶⁶

In terms of economic policy, the Taiwanese government also introduced policies that sought to diversify its economic relations outside China, yet they were mostly unsuccessful. The first attempt was a Go-South policy, which was designed to promote Taiwanese entrepreneurs' investments in South Asia.⁶⁷ The policy, however, was unsuccessful due to the Asian Financial Crises. President Lee also adopted the "Go Slow, Be Patient Policy". Taipei banned larger firms whose investments on the mainland exceeded 50 million US dollars.⁶⁸ He also threatened to punish business people for illegal investment. But, Chen Sui-bien was more reluctant to impose economic restrictions across the Strait because the

⁶⁴ Rigger, *From Opposition to Power*, 180.

⁶⁵ Shelley Rigger, "The Unfinished Business of Taiwan's Democratization," In *Dangerous Strait: The US-Taiwan-China Crisis* (New York: Columbia University Press, 2005), 18.

⁶⁶ Tian, *Government, Business, and the Politics of Interdependence and Conflict*, 21.

⁶⁷ Kastner, *Political Conflict and Economic Interdependence*, 56–57.

⁶⁸ Kastner, *Political Conflict and Economic Interdependence*, 58.

DPP was experiencing a difficult financial situation, so he had to consider the business interests of the supporters of the party.

In sum, although Taiwan's economic dependence upon China continued to deepen during this period of time, the tie failed to result in favorable mainland policy. Domestic split can account for this anomaly of capitalist peace. As the ethnic problem emerged into Taiwan politics as a central issue, domestic politics were largely shaped by native Taiwanese-mainlander rivalry. The DPP successfully concentrated native Taiwanese support and came into power by adopting radical policy.

III. Post-domestic split (2005–2009)

Economic Dependence

Between 2005 and 2009, Taiwan became even more dependent upon the mainland. Trade across the strait dramatically went up. From 2005 to 2008, the amount of trade with the mainland increased from 76,365 million dollars to 105,369 million dollars.⁶⁹ During this period, however, trade with the mainland's share of total foreign trade remained constant at around twenty percent.⁷⁰ In addition, the amount of Taiwanese approved investment in mainland China increased from 6,006 million dollars to 10,691 million dollars.⁷¹

Domestic Politics

In this period, the Taiwanese overcame the domestic split. Many Taiwanese, including those who had supported the native Taiwanese faction, now realized the problems of ethnic duelist politics. They witnessed an unfavorable result of radical policy.⁷² A *de jure* independence

69 Mainland Affairs Council, *Cross-Strait Economic Statistics Monthly*, no. 197, 23.

70 Mainland Affairs Council, *Cross-Strait Economic Statistics Monthly*, no. 197, 26.

71 Mainland Affairs Council, *Cross-Strait Economic Statistics Monthly*, no. 197, 28.

72 Tian, *Government, Business, and the Politics of Interdependence and Conflict*, 35.

policy led the island into a risky situation.⁷³ Trouble with the PRC posed economic risk as well as a security threat. After the PLA's missile practice toward the Taiwan Strait, Taiwan's stock market suffered a dramatic loss of its stock price and approximately 10 billion dollars of foreign capital fled the island.⁷⁴ Independence was a virtually infeasible policy for Taiwan as it lacked sufficient power to achieve its own independence. Such radical policy merely resulted in diplomatic trouble, especially with its most important economic partner, the PRC. When political relations across the strait worsened, Taiwanese citizens realized that their economic interests were being threatened. Many taxpayers were disenchanted with factionalism and began to pursue their own interests.

In addition, ethnic grievances seemed to have been resolved during the democratization period. The DPP's "Resolution on Ethnic Diversity and National Unity," which was introduced six months after Chen Sui-bien's inauguration, emphasized harmony among ethnic groups and the national unity of Taiwan.⁷⁵ The resolution also states, "national oppression is not to be considered as an original sin of the mainlanders".⁷⁶ One remarkable point is its emphasis on the DPP's leading role in political change "as the ruling party." It implies that there was a departure from the party's long history of resistance. The DPP, which used to suffer from authoritarian oppression, now produced a re-elected president and emerged as the largest party in the Legislative Yuan. Therefore, there was little room for longstanding ethnic grievances. Rather, the party highlighted ethnic harmony.

73 Some experts point to Formosa Island as the most likely place for a potential war involving the United States to occur. See, Kurt M. Campbell and Derek J. Mitchell, "Crisis in the Taiwan Strait?" *Foreign Affairs* 80, no. 4 (2001): 14-25.

74 Roy, *Taiwan: A Political History*, 197.

75 Democratic Progressive Party. "Resolution on Ethnic Diversity and National Unity," 2004. <https://ah.nccu.edu.tw/bitstream/140.119/37472/12/92401512.pdf>.

76 Democratic Progressive Party. "Resolution on Ethnic Diversity and National Unity."

As ethnic rivalry receded from the center of the politics, its symbolic issue, *de jure* independence, also became less attractive. There was a remarkable change in the DPP's pledge for the 2008 presidential election. Although he could not resist President Chen Sui-bien's decision to take a vote that touched upon Taiwan's status in the United Nations,⁷⁷ the presidential candidate Hsieh Chang-ting clearly drew a line between Chen and himself by adopting a more pragmatic pledge in regard to the Cross-Strait issue.⁷⁸

The shift of generations in the KMT also clearly demonstrates this new trend. In 2005, Ma Ying-jeou was selected as the KMT chairperson. This represented a hegemonic transition between old and new members. Ma's rival Wang Jin-pyng was an old generation member who supported pro-unification policy.⁷⁹ In contrast, Ma pursued a status quo policy in terms of Cross-Strait relations. Although he often criticized pro-independence politicians, he was not a pro-China individual. Ma made harsh comment on the Tiananmen Incident in 2005.⁸⁰

In the 2008 presidential election, candidate Ma Ying-jeou won the majority of votes. He defeated the DPP candidate Hsieh, 58.45 to 41.55 percent of the total votes. Despite his more pragmatic and moderate posture, some argued that Hsieh still clung to the issue of independence.⁸¹

77 Yun-han Chu, "Taiwan in 2007: The Waiting Game," *Asian Survey* 48, no. 1 (2008), 129–131.

78 Thomas B. Gold, "Taiwan in 2008: My Kingdom for a Horse," *Asian Survey* 49, no. 1 (2009), 91.

79 Shu-ling Ko, "Wang courts the support of old KMT," *Taipei Times*, July 15, 2005, <https://www.taipeitimes.com/News/taiwan/archives/2005/07/15/2003263570>.

80 Jewel Huang, "Ma Ying-jeou Hopes Truth Will Out," *Taipei Times*, Jun 5, 2005, <https://www.taipeitimes.com/News/taiwan/archives/2004/06/05/2003173813>.

81 Eugene Liu, "Letters: Open letter to the DPP," *Taipei Times*, March 30, 2008, <http://www.taipeitimes.com/News/editorials/archives/2008/03/30/2003407733>.

Mainland Policy

During the third period, Taiwan gradually adopted a conciliatory mainland policy. Although he did not entirely abandon the pro-independence policy, Chen Sui-bien took a more conciliatory posture than expected. Immediately after his inauguration, Chen declared “no independence, no unification, and no use of force,” which relieved Beijing’s concerns about Taiwan’s independence. In return, the PRC allowed Taiwan observer status in the World Health Organization. After 2008, Taiwan showed an even more conciliatory posture. Taiwan and the PRC reopened the quasi-governmental Cross-Strait talk between the ARATS and SEF that had been halted in 1999. The two agencies agreed to establish a regular direct flight across the Strait and to open Taiwan to mainland tourists. Further, Taiwan’s Ministry of Economic Affairs agreed to accept investments from the mainland.⁸² In 2009, the two governments across the Strait agreed to make a free trade agreement.⁸³

In essence, as the Taiwanese people underwent the side effects of ethnic-centered politics and as the native Taiwanese began to overcome long-lasting ethnic discrimination, the domestic split was resolved over time. Being disillusioned with the ethnic populist politics, people started to support politicians who addressed a policy that was more likely to promote their economic interests. Therefore, strong economic ties resulted in a policy that is more conciliatory.

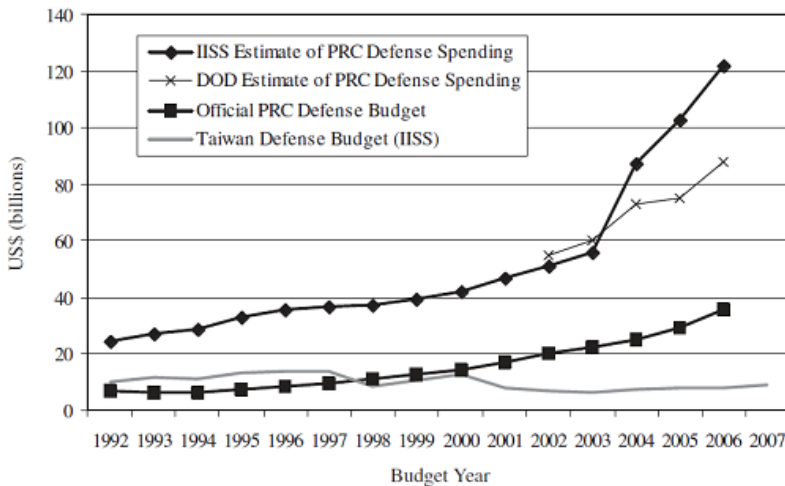
Comparing Explanatory Power

In this section, the main hypothesis’s explanatory power is compared

82 “Talking to Taiwan’s New President,” *Time*, August 11, 2008, <https://content.time.com/time/world/article/0,8599,1831748,00.html>.

83 Thomas B. Gold, “Taiwan in 2009: Eroding Landslide,” *Asian Survey* 50, no. 1 (2010), 68. This agreement was signed on June 28, 2010. See, “Chinese Mainland, Taiwan Sign Landmark Economic Pact,” *Xinhua*, June 29, 2010, https://www.china-daily.com.cn/imqq/china/2010-06/29/content_10036381.htm.

with that of the balance of power theory. As mentioned above, a widening balance of power across the strait is likely to result in Taiwan's conciliatory policy according to a realist perspective. Figure 1 below illustrates estimates of the military expenditures of the PRC and Taiwan.⁸⁴ Both the US Department of Defense and the International Institute for Strategic Studies calculate sharp increases in the mainland's defense expenses. Meanwhile, Taiwan defense budgets remained fixed. Balance of power theorists would argue that Taiwan's mainland policy would have moved toward a more conciliatory position. It cannot account for the varied posture of Taiwan toward the PRC. Therefore, the author's hypothesis, whose prediction is consistent with the variation of Taiwan's mainland policy, is demonstrated to have stronger explanatory power than the balance of power theory.



Sources: Official defense budget of the People's Republic of China, the International Institute for Strategic Studies' *The Military Balance*, and the Defense Department's *Military Power of the People's Republic of China* reports.

⁸⁴ Justin Logan and Ted Galen Carpenter, "Taiwan's Defense Budget: How Taipei's Free Riding Risks War," *Cato Policy Analysis* 600 (2007).

Conclusion

The empirical evidence from the case study supports the main hypothesis. As Taiwan's economic dependence on the PRC increased, the Taiwanese people adopted a more favorable stance toward the mainland, influencing their government's policies in the first and third periods of the case study. However, during a split between native Taiwanese and mainlanders, ethnic interests took precedence, leading to a provocative mainland policy in the second period. This variation in Taiwan's mainland policy is not adequately explained by either the capitalist peace or the balance of power theories.

This study holds crucial theoretical implications. From a Lakatosian perspective, it contributes to both theoretical and empirical progress related to the capitalist peace research program.⁸⁵ Introducing the variable of domestic split, the research maintains that it can hinder economic dependence from influencing foreign policy, providing insights into the anomalous case of Taiwan. Moreover, it adds methodological diversity to the research program, departing from the predominant quantitative analyses in existing studies. Adopting a case study approach allows for a more tangible description of the explanatory power of the hypothesis.

This research provides a clear prediction for the future Cross-Strait relations, suggesting that Taipei is unlikely to exacerbate tensions by seeking formal independence. The resolution of Taiwanese ethnic issues, facilitated by the consolidation of democracy and generational changes, along with an awareness that assertive policies can endanger economic interests and national security, has prompted a more cautious approach. The current DPP administration, in line with this prediction, abstains from

85 Imre Lakatos, "Falsification and the Methodology of Scientific Knowledge," In *Criticism and the Growth of Knowledge: Volume 4: Proceedings of the International Colloquium in the Philosophy of Science, London, 1965*, ed. Imre Lakatos and Alan Musgrave (Cambridge: Cambridge University Press, 1970), 118.

discussions on de jure independence, maintaining that the ROC is already an independent country.⁸⁶

Nevertheless, Taiwan may still adopt a confrontational policy in response to Beijing's aggressive actions. With a recent survey indicating twice as many individuals identifying solely as Taiwanese (62.8%) compared to those with both Taiwanese and Chinese identities (30.5%),⁸⁷ Beijing's assertive stance may trigger nationalistic sentiments.⁸⁸ While the majority of Taiwanese prefer maintaining the status quo,⁸⁹ provocative actions by Beijing could push them toward supporting a more confrontational policy.

Regarding future U.S.-ROK relations, this research anticipates that China's potential economic coercion will not impede the alliance between the two countries. The mitigating effect of trade is likely to be nullified by aggressive behavior. In response to China's increasing use of economic coercion,⁹⁰ South Korea aims to diversify its economic relations. Similarly, if China attempts economic leverage for coercion, it could fuel nationalistic sentiments among South Koreans, boosting support for the U.S.-ROK alliance, as witnessed during the THAAD dispute.⁹¹

86 Lev Nachman and Brian Hioe, "No, Taiwan's President Isn't 'Pro-Independence': Calling Tsai Ing-wen 'Pro-independence' Isn't Just Lazy; It's Wrong," *The Diplomat*, April 23, 2020. <https://thediplomat.com/2020/04/no-taiwans-president-isnt-pro-independence/>.

87 Election Study Center, National Chengchi University, "Changes in the Taiwanese/Chinese Identity of Taiwanese," July 12, 2023. <https://esc.nccu.edu.tw/PageDoc/Detail?fid=7804&id=6960>.

88 Bates Gill, *Daring to Struggle: China's Global Ambitions Under Xi Jinping* (Oxford: Oxford University Press, 2022), 196-197.

89 Election Study Center, National Chengchi University, "Changes in the Unification - Independence Stances of Taiwanese as Tracked in Surveys," July 12, 2023. <https://esc.nccu.edu.tw/PageDoc/Detail?fid=7805&id=6962>.

90 "G7 Struggles With Response to China 'Economic Coercion' Threat," *Al Jazeera*, May 17, 2023, <https://www.aljazeera.com/news/2023/5/17/g7-struggles-with-response-to-china-economic-coercion-threat>.

91 Richard Q. Turcsanyi and Esther E. Song, "South Koreans Have the World's Most Negative Views of China. Why?" *The Diplomat*, December 24, 2022,

For future research, certain considerations should be addressed. The case study relies on limited empirical evidence from secondary sources in English, potentially neglecting information. Utilizing more primary sources could enhance process tracing. Additionally, future studies might explore the applicability of the theory, focusing on the role of domestic split between economic dependence and foreign policy, in non-democratic states, albeit in a modified form.

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