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Taiwan: Midterm Prospects

Interagency Intelligence Memorandum

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NI IIM 81-10007
February 1981

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TAIWAN: MIDTERM PROSPECTS

Information available as of January 1981 was used in the preparation of this Memorandum.


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KEY JUDGMENTS

Taiwan enters the 1980s with favorable odds for maintaining a high degree of continuity with the past. The prospects for political stability and economic prosperity three to five years from now depend on how Taipei moves to solve the interlocking problems of:

- Sustaining economic growth despite increasing protectionism, competition, and rising energy costs.
- Maintaining military defenses against China.
- Arranging a smooth succession to 70-year-old President Chiang Ching-kuo.
- Meeting increasing pressure from native Taiwanese for a greater share in effective political power.
- Maintaining domestic and investor confidence in the future of Taiwan.
- Shaping the nature of Taiwan's relationship with China and the United States.

Normalization of Sino-US relations has altered the framework within which these problems will be faced. Relations with the United States are likely to remain central to Taiwan's foreign policy. In the midterm period of three to five years, the United States will remain the major source of modern arms and military equipment, nuclear power equipment, technology, and enriched fuel, and it will be the island's leading economic partner. Still, Taiwan will attempt to reduce its dependence on the United States in these areas by expanding its markets, seeking arms and nuclear imports elsewhere and striving for self-sufficiency.

Taipei's satisfaction with the continuation of extensive, substantive relations with the United States coexists uneasily with a view that US power in international affairs has declined and with reduced confidence that, in the long run, the United States will remain cognizant of Taiwan's interests. As a result, there is an increasing feeling in Taipei that more than ever Taiwan is on its own.

Note: This Interagency Intelligence Memorandum was produced under the auspices of the National Intelligence Officer for East Asia. It was drafted by [redacted] the East Asia-Pacific Division of the Office of Political Analysis, National Foreign Assessment Center, Central Intelligence Agency. The Memorandum was coordinated with the intelligence components of the Departments of State and Defense and within the National Foreign Assessment Center. Information available through January 1981 was used.

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This concern is unlikely, however, to lead to a major opening toward the USSR in the midterm, despite Taiwan's efforts to broaden economic contacts with Eastern Europe. Chiang Ching-kuo opposes turning toward Moscow—a move which might damage relations with Washington, outrage Beijing, and alarm Taiwan's neighbors in Southeast Asia and the Western Pacific.

Increased stress on self-reliance is likely to have a mixed effect on Taiwan's largely inactive nuclear weapons development program. Some military and civilian officials hope eventually to reactivate the program, but concern over the adverse effect this would have on Taiwan-US relations will continue to act as a powerful deterrent.

The leadership in Taipei also appears to be reexamining the island's future vis-a-vis China. In the past year or two Taiwan has adopted more flexible, pragmatic policies, for example, permitting a dramatic increase in indirect trade with China. But there has been no softening in Taipei's refusal to engage in negotiations with China.

Movement toward some kind of accommodation with Beijing may be possible in the midterm. Governments in Taipei and Beijing share certain interests: both assert Taiwan is part of China, thus precluding an independent Taiwan; both promote the island's economic prosperity, desire political stability, and indicate wariness over Taiwanese demands for a greater share of political power; and neither wants Soviet meddling in the "Taiwan question."

Beijing has outlined a position on reunification that offers substantial autonomy for Taiwan under Chinese sovereignty, but not under Chinese administration.

Beijing is unlikely in the midterm to abandon a policy of peaceful reunification, but there is a growing sense of urgency over the need to make some progress. China fears that the death of Chiang Ching-kuo could leave a successor Kuomintang (KMT) regime that might fragment or that might have a limited popular base. A weakened, insecure successor might feel unable or unwilling to bargain with Beijing.

President Chiang has not groomed a successor, relying instead on institutional arrangements. So far the locus of political power in the post-Chiang period appears uncertain and may shift, becoming fragmented among institutions and individuals. There are signs, however, that maneuvering for position among potential successors has begun.

Deterioration in relations between China and the United States might result in a tougher Chinese stance toward Taiwan, particularly if

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Washington unilaterally abrogated agreements on Taiwan reached in late 1978 or if Taiwan became a contentious issue in Chinese politics.

Developments that reinforce the KMT view that moves toward accommodation with the mainland are not required could also result in a hardened Chinese position on reunification as well as serious Sino-US bilateral problems.

A KMT move toward political association with China could easily provoke an uprising among Taiwanese. When combined with Taiwanese pressure for political reform, their perception that the KMT was preserving its political future by selling out to Beijing could be politically explosive.

Although Taiwan's economic future appears relatively secure in the midterm, problems of inflation due to soaring energy costs, increasing protectionism in foreign markets, increasing competition, and uncertainty in traditional export markets could further slow the economic growth that has been so important in limiting political unrest.

The most likely goal, because it would be the least destabilizing, probably would be maintenance by the KMT of the status quo along with cosmetic changes to meet Taiwanese pressure for political reform and with a glacially slow increase in contacts with the mainland. Taipei would do its utmost to maintain its identity as a de facto independent entity, but could tacitly acknowledge a special relationship with the mainland. This might avoid provoking a militant reaction on Taiwan, receive acquiescence from middle class people and businessmen of the island—who seek economic security and political stability—and isolate the more militant advocates of Taiwan independence.

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DISCUSSION

Surviving Normalization

1. Nearly two years after the reestablishment of Sino-US relations, Taiwan has survived with its economic prosperity intact and the island's political stability and security unshaken. The long-awaited shock wore off quickly, causing only minor and temporary economic perturbations and no widespread popular loss of confidence in the island's future as an international entity. There has been no unusual population or capital exodus from Taiwan. The island has retained its appeal for foreign investment, which was as strong as ever in 1979—the first full year after normalization in Sino-US relations.

2. Contributing to public confidence on the island were the Taipei government's handling of the crisis, the prospect of continued substantive ties to the United States, and the absence of military tension with China. The early passage of the US-Taiwan Relations Act—although no substitute in Taipei's eyes for full diplomatic relations—was reassuring by providing unofficial continuation of relations, by indicating continued US interest in the island's security and a peaceful resolution of Taiwan's relationship with Beijing, and by providing continued access to US military equipment. The resumption of new sales of defensive weapons in January 1980 and the later announcement that the United States will consider sales of the FX fighter further reassured Taiwan's leadership.

3. The successful transition to a new relationship with Washington was accompanied, however, by evidence that Taiwan will be more on its own than before. Many on Taiwan are skeptical about the durability of Washington's interest in preserving Taiwan's international status. There is concern on Taiwan that the US interest in improving relations with China to counter Soviet expansionism will make Washington susceptible to Chinese suggestions that the United States press Taipei into negotiations with Beijing.

4. Taipei appears to be attempting to steer a course that will:

- Preserve what remains of Taiwan's diplomatic relations with other governments.

- Maintain foreign interest and presence in Taiwan by developing substantive, unofficial relations—particularly economic—with those nations that have no diplomatic ties with Taiwan.
- Expand Taiwan's foreign trade markets to maintain rapid economic growth by spreading trade and investment opportunities and risks.
- Maintain major economic ties with the United States and Japan but limit as much as possible the effects on Taiwan of the economic troubles of either partner.
- Continue Taiwan's access to up-to-date US military equipment, while working to limit dependence on the United States by developing Taiwan's defense industries and seeking other sources of military equipment and technology.
- Maintain access to US nuclear power technology, equipment, and fuel while again attempting to reduce the political-economic risk by seeking other suppliers.
- Re-examine Taiwan's future relationship with China to preserve both Taiwan's sense of identity and its ability to deal with a possible evolution toward an accommodation with China from as strong a position as possible.

Relations With the United States

5. In the midterm, relations with Washington are likely to remain the keystone of Taiwan's foreign policy. New markets and new sources of military and nuclear equipment and fuel are unlikely to limit the crucial role of the United States in these areas. Extensive substantive ties with the United States play a major role in maintaining the government's self-confidence and popular confidence in the government. The KMT government will exploit the relationship to the utmost, using longstanding relations in the US Congress and the Executive Branch to buttress other activities. Conversely, it is unlikely that many in Taipei envisage any future US administration reverting to the prenormalization framework of US-Taiwan

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relations. Even so, the leaders in Taipei probably will continue to invest US-Taiwan relations with as much tangible content and degree of "officiality" as Washington will allow.

6. A reversal in current US willingness to supply Taiwan with selected, defensive armaments would not only affect prospects for maintaining a credible deterrent, but would be taken by many on Taiwan as a sign that the United States was no longer interested in the island's long-range security against China. To those on Taiwan, the corollary would be that the United States favored the island's reunification with the mainland. (For an evaluation of the military balance between Taiwan and China, see annex C.)

The Other Partner—Japan

7. Although Japan is Taiwan's second largest trade partner, largest exporter, and an important source of capital, Tokyo currently cannot occupy the key position held by the United States in Taiwan's foreign affairs. Continued extensive economic ties between Taiwan and Japan do not extend into the military and security spheres as do relations with the United States. Japan does not supply defensive arms to Taiwan. Although undoubtedly interested in Taiwan's future as it might apply to the security of Japan, officials in Tokyo have not expressed their views publicly.

8. From Taiwan's point of view, political ties with Japan have been diminishing since normalization of Sino-Japanese relations in 1972. Taipei's ability to influence Japanese official points of view has steadily diminished as its supporters in Japan grow old or come to place greater importance on Sino-Japanese relations.

9. Aside from taking diplomatic or economic action to preserve its economic interests in Taiwan, it is unlikely that Japan in the midterm wishes to or is in a position to decisively influence the island's future, particularly from a security point of view. It is unlikely that Japan would encourage Taiwan's independence or jeopardize Sino-Japanese relations by supporting Taiwan's resistance to reunification with the mainland. On the other hand, China's use of force to effect reunification would harm Sino-Japanese bilateral relations, as Tokyo evaluated the effect on regional stability and the impact on US-Japanese security relations. Should Taiwan become politically unstable, Japan might attempt to use what economic leverage it has to facilitate a return to stability. In the

unlikely event that a government on Taiwan turns toward the USSR, Japan probably would have a mutual interest with China and the United States in forestalling or reversing such a development. In any case, Japanese leverage over Taiwan is limited. While US investment usually takes the form of capital investment, Japanese money usually finances trade, or is aimed at earning a quick return, thus limiting risk and leverage.

10. If Japan is likely to be satisfied with the status quo on Taiwan and with Taiwan's current position vis-a-vis China and the United States, Tokyo also recognizes that friction could grow in Tokyo's relations with Taipei. A major source of friction would be the conflicting claims of Taiwan, China, and Japan to the Senkaku Islands. In the midterm, however, all three parties may find it more useful to concentrate their search for oil in other places, rather than complicate their relations by raising this contentious issue.

A More Flexible Foreign Policy

11. The continued cultivation of a special relationship with the United States is aimed at maintaining Taiwan's economic development and enhancing its economic strength and military self-sufficiency. The experience of the past decade has taught Taipei the importance of substance in foreign relations over the embellishments of diplomatic form. Only 21 governments—most of them in Central America and the Caribbean—now have diplomatic relations with Taipei, and a further reduction of diplomatic ties in the 1980s is likely. The Taiwan authorities hope to preserve what diplomatic ties they can, substituting substantive economic relations where they must.

12. This emphasis on economic contacts helps Taiwan keep its identity as an international entity and retain the prosperity that helps dampen potential domestic political problems. Diplomatic relations with Saudi Arabia remain important because Saudi Arabia, along with Kuwait, provides a major share of resource-poor Taiwan's imported petroleum. The authorities in Taipei cultivate the Saudis by sending high-level delegations, assisting the Saudi armed forces

Relations with South Africa center on shared interests in the development of military production and technology and of their respective nuclear power industries, as well as a mutual interest in

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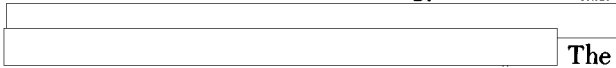
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avoiding international political isolation. Earlier this year Taiwan added to earlier procurement a six-year purchase, starting in 1984, of 4,000 tons of natural uranium. Taiwan has also indicated interest in South Africa as a potential source of enriched uranium fuel for Taiwan's nuclear power program. Despite Taiwan's prodding, however, the South Africans apparently have not shared nuclear technology with Taiwan.

 The natural uranium purchases are important to Taiwan's plans to ease its heavy dependence on foreign oil by eventually deriving 40 percent of its electric power from nuclear sources. South Africa has only limited enrichment capacity, however, so that in any event Taipei will continue to depend on the United States or Europe for this service.

13. Whereas Taiwan's deepening relationship with the Saudis and South Africans represents an intensification of prenormalization trends, its increased trade and expanding unofficial relations with Western Europe are new. Since normalization, total trade with Western Europe has increased from \$4 billion in 1979 to a predicted \$5 billion in 1980, with Taiwan enjoying a projected \$1 billion surplus. Unofficial representation on Taiwan from West European nations has been increasing. Most European nations either have unofficial representation in Taipei or are actively interested in obtaining it. Five West European banks representing three countries also have offices there.

14. Western Europe is attractive to Taiwan as an additional export market and as a source of technology, such as transport aircraft (the airbus from France), nuclear power equipment, and modern military weapons and technology. There are built-in limits, however, to rapid growth in trade and to Western Europe's usefulness as a source of sensitive industrial and military equipment and technology. Taiwan's large trade surplus and world economic conditions may prompt West European nations to raise protectionist barriers, and most West European governments have been cautious about selling Taiwan nuclear or military equipment and technology. Efforts by Taiwan to purchase such items have been only partially successful, although Taipei is inviting two West European firms to bid on two future nuclear power reactors. Over the past two years, Taipei has procured a small number of antiaircraft guns from Sweden and Switzerland. Efforts to obtain sonars, torpedo boats,

combat aircraft, tanks, and submarines from other West European nations have been largely unsuccessful. Recently, however, the Netherlands, despite strong protests from Beijing, have agreed to build two submarines for Taiwan. Expanded economic ties with Western Europe might provide a conduit for the importation of some dual-use technology serving Taiwan's efforts to expand and modernize its military industries.

15. Israel has proved a more fruitful source of equipment and technology by supplying the Gabriel antiship missile. 

16. Taiwan's efforts to reduce nearly total dependence on the United States by acquiring nuclear technology, fuel, and power-generation equipment from Britain, France, Italy, West Germany, or Belgium have been fruitless. A high-level nuclear delegation from Taiwan returned home emptyhanded after a swing through Western Europe in May 1979. In November 1979 the West German firm of Kraftwerk Union (KWU) offered to provide Taiwan a complete nuclear cycle, similar to one promised earlier to Brazil. Negotiations on this basis are likely to founder because of caution on both sides. Since its Brazilian deal, KWU has refrained from selling sensitive technology, such as nuclear fuel reprocessing. KWU does, however, use the prospect of acquiring such technology as bait to arouse interest among prospective foreign purchasers. In line with its interest in expanding its sources of nuclear equipment and technology, Taiwan has invited West German and French firms to bid on construction of reactor units seven and eight in its nuclear power program along with the provision of associated fuel. US firms may still have an edge in this competition and are probably favored by the program's civilian managers.

17. One of the major inhibitions on Taiwan's efforts to reduce nuclear dependence on the United States is that the bilateral nuclear cooperation agreement with Taiwan now provides the only suitable mechanism for safeguarding nuclear facilities on Taiwan. France and West Germany thus far have shown no interest in a separate bilateral agreement with Taiwan for fear of alienating China.

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18. Even if Taiwan were successful in limiting its dependence on the United States in these two key areas, using other sources to expand the island's still-limited industrial technological base would take years, particularly in the nuclear power industry. Taiwan may have greater success in developing a more self-sufficient military industry capable of producing anti-tank and shipboard cruise missiles, patrol boats, light fighter planes, tanks, and artillery. Even here, however, progress is likely to be slow, and long-term reliance on key imported components—mainly from the United States—is likely to continue.

19. Continued heavy reliance on the United States as a partner in developing the island's nuclear energy program will remain the main stumblingblock to the reactivation of nuclear weapons research on Taiwan. Taipei's weapons research program has been largely in abeyance since 1977. Although some military officers and officials—particularly those associated with the Chungshan Institute of Science and Technology, and the Institute for Nuclear Energy Research—wish to revive nuclear weapons research, they have been unable to persuade President Chiang that a reactivated effort would enhance Taiwan's security enough to offset the severe damage likely to accrue to relations with the United States. Nevertheless, there is no sign that the authorities in Taipei have completely abandoned the nuclear weapons option. Rather, the program remains in limbo, with emphasis on contingency planning.

20. It is unlikely that the relaxation of restrictions on trade with several East European countries will profoundly affect Taiwan's international orientation. Poland, Hungary, East Germany, and Czechoslovakia have shown tentative interest in greater trade, but trade with Eastern Europe, although likely to grow, is also likely to remain a minuscule part of Taiwan's overall foreign trade.

21. Still less likely in the midterm is a major opening toward the Soviet Union. President Chiang Ching-kuo has consistently refused to consider entering into a dialogue with Moscow, partly from personal antipathy, partly because such a move would complicate his policies toward the United States and China. Deng Xiaoping has repeatedly avowed that a turn by Taiwan toward the Soviet Union would cause Beijing to reconsider its peaceful approach toward reunification.

22. There are signs of Soviet interest in opening trade with Taiwan. Any positive response from Taipei

is likely to be carefully limited. Although hints of improving ties with Moscow might be used to remind Beijing and Washington that Taiwan has options other than reunification or continued heavy reliance on the United States, Taiwan's foreign policy is unlikely to move in that direction.

23. Taiwan's more pragmatic foreign trade policy will help expand Taipei's markets but is unlikely to be translated into diplomatic support for independence from China. It is unlikely that any major foreign government would recognize a self-proclaimed independent Taiwan. What the more pragmatic policies do serve is continued acceptance of Taiwan's de facto independence as well as enhanced possibilities for continued economic prosperity. These efforts would help maintain confidence and stability on the island, as well as strengthen Taipei's position if it eventually were to probe for a new relationship with the mainland.

Internal Unrest

24. The major threat to Taiwan's stability comes from potential domestic political unrest that could affect the KMT's ability to govern. The potential for political instability comes primarily from the split in Taiwan's society between the mainlanders who retreated to the island with Chiang Kai-shek and those native to the island. Although linked by Chinese culture, both groups retain a strong sense of self-identity. This self-consciousness is reinforced by language differences—despite 30 years of compulsory Mandarin training in the schools—and by differing historical experiences. Taiwanese have little reason to feel closely tied to the mainland. A largely neglected province of the old Qing Empire, the island was under Japanese rule from 1895 to 1945. Within two years of the restoration of Chinese rule by the KMT, misgovernment, corruption, and a faltering economy provoked a spontaneous uprising in February 1947. The ensuing suppression, still vividly remembered by many Taiwanese, wiped out almost a whole generation of local leadership. An estimated 10,000 to 20,000 people lost their lives, or disappeared. About 3,000 Taiwanese went into exile to carry on a sporadic, ineffectual opposition.

25. The mainlander elite still dominates the island's political affairs, commanding positions in the armed forces, security services, government ministries, and the KMT. Since the early 1970s, concessions have been

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made in response to Taiwanese pressure by bringing some Taiwanese into the higher reaches of the political structure, including ministerial positions. About one-third of the KMT Central Standing Committee elected last December is Taiwanese, and a Taiwanese commands the Eighth Army in the southern port city of Kaohsiung.

26. None of these concessions, however, has altered the fact of mainlander rule. President Chiang Ching-kuo and his closest advisers, the men who run Taiwan, are mainlanders. Their authority is legitimized by the myth of return to the mainland and their continued claim to be the legitimate government of China, temporarily residing in the province of Taiwan.

27. In practical terms the goal of mainland recovery has been long abandoned. In recent years greater propaganda emphasis has been placed on Taiwan as a model province whose example will someday inspire the people of mainland China to overthrow Communist rule. The KMT cannot abandon, however, its claim to be the legitimate government of China without bringing into question the right of a small minority—15 percent of the population—to govern the remaining 85 percent, which is Taiwanese. The importance of this claim, along with the mainlander Chinese identity of the ruling elite, precludes the KMT government from accepting the concept of Taiwan independence.

28. The simple dichotomy of mainlander versus Taiwanese, however, is not a wholly faithful image of the complexities of Taiwan's society or politics. Even in 1947 there were many Taiwanese who linked their personal fortunes to the KMT and to China. Between 50 and 80 percent of the KMT membership is Taiwanese. Many of the Taiwanese businessmen who dominate the large private sector of the economy have a symbiotic relationship with the mainlander-controlled regime. Three decades of KMT-directed, anti-Communist propaganda and education in Chinese nationalism probably have had some effect in shaping the attitudes of younger generations. Certainly support for Taiwan independence exists among a number of Taiwanese, but its extent is impossible to measure and becomes confused with a desire to liberalize the more oppressive aspects of KMT rule and open up the system to allow the rise of Taiwanese talent.

29. Thirty years of nearly unbroken economic growth and the concentration of middle and upper

class Taiwanese on enhancing their personal prosperity have muted communal antagonism and diverted Taiwanese energies from politics into business, the professions, and education. Taiwanese concern with maintaining and improving the standard of living—which is far above that of mainland China—has tended to reinforce KMT efforts to maintain the status quo at home and to resist political and military pressure from the mainland for reunification.

30. Although the majority of working and middle-class Taiwanese do not appear to be highly politicized, eight Taiwanese oppositionists in their thirties or early forties were sentenced to prison in April 1980 for fomenting the antigovernment riot in Kaohsiung in late 1979. They are part of a growing, better-educated Taiwanese middle class, which may feel its lack of political influence more keenly than its elders.

31. "Taiwanization" of the legislative branch of the government, the civil service, and the lower reaches of the KMT will increase sharply during the 1980s as elderly mainlanders die or retire. If not forestalled by second-generation mainlanders, this trend could leave the Taiwanese in control of local government, national parliamentary bodies, and with a larger share of KMT membership. Such a development might temporarily mollify moderate Taiwanese by bringing them into greater participation in the political system, but it is equally likely that it will whet Taiwanese appetites for greater political power. Moreover, with creeping Taiwanization, the validity of the concept of mainlander control of the KMT government will come increasingly into question. In addition, increasing Taiwanization of the KMT would raise the possibility of a slow takeover from within by "KMT" Taiwanese with no interest in political reunification with the mainland.

Chiang Ching-kuo, the KMT, and Reform

32. Starting in the early 1970s, before becoming President, Chiang Ching-kuo—in league with the more reformist, liberal elements in the Kuomintang—instituted a cautious liberalization of the political system. In part this effort represented Chiang's attempt to carve out his own constituency and points of view within the KMT in preparation for his succession to power. In part, however, it also represented an attempt to come to grips with an aging political elite whose politically conservative ideas appeared ill-suited

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to meet the changes occurring in Taiwan's society and international status. As a result of Chiang's efforts, unprecedented numbers of Taiwanese were brought into political office. Many moderate Taiwanese reformist politicians, including some who later became anti-KMT, came to regard Chiang as a moderate reformist whose interests were compatible with those of the Taiwanese.

33. To effect his reforms, Chiang enforced anti-corruption laws, called on the services of technocrats in government rather than party hacks, and stressed a government bound by its own laws, rather than entirely relying on arbitrary action.

34. Chiang attempted to reinvigorate and reform the KMT, though with only limited success. The party remained filled with personnel who could perform no other jobs. It failed to attract many of the most capable younger men, who chose to enter the professions, the government bureaucracy, or business. At the grassroots many party members remained entrenched within their local political alliances. They were suspicious of reform and enforced it halfheartedly.

35. One aspect of the party structure that Chiang Ching-kuo had no intention of reforming was the centralization of final decisionmaking in the hands of the party leader. The structure of the KMT, patterned after that of the Communist Party of the Soviet Union, tends to concentrate authority at the top.

36. The KMT, however, is only one of several institutions, and not the most powerful, that President Chiang uses to govern. Decisions by the KMT bureaucracy are often overridden by other government organizations. For example, the opposition of some party bureaucrats to the crackdown on the non-KMT opposition after the Kaohsiung riot was outflanked by the security services.

37. Personal rivalries are numerous, and allegiances and factions can change kaleidoscopically. In balancing these political blocs, Chiang, in order to achieve a specific goal, often permits one group to gain temporary prominence. When the political task at hand is accomplished, he reduces its power and restores factional balance. Since the Kaohsiung riot, Chiang has permitted the more hardline, conservative element to

increase its influence in the party. Currently the KMT appears divided into five factions:

- The Wang Sheng group, headed by the director of the armed services Political Warfare Department.
- The old line KMT conservative faction, composed mainly of elderly KMT leaders.
- The Chang Pao-shu group, led by the now-retired, elderly secretary-general of the KMT.
- The Hsieh Tung-min (Shieh Tung-min) faction represents the large Taiwanese element within the KMT.
- The Li Huan group, headed by one of President Chiang's old political lieutenants, is the most liberal and reform minded of all the factions in the KMT.

The Rise of a New Opposition

38. The more liberal political atmosphere of the early 1970s encouraged non-KMT Taiwanese to become more politically active. Supplemental national legislative elections in 1969 and 1972 had gone well for the KMT in starting a carefully controlled process of injecting new blood into the aging ranks of KMT officeholders. The smooth evolution of this process, however, received a jolt from symbolically important and unforeseen opposition victories in the Taiwan local election of November 1977. Moreover, an election-associated riot suggested a new volatility among the population. The Taiwanese oppositionists, encouraged by the election, looked forward to greater victories in the next round of supplemental national legislative elections scheduled for December 1978. Although the Taipei authorities' reaction was restrained, their concern increased as signs multiplied that the oppositionists were organizing and attempting to reach out to the Taiwan Presbyterian Church—a longtime advocate of Taiwan independence and expanded human rights.

39. The KMT government took advantage of the announcement of normalization of Sino-US diplomatic relations to postpone the elections. The oppositionists' reaction was mixed, but most did not resist a short postponement as an emergency measure. The government, however, quickly adopted a harder line toward opposition activities. By mid-1979, a more organized opposition group—associated with the highly critical new magazine *Formosa*—began sponsoring rallies and

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attempting to coordinate oppositionist political activity. The authorities probably were particularly alarmed by *Formosa's* effort to organize an embryonic political party by setting up "service centers" around the island. Opposition moderates, perhaps fearing that they might be politically outbid by the "Formosans," were uneasy about such activity but appeared unable or unwilling to moderate it. By November, at the order of Chiang Ching-kuo, the authorities had decided to suppress *Formosa*. The *Formosa* group's decision to hold an unauthorized rally in Kaohsiung on 10 December 1979 (Human Rights Day) provided the opportunity. Either spontaneously or through the action of government provocateurs (many Taiwanese believe the latter) the rally quickly became a riot. This event was followed by the suppression of *Formosa*, and the imprisonment of its leadership.

The Current Scene

40. The crackdown after the riot has set back opposition attempts to organize. Opposition moderates, never fully in sympathy with the increasingly confrontational tactics of the *Formosa* group, worry that the Kaohsiung affair will reverse the political gains of the 1970s. The continued suppression of opposition publications, including one representing young, moderate KMT intellectuals—even though masked by the banning of some KMT rightist journals—indicates that the limits of permissible debate have been narrowed. Moderates within the KMT have been discredited by their support for a more open political system. Chiang Ching-kuo may eventually moderate the crackdown on the opposition and curtail the growing influence of the conservatives in the KMT. The KMT's success in the December 1980 national legislative elections redounded to the credit of the conservatives who managed them, however, and could give them a permanent edge in the maneuvering to direct the party's future.

41. The elections reflected the government's attitude toward further liberalization of the political process. A new electoral law, although containing a few provisions more liberal than previous regulations, in practice is more restrictive. In particular, the new law restricts the conduct of campaign rallies. It also continues to prohibit student participation in the electoral process either as candidates or as campaign assistants. The net effect is to enhance the electoral fortunes of the KMT.

42. Nevertheless, the expansion of the number of positions open for election—from 124 in late 1978 to 204 last December—allowed room for the election of more Taiwanese candidates within the party without threatening KMT control of the legislature. The party leadership was able to limit the election of non-KMT candidates to merely a handful. The authorities made a special effort to limit public discussion of the Kaohsiung incident during the campaign to preclude the election turning into a referendum on the government's handling of the affair. While this effort was generally successful, the election of five opposition figures linked with the disturbance—including the wives of two jailed Kaohsiung dissidents—reflected continued desire among the native Taiwanese for wider participation in the political process at the national level outside the KMT. The KMT victory may reinforce the impression held by many Taiwanese that the mainlander element of the KMT and its Taiwanese allies have no intention of liberalizing the political system.

43. Even though the Kaohsiung incident did not spark widespread popular expressions of support for the demonstrators or their political goals, it jolted the KMT establishment as well as the security services and the armed forces high command. The latter two institutions launched a sweeping security investigation of all armed services personnel. The investigation will encourage the military to follow the KMT position, or to keep their political feelings to themselves. The mostly Taiwanese rank and file do not appear to be highly politicized or unwilling to obey their officers. The heavily mainlander professional officer corps is political to the extent that it tends to support the status quo and the legitimacy of the regime.

44. In the longer run, however, the regime may have cause for concern. One of the defendants in the Kaohsiung riot trials touched obliquely on this sensitive subject by pointing out that the Iranian revolution suggests that the army could not be used to "suppress the masses." This implies not only that Taiwan's conscript army might hesitate to fire on civilians; but also that the 90-percent-Taiwanese army might not suppress a Taiwanese uprising.

A Turning Point

45. The Kaohsiung incident and subsequent restrictions on opposition political activity may mark a symbolic turning point. By their handling of the incident,

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Chiang Ching-kuo and the KMT conservatives have made clear their view that Taiwanese political aspirations must be fulfilled only within the KMT framework. The message received by politically conscious Taiwanese is that Chiang and the KMT do not intend to share power. In October 1979, Chiang remarked that the organization of an opposition party must be prevented because its existence would mark the beginning of the end of KMT control of local politics and ultimately of Taiwan.

46. Conversely, those politically conscious Taiwanese who have cast their lot with the KMT may for the moment feel vindicated. The KMT government has demonstrated its ability to suppress dissent. The more militant Taiwanese—although now few in number—may feel convinced that only greater activism, perhaps including violence, will weaken KMT rule. The moderate middle group faces a difficult choice. To continue moderate efforts at political reform risks absorption into the existing system. To turn toward militant activism risks not only government suppression, but also political instability that might undermine KMT rule, damage the island's economy, scare off foreign investors, and—in an extreme case—invite Chinese intervention.

25X1 47. [] authorities have expressed concern that the Taiwan Independence Movement (TIM) is renewing its efforts to bring about political instability in Taiwan. They fear that the TIM is procuring arms in the black market on Taiwan and through smuggling. Whether or not the authorities' alarm is justified, it indicates new concern about potential instability in the island. The KMT also has attempted to link TIM with opposition groups on the island. These opposition groups, however, are quite distinct from TIM and represent diverse interests. Opposition elements range from those who actively oppose the Taiwan authorities as representative of all China and, like TIM, seek independence for Taiwan from both KMT and Communist control, to those who generally support the KMT and seek public office. There is general agreement among the majority of oppositionists on issues such as the cessation of martial law; parliamentary reform so that representation reflects the constituency governed; direct election of mayors and the Taiwan provincial governor; an independent judiciary; removal of KMT control from schools, the military, and the courts; amnesty for political prisoners; and freedom of speech.

The China Angle

48. The special relationship remaining between the United States and Taiwan, including the declared US interest in a peaceful solution to the Taiwan issue, poses difficult problems for Beijing. Continued US arms sales to Taiwan draw Chinese criticism as providing disincentives to Taipei to negotiate peaceful reunification. The Chinese are also sensitive to any signs of US backsliding from what they regard as the terms of the normalization agreement. At the same time, Beijing must take into account Taiwan's expanding economic relations with Western Europe and its trade opening to Eastern Europe. Combined with other links—particularly with South Africa, Israel, and Saudi Arabia—these ties afford Taipei access to investment funds, modern industrial and defense technology, and favorable trade balances. These factors will help deflect pressures on Taiwan to contemplate closer and more direct ties with China and also help strengthen Taiwan's bargaining position.

49. Increased Taiwanese pressure on the KMT for a more open political system also poses problems for China. Although this pressure affords Beijing propaganda opportunities to pose as a champion of political change in Taiwan, such efforts also contribute to KMT attempts to discredit the Taiwanese reformers and the TIM as dupes, or even agents, of the Chinese Communists. Moreover, Beijing is concerned that an increasingly effective Taiwanese opposition movement might eventually be in a position to achieve self-determination for Taiwan. The Kaohsiung incident thus has forced Beijing to examine Taiwanese demands seriously, if only to counteract them in the cause of reunification. Fashioning a policy to deal with these dilemmas, however, has caused confusion and dissent within the Chinese Communist Party (CCP).

Chinese Strategy and Tactics

50. China's official policy on reunification is contained in the open letter of 1 January 1979 from the Standing Committee of the National People's Congress to "compatriots on Taiwan." The letter sums up policy previously enunciated by Deng Xiaoping and other officials throughout 1978. The letter promises to respect the status quo on Taiwan; guarantees the island will retain its superior standard of living; and calls for the establishment of trade, communication, transportation, and cultural links between Taiwan and the main-

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land. It also implies a major role for "Taiwan authorities" (that is, the KMT) after reunification. Deng later stated that Taiwan could retain its own armed forces.

51. The letter leaves the impression that China is willing to allow Taiwan to retain a large measure of autonomy after reunification. This impression was reinforced by a later statement by Deng recalling the special district permitted the Chinese Communists by the Nationalist government during the war against Japan. Deng stated that China would be willing to designate Taiwan as such a zone.

52. This approach, which emphasizes negotiation with the Taipei authorities, prevailed throughout 1979 and 1980. The Chinese also stopped "shelling" the Nationalist-held offshore islands and reduced their air forces in Fujian Province opposite Taiwan. The idea of the use of force was downgraded to be used only as a form of psychological pressure on Taipei, or as a last resort if:

- Taiwan sought support from the USSR.
- Taiwan declared itself independent.
- The authorities in Taipei refused for a prolonged period to enter into negotiations with China.

53. China has removed restrictions on trade with Taiwan, encouraged visits by Taiwan people to the mainland and contacts in third countries between Taiwan people and mainlanders, and courted overseas Chinese who might have influence to urge the Taipei government to open talks with Beijing.

54. Increasing Taiwanese pressure for political concessions from the KMT, evident in the activities of the *Formosa* group, complicated Beijing's policy. After first treating the Kaohsiung riot and the ensuing arrests cautiously, the Chinese media in early 1980 became more critical, accusing the Taiwan authorities of suppressing legitimate Taiwanese demands for greater political rights. The new tack was meant to turn political tension and anti-KMT feeling on Taiwan to China's use:



- Politburo member Deng Yingchao's public appeal in early March 1980 for dialogue with supporters of Taiwan independence, although she carefully repeated Beijing's refusal to consider such a solution.

— A letter of 15 February 1980 from the Chinese People's Political Consultative Conference (a CCP united front organization) calling on the people of Taiwan (not the "Taiwan authorities") to pressure the Taipei government to seek reunification.

55. Implicit in these appeals was the notion that the Taiwanese after reunification would enjoy the full political rights they did not possess before.

56. Probably most of CCP leadership preferred the Taiwan policy set forth in Central Document Number Ten, issued in the first five months of 1980. Viewing with alarm the rising potential for a Taiwan independence movement, and fearing possible Soviet meddling in the island's affairs, Document Ten asserted that negotiations with President Chiang remained the only viable way to reunification and that China should do nothing to bring about his downfall. Implicit in this policy is a rejection of support for anti-KMT Taiwanese, along with the idea that the KMT would remain in control locally after reunification.

China and the Taiwan Succession Crisis

57. Document Ten contained a note of urgency about starting the negotiation process with Chiang Ching-kuo. The Chinese fear that achieving reunification with a successor regime may be even more difficult than negotiating with the 70-year-old Chiang, who has not designated a successor. A mainlander-dominated successor regime might be interested in securing its political privileges through some form of association with China, but might lack the popular support to be a credible negotiating partner. Under such conditions, negotiations might provoke an uprising by the Taiwanese. If a mainlander regime then called for Chinese aid to suppress the revolt, China would be presented with the military conflict it seeks to avoid. A Taiwanese-dominated government might, on the other hand, choose independence and appeal for US support or—in the worst case—intrigue with the USSR.

58. The decision, reportedly favored by Vice Premier Deng, to concentrate on securing negotiations with Chiang Ching-kuo is necessarily a relatively short-run approach, dependent on an early positive response from an elderly opponent. Such a plan does not deal with the prospect of "creeping Taiwanization" of the island's political institutions. Should Chiang prove

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unresponsive, other voices within the CCP—particularly the party's Taiwanese members living in exile in China—prefer to direct China's appeals for reunification to the Taiwanese, hoping to take advantage of the latter's resentment of KMT rule. This approach, however, appears even less promising than Deng's. Even if the KMT as an institution survived Chiang's death, a "Taiwanized" KMT might not be willing to negotiate on reunification. Alternatively, the KMT factionalism might polarize around mainlander versus Taiwanese, with neither able to force a clear-cut decision for reunification or for independence.

Taiwan's Reaction to China's Overtures

59. The government in Taipei has refused to enter into direct negotiations with China on any issue. It has, however, shown greater pragmatism in dealing with China's political offensive by adopting a more flexible approach toward the subject of reunification. Taipei seeks to avoid being characterized as the intransigent party while seeking to present itself as reasonable, concerned with human rights and popular welfare, and clearly the best economic and political model for Chinese development. Taipei has continued the trend, noticeable in 1978, of permitting informal meetings in third countries between people from Taiwan and the mainland—such as scientists, journalists, academicians, students, and athletes.

60. Taiwan has modified its official instructions for handling these contacts. Targets such as students from the mainland are to be won over to support the Taiwan model and encouraged to propagate these views back home. Defections, although not rejected, are not greatly encouraged. Although Taipei does not publicly encourage visits by businessmen and others from Taiwan to the mainland via Hong Kong and other third countries, neither has it arrested and prosecuted the increasing number of such visitors. In certain cases Taipei has permitted its delegations at meetings of inconspicuous, specialized, international societies to attend under names other than "Republic of China."

61. Parallel with the easing of restrictions on "people-to-people" contacts, Taiwan for the most part has turned a blind eye to a major increase in indirect trade between Taiwan and the mainland via Hong Kong, Japan, and other nations. Taiwan's exports to China increased from \$1 million in the first quarter of 1979 to \$26 million during the same period in 1980. Imports from China during the first quarter of 1980 were

\$19.4 million. Taiwan mainly exports raw materials (such as synthetic fiber), parts, and consumer goods (watches, tape recorders, and television sets).

62. China welcomes this trade and pushes for further increases. It has made goods from Taiwan duty free and urged the exchange of Chinese petroleum and coal for Taiwan's industrial products.

63. The potential of trade as a lubricant for easing a move toward political relations has built-in limits. From an economic point of view, China can afford to spend little on imported consumer goods, although probably more on raw materials such as synthetic fibers. Conversely, Taiwan—while willing to import specialized consumer goods and perhaps coal—is wary of becoming overly dependent on the mainland. Although the trade is likely to continue to grow, perhaps at a more modest rate than in 1979, it is equally likely to remain a small percentage of Taiwan's overall foreign trade.

64. Taiwan is careful to avoid signaling Beijing that increased trade means a softening in Taipei's rejection of political negotiations, or indeed of direct contacts of any kind. The Taiwan authorities try to keep the growth in indirect trade under control and occasionally crack down on overambitious businessmen or those who engage in direct trade. Similarly, Taiwan attempts to keep under control the extensive trade in gold and small consumer goods between fishermen from Taiwan and the mainland. As object lessons, the authorities occasionally arrest fishermen and confiscate their goods. Control of the trade on the China side appears spottier and unevenly enforced.

Outlook

65. The forces making for the island's stability and continued existence as a de facto independent entity are strong, but it is likely that the midterm and beyond could be a period of flux both at home and in Taiwan's relations abroad.

66. Taiwan's greatest strengths are its well-run, still-expanding economy, the continuation of extensive ties with the United States, and a leadership that has demonstrated the ability to maintain its own confidence, and that of most of its citizens, in the future of Taiwan. The government has demonstrated its willingness and ability to maintain public order and suppress overt opposition.

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67. The island also has vulnerabilities. It has few natural resources. Increased participation in the international market makes the resulting prosperity more subject to fluctuations in the international economy. Rapid, still-continuing urbanization will continue to have an unsettling effect on traditional social bonds and mores. Taiwan still must import most of its advanced industrial machinery, and its defense industries are only partially self-sufficient. The continuation of political domination by a mainlander elite over a much larger Taiwanese population provides the potential for friction. The legitimacy of the regime rests on justifications which make domestic political reform difficult.

68. In the midterm, the KMT government's most difficult political problem is likely to be containment of pressure by Taiwanese for more meaningful participation in the political process and for a share of political power. To be successful, the Taiwanese opposition needs able leaders, a central organization, money, and consistent plans. Funds are available from Taiwanese businessmen, from the sale of publications, and from Taiwanese organizations in the United States. Although the *Formosa* group has been imprisoned, other Taiwanese leaders remain active on the island and in the United States. Their abilities, however, have not been fully tested. The more moderate non-KMT Taiwanese politicians, such as Kang Ning-hsiang, may be more successful in the long run in gaining concessions from President Chiang, but they run the risk of eventually being absorbed into the system of mainlander rule. The Taiwanese opposition, both at home and abroad, lacks unity, cohesive and consistent plans, and any common ideology apart from their anti-KMT orientation.

69. The suppression of the *Formosa* network ended the only effective formal opposition organization on the island, and the KMT is unlikely to allow a similar organization to be formed any time soon. The various overseas Taiwan independence groups have formed an umbrella organization, the United Front for a Taiwan Nation, but their chronic disunity and bickering provide little hope for effectiveness.

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70. [redacted]
[redacted] The government's ability to act decisively will not change in the midterm. In particular, increased activity by oppositionists that

might complicate movement by the authorities on reunification will be dealt with swiftly and effectively. To mount a serious threat to the regime the oppositionists must construct some sort of organization.

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71. The KMT finds itself faced with the classic problem of maintaining an effective monopoly of political power by suppression, judicious concessions, or a combination of both. As long as President Chiang is active, the government probably will attempt both approaches. Concessions, such as the inclusion of more Taiwanese in the government and party bureaucracy, will be accompanied by suppression of any attempt to create a Taiwanese political party. Chiang is likely to continue to tolerate moderate Taiwanese politicians who work for reform within the system, while attempting to limit their popular appeal to the Taiwanese by co-opting them.

72. These political tactics are likely to be accompanied by continued concentration on economic growth and an equitable distribution of income to preclude the development of widespread economic grievances. Taiwan economic technocrats already are planning to increase the industrial sectors of the economy while reducing the agricultural and service components. This will entail some consolidation of landholding to encourage more efficient agricultural production with a concomitant increase in the urban population. To provide jobs and shift exports from fields such as textiles, where Taiwan is slowly losing its competitive edge, the government plans on the growth of higher technology industries.

73. Despite a slower rate of growth in GNP over the last three years (12.8 percent in 1978, 8 percent in 1979, and 6.7 percent in 1980), Taiwan's economic prospects appear good. There is no difficulty in procuring foreign loans from the United States or from Western Europe. Taiwan's recent loss of membership in international financial institutions is unlikely to have major repercussions.

74. Taiwan, however, will remain wholly dependent on imported oil. No commercially exploitable sources have been discovered in or around the island, although exploitable deposits of natural gas have been located. Growing imports of petroleum to provide the

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energy needs for economic expansion is causing an inflation of about 19 percent.

75. If the growth in energy costs is not reduced, inflation will increase, slowing real economic growth, raising the potential for popular discontent, and diminishing Taiwan's export advantage. The government hopes to limit dependence on imported oil by implementing a major nuclear electric power program and partially switching to coal. Both alternatives would maintain Taiwan's economic dependence on the United States, which is the island's major source of nuclear technology and low enriched fuel as well as of coal. This dependence can be partially offset by importing coal from other sources, such as South Africa and Australia.

76. Diversification of markets—Western Europe, Latin America, and Africa—will help counter rising protectionism, but in the midterm these areas are not likely to absorb more than a small amount of Taiwan's overall trade. The opening of trade with the European Communist nations, with its political implications, must be handled carefully to avoid arousing Beijing.

77. If pressure from the Taiwanese for reform is the most important midterm political problem, the looming succession crisis probably is the most troublesome immediate question. Estimates of the state of Chiang Ching-kuo's health differ. Japanese observers believe it is declining rapidly; the Chinese also evidently believe he does not have many years left. As a 70-year-old diabetic, Chiang has already outlived actuarial expectations.

78. Chiang has not attempted to groom a successor. Rather Chiang appears to be relying on the machinery of the constitution and a reshuffle in December 1979 of the KMT Central Standing Committee to ensure a smooth succession.¹

¹ Under the Constitution, should Chiang die in office before the next presidential election in 1984, he would be succeeded by Vice President Hsieh Tung-min. Although a factional leader in his own right, Hsieh, a Taiwanese, is unlikely to retain the presidential office. The mainlander-dominated Central Standing Committee is more likely to choose a mainlander. Nevertheless, Chiang's reordering of the Committee raised its Taiwanese contingent to nine, one-third of its membership. This increase, plus the precedent of having a Taiwanese vice president (Hsieh) suggests that Taiwanese feelings may be taken into account in the selection of the island's future leadership, perhaps in the form of another Taiwanese in the largely ceremonial vice president's office.

79. Chiang's reshuffle of the Central Standing Committee raises the possibility that in the event of Chiang's incapacitation or death the Committee will assume a more important political role. The Committee now contains all the most likely "power brokers" for a post-Chiang regime in the form of important figures from among the technocrats, armed forces, security services, and the KMT itself. If the Committee does not select one of its own number to succeed Chiang Ching-kuo, it is likely to have the major voice in choosing an outsider. The representative balance within the committee may be altered, however, at the 12th KMT party congress, scheduled for March 1981.

80. Chiang's institutionalization of a succession mechanism and adherence to constitutional processes probably will guarantee a smooth succession in a legal sense. Chiang's efforts, however, may not guarantee a determination of the future locus of political power. The succession to Chiang will present a unique political problem. Chiang Ching-kuo was a carefully groomed, logical successor to his father. From the time he became Premier in 1972, it became increasingly apparent that he was the real authority in the regime, particularly during his father's bedridden final years. After Chiang Kai-shek's death in 1975, Chiang remained Premier for three years. When he moved on to the presidency, he shifted the center of political authority into his new position. However, he has no Chiang Ching-kuo to succeed him. None of the members of the Central Standing Committee have his prestige or inherent legitimacy as the inheritor of the mantle of Chiang Kai-shek.

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[redacted] concerned that political instability would damage its economic interests by frightening off foreign investment and disrupting commerce.

83. Under these circumstances the military and security services may play a more decisive political role in the post-Chiang period. This would particularly be so if a successor civilian regime ran into political troubles, if public unrest generated by political and/or economic complaints became serious, or if a civilian regime made what the officer corps—the last bastion of mainlander domination and conservatism—regarded as excessive concessions to the Taiwanese opposition. The possibility of rule by the military with a civilian facade is not out of the question for Taiwan's future.

The KMT Government's Options

84. In broad terms there appear to be three options open to the regime in the midterm: maintaining the status quo, seeking an accommodation with China, and declaring Taiwan independent.

85. *Maintaining the status quo.* This would entail continuation of mainlander KMT rule using current tactics. Economic growth and prosperity probably would continue even if international conditions lowered the growth rate. This course is likely to maintain stability at first, but in the longer term may not be able to deal with the "Taiwanese question."

86. Indeed, ever increasing prosperity may ultimately accelerate demands by the Taiwanese for a share of political power commensurate with their economic and social importance. The status quo would also mean continued close relations with the United States—welcome for its economic and military gains, but unlikely to reduce drastically US leverage on Taiwan. To meet this problem, Taiwan would continue its efforts to enlarge substantive relations with a variety of nations without much regard for ideology. Efforts to increase military self-sufficiency would continue.

87. Maintenance of the political and economic status quo on the island and in Taiwan's relation to China is probably attractive to many in the KMT and to Taiwanese businessmen, but it is probably impractical in the long run. If the KMT continues its policy of Taiwanization, this could make possible political participation by the Taiwanese at a level acceptable to all but the diehards on each side.

81. The decision in May 1980 by President Chiang to extend by one year in their present position the Minister of National Defense; the Chief of the General Staff; the commanders of the army, navy, and air force; [redacted]

[redacted] suggests that maneuvering for the succession has already begun and will continue. [redacted]

82. Chiang has attempted to staff the government and economic bureaucracy with able, bright young technocrats, but they do not constitute a political power base. The armed forces officer corps and the security services appear to be a potentially more powerful political base for ambitious officers, but Chiang has carefully kept the armed forces from exercising independent political power as an institution. The Taiwanese business community appears to be unlikely to provide a political power base. It has prospered by going along with the government and KMT, and it is

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88. *Seeking an accommodation with China.* Under present circumstances, there appears to be virtually no sentiment on the island among mainlanders or Taiwanese for physical reunification. A KMT move in that direction could easily provoke an uprising by the Taiwanese. A moderate Taiwanese politician, when asked what the Taiwanese might do if the KMT reached such an agreement, replied in that case "we would have to kill them."

89. An accommodation short of physical reunification, however, might not provoke a Taiwanese rebellion if skillfully handled over a considerable period of time. Some moderate Taiwanese politicians have suggested that Taiwan's relationship with China would come under discussion after Taiwan had achieved self-determination but have not ruled out all ties with the mainland. Taiwanese businessmen have expressed to the Taipei authorities interest in more trade with the mainland.

90. Taiwanese businessmen may estimate that a loose form of association with China might benefit them economically. The 1980s are likely to be a difficult period, with Taiwan facing increasing competition for markets, and these businessmen may believe that the mainland offers an immense market in which Taiwan would occupy a privileged position—although we think this is unlikely.

91. A limited move toward accommodation might also assuage mainlanders' fears of being unable to preserve their political privileges against Taiwanese encroachment. The Taipei authorities could draw on a mutual interest with Beijing in preserving the concept that Taiwan is part of China to thwart the desire of more militant Taiwanese for an independent Taiwan. Moreover, an article in the Communist-controlled Hong Kong newspaper *Ta Kung Pao* on 23 March suggested that the "Taiwan authorities" would continue to control appointments to office on Taiwan after reunification. Of course it is most unlikely that an arrangement of this sort would be reached in the time frame we are discussing.

92. Conversely, the more moderate non-KMT Taiwanese politicians may hope that if independence is not a viable solution, China in the long run might support Taiwanese demands for greater power on the island in return for loyalty to Beijing as a way of keeping the KMT in check.

93. *Declaring Taiwan independent.* Undoubtedly there is sentiment for independence on the island and among Taiwanese overseas. Sentiment for independence appears strongest among the Taiwanese but is also present to a small extent among mainlanders, particularly the younger generation. Opposition to independence probably is strongest among elderly or middle-aged mainlanders. Within the top leadership, Chiang Ching-kuo and his close advisers adamantly oppose formal independence. Moreover, there is fear that independence would draw a PRC military reaction. Deng Xiaoping has stated several times that a declaration of independence by Taipei would cause China to consider a military solution to the Taiwan problem.

94. For these reasons, Taiwanese politicians may judge that Taiwan's possibilities for full self-determination and independence are slim. Although Taiwan has managed to retain economic ties with a large number of nations, the prospects are slim that many nations would recognize an independent Taiwan. Economic ties to the United States and procurement of advanced US military equipment might be jeopardized, because Taiwan's independence would be inconsistent with Sino-US normalization and thus conflict with a major US foreign policy interest.

95. As long as Chiang is alive, independence is probably out of the question. But even though there is little sentiment under present circumstances for political affiliation with China, the KMT leadership might find a resurgence of Taiwanese pressure for the island's full independence so intolerable that it would be more inclined toward a form of association with China. For the reasons indicated above, some Taiwanese would also take this position.

An Uncertain Future

96. For the midterm (into the mid-1980s), Taiwan probably will remain stable and prosperous, as long as Chiang Ching-kuo remains physically capable of governing.

97. There appears little danger in the midterm of an attack from the mainland. Beijing understands that an attack would be costly in men and equipment, and that in the next few years it will continue to lack adequate resources to mount such an operation with a reasonable certainty of quick success. An attack would damage Beijing's relations with the United States, Ja-

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pan, and the West—thus jeopardizing Chinese defense and economic modernization. In military terms, an attack would detract from China's defenses against the Soviet Union, primarily in air defenses, and would add an additional military burden to the current one of sustaining heavy pressure on Vietnam. Taiwan recognizes this situation, and its desire for continued access to modern US weapons reflects concern for maintaining a credible military deterrent to meet future contingencies and to inspire public confidence.

98. A deterioration in the Sino-US relationship might lead Beijing to revert to a harder line toward Taiwan, particularly if an internal debate over foreign policy caused the Taiwan question to become a sensitive issue in domestic Chinese politics. If Washington unilaterally altered the "Taiwan compromise"—which allowed the United States and China to circumvent the Taiwan issue in the interest of achieving more important foreign policy goals—the Chinese leadership might feel obliged to adopt a tougher stance toward Taiwan.

99. Termination of Taiwan's access to advanced US military equipment or a reversion by Beijing to a harder line on Taiwan might embolden the advocates of a nuclear weapons capability to press for reactivation of Taiwan's research program. Under these circumstances, Chiang Ching-kuo's successors might be more sympathetic to such a move. Similarly, if Taiwan were to declare independence, both a mainlander-dominated or a heavily Taiwanese leadership might be more receptive to the nuclear weapons option if they feared a more militant China and perceived a receding US interest in the island's future.

100. In the midterm, the chances are favorable for maintaining continuity with the past. Prospects become less certain for continued political stability and economic prosperity toward the end of the period.

101. Having demonstrated by its handling of the *Formosa* group an ability to suppress organized dissent, the government is unlikely to allow similar organizations to surface. In the midterm the limits of permissible political conduct are likely to be more narrow than they were in the late 1970s. Although Taiwanese pressure for a greater role in politics is likely to persist, the government probably can contain such pressures for the next few years. The opposition is likely to remain disorganized, disunited, and unable to tap potential mass Taiwanese political discontent.

102. Continued economic growth and relatively widespread prosperity will remain a vital lubricant for passing political frictions. The authorities in Taipei will remain sensitive to any development that might shake popular confidence in Taiwan's economic future, and thus they will maintain a close substantive relationship with the United States even as Taiwan seeks to broaden its international markets and sources of foreign investment and industrial imports.

103. So far the potential for instability resides in popular political grievances. More difficult economic times could increase prospects for instability. Even though government management of the economy will remain growth oriented, economic developments over which the authorities have no control—such as rising foreign protectionism, increased competition in or decline of overseas markets, and inflation caused by ever-increasing costs for imported oil and industrial goods—could severely limit the prospects for growth. Economic discontent coupled with Taiwanese political grievances could then become a potent combination.

104. If the 1980s are to be troubled years for the international economy, Taiwan can hardly hope to escape unscathed. In this new economic environment the island's past performance may no longer be a completely reliable guide. Nevertheless, Taiwan probably could weather several years of economic difficulties without suffering major political unrest if those difficulties were not too sudden and severe and did not immediately cause high unemployment or high inflation. In the midterm Taiwan probably can adjust to new world economic conditions by continuing its current programs.

105. The sudden death or incapacitation of Chiang Ching-kuo might bring Taiwan's domestic political arrangements and its relationship with China into question. Beijing has indicated nervousness over this possibility, fearing that a successor regime lacking Chiang's unifying presence and his authority might feel too weak to bargain with China, or that it might provoke unrest on the island by cracking down too harshly on non-KMT Taiwanese politicians, or conversely be too pro-Taiwanese.

106. Beijing's preference for negotiating with Chiang, coupled with concern about his health, lends urgency to China's otherwise patient attitude toward reunification. Beijing has made reunification one of the "three great tasks" of the 1980s along with eco-

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conomic modernization and countering Soviet expansionism. Although there is a heavily propagandistic tone to this pronouncement, Beijing clings to the hope that early, if minor, movement on establishing a new Chinese-Taiwan relationship is possible in the next few years. Beijing apparently believes that increasing international isolation will prompt the KMT government to reconsider its opposition to all direct links with the mainland. Building on growth in indirect trade, the next step might be unacknowledged direct shipping and commercial ties, through the use of altered documents.

107. If China is relying on the KMT's heightened feeling of being on its own to prompt movement toward reunification, any development that strengthens the KMT belief that it need not move toward accommodation is unwelcome to China. For this reason the status of Taiwan in the US-Taiwan-Chinese relationship is likely to remain a sensitive issue. The publicity given future sales of US arms to Taiwan will remain of particular concern to Beijing as will any sign of a return to "officiality" in US-Taiwan relations.

108. Renewed confidence in Taipei might make the KMT more willing to reach an accommodation in the

long run, but might equally assure the KMT that it need not do so. On the other hand, lack of confidence would reduce the KMT leadership's willingness to bargain unless the island's economy was so damaged or increasing political strain so great that the KMT is compelled to turn to Beijing rather than abdicate power to the Taiwanese.

109. For the midterm, the most likely goal for the KMT, because it is the least destabilizing, would be maintenance of the status quo on the island and in the island's relations with China. This trend might be combined with cosmetic concessions by the KMT to dampen Taiwanese political pressures and a glacially slow increase in contacts with the mainland. Taipei would strive to maintain its identity as a special international entity, but in a tacitly acknowledged special relationship with China. The slow evolution of such a limited arrangement—which might seem to China to be analogous to the current status of Hong Kong and Macao—might avoid provoking a Taiwanese reaction, receive support from the Taiwanese middle class and businessmen (who seek economic security and political stability), and isolate the more militant advocates of Taiwan independence.

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Annex A

The Rise of a New Opposition on Taiwan

The Election of 1977

1. The liberalizing reforms of the early and mid-1970s were meant by the KMT to modernize the political system and to foster national unity by granting moderate concessions to the Taiwanese. The more open atmosphere, which included the public airing of views long proscribed, encouraged many reformist Taiwanese politicians to engage in political activity independent of the KMT. The results of the elections for local offices in November 1977 encouraged them even more. Although the KMT easily won an overall victory, an unexpected number of independent candidates, all of them Taiwanese, were elected to county and city offices.¹

2. Chiang correctly blamed the setback on KMT overconfidence, poor candidate selection by local KMT organizations, and the party's lack of rapport with the masses. Well-worn election devices such as marshaling the votes of military dependents no longer worked automatically. Even more disquieting was the first mass political violence in many years. The riot at Chungli over alleged election irregularities, although quickly contained, revealed a new popular political volatility. Moreover, the authorities' restrained handling of the affair may have encouraged the belief that the government was unsure of its ground and on the defensive.

3. Despite his disappointment with the election results, President Chiang did not abandon his effort to open up the political process. Although KMT conservatives saw the election results and the riot as proof that further liberalization would eventually jeopardize party control and political stability, Chiang guaranteed that the national legislative elections scheduled for December 1978 would be scrupulously fair. In addition, Chiang quickly opened a dialogue with the new opposition office holders.

¹ Independent candidates, some of whom were disgruntled former KMT members, won four of the city mayoral or county magistrate races and 21 of the 77 Taiwan provincial assembly elections.

4. The non-KMT Taiwanese victors had no common organization or ideology. This did not mean, however, that the new oppositionists did not have common goals or that they did not maintain informal ties. Kang Ning-hsiang, a member of the national legislature and an influential moderate Taiwanese, probably spoke for the majority of them when he remarked in early 1978 that the KMT government should end martial law, release all political prisoners, and renounce the KMT claim to govern the mainland.

5. Although the oppositionists were buoyed by their success and Chiang's acceptance of it, most of them were careful not to adopt too militant a stance. Most oppositionists, particularly the moderates, believed early formation of a new political party (which some had urged) would be too provocative and give the conservative mainlanders and the security services a prominent target.²

6. With the advent of the national-level election campaign in November 1978, the oppositionists adopted a slightly higher organization profile by organizing a "nonparty" campaign office in Taipei to assist non-KMT candidates. This enterprise was under the leadership of Huang Hsin-chieh, a member of the national legislature who within two years was to be caught in the crackdown following the Kaohsiung riots. The office formulated a political platform emphasizing human rights issues,³ underlining this point by adapting a symbol depicting a clenched fist and an olive branch.

² Taiwan has two small opposition parties, the Democratic Socialists and the Young China Party. Both are small, powerless, and probably subsidized by the KMT.

³ The 12-point platform called for strict observance of the constitution; lifting of martial law; banning persecution, illegal arrest and violation of homes and privacy; medical care and unemployment insurance; abolition of protectionism favoring capitalists; a basic labor law granting the right to collective bargaining; subsidies and assistance to the fishing industry; abolition of discrimination against local dialects; and amnesty for political prisoners.

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7. Earlier in the year, Kang Ning-hsiang attempted to widen the informal oppositionist coalition through an approach to the Taiwan Presbyterian Church. The church—with perhaps 200,000 well-organized members and access to coreligionists in the United States and Britain—is almost wholly Taiwanese in membership. Its support for Taiwan independence and greater human rights, as well as its church connections overseas, make it suspect to the government and KMT and a natural ally for anti-KMT politicians. Although many church members and officials were sympathetic with oppositionist goals, the church as an institution did not formally align itself with any particular independent politician or group.⁴

8. As the election drew nearer, both the oppositionists and the KMT foresaw important symbolic victories for non-KMT candidates. Even the election of a few more new independent legislators, coming after the results of the 1977 local election, would symbolize the evolution of an increasingly effective Taiwanese political movement. Cosmetic concessions, such as Chiang Ching-kuo's order permitting KMT members who failed to obtain party nomination to run as independents without fear of party discipline, would be unlikely to change the image of a declining party that is slowly losing its internal discipline as well as control of the electoral process.

9. An additional cause for official alarm was the unprecedented number of university and secondary school students working for opposition candidates. Except for officially approved causes, student political unrest has been minimal on Taiwan. Compulsory military training overseen by military officers, extensive propaganda and political work by the KMT and the government, plus student concentration on preparing for lucrative careers had long combined to dampen political activism.

10. The government and the KMT responded to growing opposition organization and self-confidence with a combination of petty political harassment at the grass-roots level and restraint. Fearing a repetition of riots, the authorities adhered to Chiang Ching-kuo's

⁴ This caution did not later save several of its members from arrest in the aftermath of the Kaohsiung riot. This caution, along with government concern about the possible reaction in the United States, enabled the church as an organization to escape the crackdown that followed the Kaohsiung incident, although its secretary general was arrested.

orders forbidding election chicanery and promising fair and free elections. When combined with the perception held by some oppositionists that the regime was losing confidence and was vulnerable to pressure, the "open-election policy" was later to lead to misjudgment by the more militant of the opposition. The latter overestimated the government's defensiveness and reluctance to suppress its opponents.

After Normalization

11. The timing of the announcement of the normalization of Sino-US diplomatic relations was a political windfall for the KMT. Under the guise of responding to the emergency, the government postponed the supplemental national elections. With the election postponed, Chiang and his advisers would gain time to strengthen the party's position, while using the occasion to shift to a somewhat harder policy toward the opposition. The reaction to normalization among the oppositionists was mixed. Some believed it would make Chiang and the KMT more amenable to Taiwanese interests in the overriding interest of preserving national unity. Others suspected that Washington had timed the announcement to forestall Taiwanese gains in the election. The more suspicious believed that the United States did not want to see the growth of a movement that might call for Taiwan's self-determination and complicate Washington's relations with Beijing.

12. Initially most of the opposition publicly accepted what it hoped would be a short-term postponement of the elections and used the crisis to demonstrate its loyalty to the government. The government, however, implemented its harder line. The imprisonment of an elderly Taiwanese oppositionist in 1979 on charges of spreading Communist propaganda and failing to report an alleged Communist agent—who later was executed—was meant to warn the opposition that Chiang Ching-kuo and the KMT government had not lost the will to defend their interests.

13. Later that year, the authorities mixed suppression and concessions to reach an accommodation with the oppositionists, the more militant of whom soon resumed political activity. Over the summer and early fall, some opposition magazines were banned and their publishers eventually prosecuted. Some opposition rallies were banned, others permitted. The rule seemed to be that indoor rallies of moderate size were allowed.

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Mass outdoor rallies were prohibited. Some new opposition magazines, including *Formosa*, published by Huang Hsin-chieh, were permitted. The group around Huang included those of a more militant bent, among them Shih Ming-te, a former political prisoner and guiding spirit of the group. The *Formosa* group early on adopted tactics—including those risking violence—designed to test government tolerance in order to quicken the pace of liberalization by forcing further concessions from the government.

14. The government did not harass the more moderate oppositionists, such as Kang Ning-hsiang. Rather, the authorities began a dialogue with the opposition in an attempt to formulate a new, informal set of rules that would permit opposition activity but avoid a direct challenge to the authority of the government and the vital interests of the KMT.

15. By fall, however, the activities of the *Formosa* group had alarmed President Chiang. The most threatening activity probably was not the publication of the magazine itself, but the magazine's establishment of "service centers" in several major cities. One of the

members of the group later admitted that the tactic was intended to cover the formation of a new, organized opposition political party.

16. The KMT authorities, split between a hardline conservative majority and a smaller liberal minority, were unable to fashion a policy to meet the situation. This stalemate led Chiang to appoint a special KMT committee that proceeded in late November to comply with Chiang's orders to thwart the formation of a new political party by deciding to suppress *Formosa*. Only the timing and method of suppression remained in question. The *Formosa* group's decision to stage a mass rally in Kaohsiung on Human Rights Day provided the opportunity. The rally, which was legally banned, quickly degenerated into a riot. The wave of arrests that followed started with the *Formosa* group and spread to include the secretary general of the Taiwan Presbyterian Church, who later received a seven-year prison sentence for aiding Shih Ming-te's futile escape attempt. A series of trials in the first half of 1980 imprisoned eight *Formosa* leaders for terms ranging from 12 years to life. The *Formosa* magazine and its "service centers" were suppressed.

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Annex C

The Military Situation in the Taiwan Strait Area

Background

1. Over the past three decades the Taiwan Strait has been an area of either actual or potential crisis. During the 1950s there were two major flareups in the Strait area: the Quemoy crisis of 1954 and blockade of Jinmen in 1958. The PRC in 1962 built up a large military force opposite Taiwan. Rising tension caused by the buildup and China's subsequent invasion of India, and further fueled by longstanding antagonisms shared by both Chinese Nationalist and Communist leaders, almost precipitated a major clash between Taiwan and China. Although actual fighting was averted in 1962, the remainder of the decade witnessed persistent calls by the Nationalists for reconquest of the mainland countered by Communist promises to liberate Taiwan. The early part of the decade of the 1970s saw the status quo continue.

2. Realization by the Nationalist leadership that reconquest of the mainland was an increasingly dim prospect coupled with PRC perceptions of the growing Soviet threat, the US commitment to assist in the defense of Taiwan, and persistent Chinese domestic political problems caused the Taiwan Strait military situation to shift from the top of the list of priorities for both sides. The PRC leadership began to advocate a policy of "peaceful liberation" and Taiwan accordingly adjusted its policies to a more practical *modus vivendi*. Peaceful liberation of Taiwan was premised on a strategy of political and diplomatic isolation of Taiwan combined with a reduction of provocative military activity in the Taiwan Strait area. Occasional ship transits and routine single-service training exercises became the standard PRC military profile in the Taiwan Strait area beginning in 1974.

3. The PRC conducted a major amphibious joint service exercise in the Taiwan Strait in July 1976. Because of the timing, high visibility, and location it was assessed that there was a dominant political, as well as military, motivation underlying the exercise. Nonetheless, this departure from precedent did underscore

Beijing's refusal to renounce the use of military force in resolving the "Taiwan question." Moreover, an improving PRC capability to conduct large-scale joint service exercises and to provide limited amphibious training for units in the Taiwan Strait area was also demonstrated. Although the exercise did not represent a break with the existing PRC strategy for peaceful liberation of Taiwan, it did signal an intention to gradually expand use of the Taiwan Strait for military exercises and maneuvers.

4. Military tension in the Taiwan Strait area continued to relax through the end of the 1970s. Beijing's prudent approach to expanded use of the Strait and Taipei's measured responses have jointly lowered the possibilities of major military confrontation due to miscalculation or accident. Additionally, the respective means employed by both sides for resolution of the "Taiwan question" seem to rule out use of direct military pressures at this time. Therefore, in the mid-term, the possibility of a significant shift in the current military situation remains highly unlikely.

Force Levels

5. In examining respective force levels over the past 15 years there is no evidence of an appreciable change in the overall force structure on either side of the Taiwan Strait. Between 1965 and 1975 Taiwan ground and naval assets changed only marginally while the number of combat aircraft decreased from approximately 350 to 300. Taiwan ground force strength decreased by approximately 7 percent. PRC air and naval forces in the Taiwan Strait and surrounding area showed a decided and sustained growth between 1965 and 1975; however, the percentage of the total air force that was directly opposite Taiwan changed very little. Ground forces also increased albeit in a less dramatic fashion. The trendline for these increases flattens between 1975 and 1978 and further sizable growth of forces in the immediate Taiwan Strait area is unlikely.

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6. Although the qualitative aspects of forces on both sides of the Strait continue to be upgraded on a selective basis, force levels over the past five years suggest that the basic defensive orientation and posture of each remains unchanged. In the immediate Taiwan Strait area, the PRC enjoys a quantitative advantage in the number of ground force divisions that could be used in an assault against Taiwan. The quantitative advantage held by the PRC Air Force is also pronounced and suggests that any qualitative edge ascribed to the Taiwan Air Force would be largely offset by the increased numbers of aircraft available in both the Taiwan Strait area and from other military regions. Taiwan's numerical advantage in principal surface combatants could be negated by augmentation of China's East Sea Fleet assets by units from either the North or South Sea Fleets. Current force levels are indicated on the chart.

7. China is not capable at present of a successful amphibious invasion of Taiwan. The PLA has sufficient ground troops in the military regions opposite Taiwan to invade the island without weakening those forces confronting the Soviet Union, but, to be successful, China would first have to win air and sea superiority around Taiwan. Such air operations would require a drawdown of fighter-bomber and bomber aircraft from the four northern military regions. Acquiring the command and control capabilities, landing ships, means for naval bombardment, and training would probably take at least 10 years.

8. Taiwan forces are not capable of seizing the strategic initiative and can mount only small-scale raids against the mainland. Furthermore, Taiwan remains dependent on external sources for raw materials, some major military hardware, and logistics sup-

port. With continued outside support, Taiwan will be able to maintain and improve its defensive military capabilities. The development of a significant offensive capability in the midterm is unlikely.

Trends

9. The level of tension in the Taiwan Strait area remains low. The current level of military activity suggests that routine training and air and naval patrol operations are being emphasized. Efforts to avoid upsetting the status quo for no appreciable political gain have been undertaken and will likely continue. Incremental improvements to force capabilities will allow a gradual upgrading of Taiwan's current defensive posture. Overall trends are unlikely to change in the near term. The shift from an openly confrontational relationship to one based on a realistic assessment of the geopolitical environment is the key factor that has, and will continue, to exert the major influence on the level and structure of opposing forces in the Taiwan Strait area.

Conclusions

10. A fundamental reorientation in the nature of the present Taiwan-PRC relationship would begin to alter the force levels and military capabilities in the Taiwan Strait area. Military forces of each side will probably remain defensively postured. Although gradual and selective force improvements will continue to occur, significant augmentation of China's offensive capabilities will be unlikely in the midterm. The current status quo will likely continue for the next five years, barring unforeseen shifts in PRC-US-Taiwan relationships.

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Annex D

Economic Conditions and Prospects

1. Taiwan's economic growth continues, but at a slackening pace. Growth of real GNP was 6.7 percent in 1980, quite respectable compared to most other national economies but registering a continuing downward trend from 13.9 percent in 1978 to 8.1 percent in 1979. Taiwan's increasing integration into the world economy and its industries' heavy dependence on exports (which amount to about 55 percent of GNP)—coupled with the island's dearth of natural resources and limited domestic market—render Taiwan increasingly vulnerable to economic fluctuations and events beyond its borders and control. Taiwan's economic managers have proved resourceful and resilient in overcoming numerous obstacles to economic growth, however, and although rapid expansion may become more difficult to maintain, the island's prospects remain relatively bright, barring severe disruptions in the world economy.

2. In the midterm the major economic problems facing Taiwan probably will be:

- Increasing energy costs both at home and abroad, which can adversely affect Taiwan's terms of trade and are already causing increased inflation.
- Continued dependence on imported energy resources, oil, coal, and nuclear fuel.
- Uncertain market conditions in Taiwan's major trade partners, the United States and Japan.
- Increasing protectionism in traditional and prospective markets.
- Competition for export markets from other less developed nations.

3. During the midterm Taiwan is attempting to deal with these problems by diversifying its trade partners—as well as its sources, use, and types of energy resources—and by developing technology-intensive industries.

4. Taiwan's almost complete dependence on imported energy resources (oil, coal, and nuclear fuel),

including reliance on oil for 71.3 percent of its energy supply, has led to increasing inflation as petroleum prices have risen. Measured by the GNP deflator, urban consumer prices, which rose at a 4.7-percent rate in 1977-78, were advancing at a 16.7-percent rate in 1979-80. The increasing price of oil not only has fueled inflation, but has introduced a higher degree of uncertainty into the island's economy. This uncertainty is especially detrimental to Taiwan's planned economy, which depends on accurate economic forecasting for the success of economic planning. An interruption of oil supplies or an unforeseen sharp increase in oil prices could cripple the economy.

5. The authorities on Taiwan hope that their energy-use diversification policy will mitigate these dangers. Use of coal and nuclear power will reduce dependence on the Middle East. Two nuclear power reactors are in operation. Four more are under construction. Twenty-four coal-fired generators and 14 more nuclear reactors will be built or under construction by 1989. According to Taiwan's economic planners, coal, which accounts for 12.7 percent of the island's energy supply in 1979, will account for 28.3 percent in 1989. The amount supplied by nuclear power is expected to increase from 5.2 percent to 13.7 percent during the same period. Conversely, petroleum will drop from 71.3 percent of the energy supply to 48.8 percent by 1989.

6. Energy resource imports will remain vital to Taiwan's economy during the midterm and beyond. In 1979 Taiwan imported 82.1 percent of its energy supply. Under current plans this ratio will increase several percentage points by 1989. The Taiwan authorities hope to cope with this dependence by diversifying their sources of oil and coal, as well as nuclear fuel and technology. Coal will be imported from South Africa, Canada, Australia, the United States, and even China. Although the island will remain dependent on US nuclear enrichment services for the midterm and beyond, it is trying to obtain nuclear power equipment

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from West Germany, France, the Netherlands, and Belgium. Kuwait and Saudi Arabia are likely to remain the principal sources of oil, but Taiwan is exploring contacts with Mexico, Nigeria, and Indonesia.

7. Taiwan's attempt to diversify its export markets is well under way, and will continue throughout the midterm. Efforts to expand trade with Western Europe have already borne fruit in the form of a projected \$5 million in two-way trade in 1980. This expansion has produced the problem of dealing with Taiwan's estimated \$1 million surplus in trade with Western Europe. Taipei has attempted to deal with this issue by increasing its purchases from that region.

8. Taiwan also intends to expand trade with Latin America, Africa, South Asia, and the Pacific Basin nations, as well as with several nations in Eastern Europe. Trade with these regions, however, probably will constitute only a small portion of Taiwan's overall trade—which is likely to continue to be heavily oriented toward the United States, Japan, and, increasingly, Western Europe. Trade with Eastern Europe is likely to grow only slowly as it encounters political as well as economic obstacles. Taipei most likely will want to be paid in hard currency for its exports, while finding little to import from the region. Taipei also will not want its trade with Eastern Europe to be interpreted as presaging a major shift in the focus of Taiwan's foreign policy.

9. Taiwan also is attempting to foster continued economic growth by emphasizing development of technology-intensive industries. This effort eventually would bring Taiwan into competition with the United States and Japan, but probably not in the midterm.

If successful, this program will help Taiwan evade increasing competition from other less developed countries, including China, in labor-intensive industries such as textiles, which up to now have been the foundation of the island's prosperity. Improved technology also will help labor productivity grow at a rate faster than the growth of real wages, thus maintaining Taiwan's export competitiveness. Additionally, development of high-technology industries will help solve Taiwan's only unemployment problem, the economy's inability to absorb the growing number of skilled workers. Overall, Taiwan has had no major unemployment or labor problems. By the standard definition of cyclical unemployment, Taiwan's rate was 1.3 percent in 1980.

10. Taiwan's history of good economic management and well-conceived plans for continued growth provide grounds for optimism. Nevertheless, adverse developments in traditional or new major export markets, inflation, increased energy prices, and increased international protectionism are among the factors that could slow the rate of growth. Equally important is the continuation of political stability on Taiwan necessary to encourage continued foreign investment. In the midterm, before Taiwan's energy diversification policies are more widely implemented, the island's major economic problem is likely to be inflation fueled by the rising cost of imported energy resources. Taipei probably can keep inflation within socially acceptable bounds, but a rapid growth in inflation and accompanying economic uncertainty could discredit the regime and might lead to political unrest, particularly among ethnic Taiwanese.

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