



INTERNATIONAL RISK ASSESSMENT

Political Risk Assessment Report on the Aftermath of the Taiwanese Presidential Election

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Introduction

The contested re-election of Chen Shui-bian as Taiwanese President by a minuscule margin has plunged the island's young democracy into political uncertainty and constitutional crisis. The Kuomintang-led ("KMT") Pan-Blue opposition has refused to accept the vote and has asked for both a recount and a nullification of the election. With emotions running high in this mounting political confrontation, Taiwan could find itself in an extended political paralysis that could spark spreading social disorder and harm economic recovery.

More importantly, relations across the Taiwan Strait are likely to become increasingly tense and could eventually erupt into a military show-down if Chen decides to pursue his already-stated intention of institutionalising Taiwan's de facto independence through constitutional reforms and the holding of more referendums.

The assessment of International Risk is that the next few months will be a period of high political risk for Taiwan. The election has shown the population is deeply polarised politically and that the democratic process is under severe strain. How the island's judicial, investigative, legislative and political institutions will be able to handle this unprecedented challenge to their authority will significantly determine whether political stability can be successfully restored and whether Chen will be able to govern effectively over the next four years. There is widespread scepticism though in the professionalism and independence of the judiciary and police in performing their roles.

The key risks for Taiwan over the next few months are:

- **Political paralysis:** Whatever the outcome of any recount and review of the election, the losing party is unlikely to be satisfied and may consider that the election has been "stolen" from them. This will make co-operation between the ruling Democratic Progressive Party ("DPP") and the KMT, which is already difficult, virtually impossible and could lead to paralysis in the parliament. Forthcoming parliamentary elections scheduled for December could become extremely divisive.

- **Social disorder:** The defeated opposition could decide to undertake a campaign of political unrest and social disorder if it is not satisfied with the reviews and investigations surrounding the circumstances of the assassination attempt on Chen and the election vote. Thousands of opposition supporters protested immediately following the announcement of the election outcome.
- **Increasingly strained Cross-Strait relations:** The Chinese leadership views Chen Shui-bian with unbridled hostility and there is a growing consensus among decision-makers in Beijing that Chen will push even further to enhance Taiwan's independent sovereign status over the next few years. In response, China's already rapid military build-up in the Taiwan Strait will likely accelerate and efforts to improve Cross-Strait political relations will go nowhere. The likelihood of a military crisis in the Taiwan Strait over the next four years will be high.
- **Economic volatility:** The economic ramifications from the political uncertainties are significant. The Taiwanese stock market fell by nearly 7 percent immediately following the election because of the political chaos taking place. The ballot recount and the stand-off between the KMT and DPP will mean continuing short-term economic volatility in the short-term.

The Immediate Fallout: Challenging the Election Results

Chen won the presidential election by a slim 0.2 percent margin, or less than 30,000 votes of the 13 million ballots that were counted. But the KMT is contesting the validity of the vote for several reasons:

337,000 ballots were declared invalid, more than 11 times Chen's margin of victory and 3 times higher than in previous elections. One reason there may have been so many invalid ballots is that a coalition of non-profit groups had called on voters to cast invalid votes. This was meant to protest that the main political parties were too interested in relations with China and the concerns of the affluent, and had not paid enough attention to the plight of the poor and the disabled. Independent foreign election monitors have said that the election process appears to have been transparent and fair.

KMT officials suggested that Chen might have staged a last-minute assassination attempt to win votes. Defeated KMT candidate Lien Chan had been narrowly favored to win until the shooting when one or more bullets grazed Chen's lower abdomen and also slightly injured Vice President Annette Lu's right knee. Some KMT politicians accuse Chen of attempting a similar trick 18 years ago when he ran for office in Tainan and

appeared at an election-eve rally with an intravenous drip claiming that he had been poisoned by the KMT.

Thousands of policemen and military personnel were unable to cast their ballots after they were put on nationwide standby following Chen's assassination attempt. Defence officials said only around 20,000 soldiers were affected, but news reports suggest that more than 200,000 troops and police could not vote. The military and security services are regarded as more friendly to the KMT than the DPP.

How this controversy is handled will have a far-reaching and long-term impact on the island's political stability and dynamics. The island's judicial, election and security apparatuses will be responsible for conducting the reviews and investigations into the charges made by the KMT, but their track record for impartiality and effectiveness has been chequered.

The High Court has appointed a three judge panel to examine the allegations of election fraud and whether a recount is necessary. The panel could take up to six months to complete its work, although it is likely to complete its investigation sooner because of the immense damage a protracted wait could inflict on the island's political stability. An appeal against its ruling could take another six months.

The legal proceedings though will not prevent Chen from assuming the reins of his second term on 20 May. But Lien has warned of a constitutional crisis if his demands to clarify the circumstances surrounding the election are not resolved. Lien's running-mate in the election, James Soong Chu-yu said Taiwan would be faced with a serious legitimacy crisis if the president took power under a cloud of questions.

Although opposition politicians are claiming that the DPP engaged in election fraud, including vote-buying and identity theft, they have produced little evidence to back their allegations. Independent and foreign election monitors have said that the election process across Taiwan appears to have been well run, transparent and fair. They point out that independent observers and representatives from all political parties witness the counting of all ballots to prevent any tampering. Seasoned political analysts in Taiwan believe that Chen is likely to emerge successfully from the recount.

If the Pan-Blue opposition is unsuccessful in having the election results overturned, they will have another chance to dent the DPP's hold on power in crucial parliamentary elections scheduled for December. The KMT and its allies currently hold a comfortable majority of seats, but the DPP and its allies, known as the Pan-Green, hope that the presidential election victory will provide an important impetus in their goal of capturing majority control of the parliament.

The Pan-Green forces will have been boosted by a large 11 percent gain in votes they won this time compared to the 2000 presidential election. This strongly suggests that the Taiwanese political process has now matured into a two-party system and that the DPP represents a viable and long-term rival to the once-dominant KMT.

Chen's Long-Term Political Agenda for Taiwan

Following his win, the key question is whether Chen is a pragmatic politician who will now back away from his pre-election agenda and adopt a less provocative approach in dealing with Beijing and political reforms or he is more of a political idealist and activist politician with a long-term vision of moving Taiwan slowly but steadily away from reunification with the mainland and to turn the island increasingly into an independent and fully democratic nation.

A growing number of well-placed analysts who closely follow Taiwanese leadership politics are revising their opinions and no longer because that Chen is an opportunist who is simply content to stay in office but that he is ideologically committed to making the island independent. Some analysts say that Chen believes that his pro-independence crusade enjoys divine backing and he claimed after the shooting that God had saved his life. "God hoped A-bian could come vote for the referendum, and so did not allow A-bian to die for the moment," Chen said referring to himself by his popular nickname. Chen's predecessor, Lee Teng-hui, had compared himself to Moses in leading his people to political salvation and Chen may have similar beliefs.

Chen originally developed his political skills as a lawyer who campaigned against the ruling KMT regime throughout his career. When he unexpectedly became president in 2000, Chen declared that he would not formally declare independence.

Chen instead concentrated his efforts to reshape the debate between Taiwan and the mainland over their relations and sought to cement the island's de facto independence by repeatedly stating that Taiwan is already an "independent, sovereign country". He also made efforts to rewrite the island's authoritarian-era constitution, arguing that this would allow Taiwan to become a "normal, complete and great country".

In his second term, Chen is likely to become more aggressive in pursuing his political goals, which includes writing a new constitution by 2006. The current constitution was established by the KMT in 1947 before it lost control of the mainland. Chen has claimed that his goal of enacting a new constitution was part of the island's democratic reform process rather than seeking to use it to push for independence.

Last November, Chen revealed that he wanted to abolish the old constitution and draft a new charter and provided a timeline for doing so. According to his plan, a referendum would be held on World Human Rights Day on 10 December 2006 and the new constitution would be enacted on 20 May 2008. Whether coincidentally or not, former President Lee Teng-hui has also advocated 2008 as the year that Taiwan should declare independence.

Political analysts interpret Chen's efforts to draw up a new constitution as a clear move to solidify Taiwan's political separation from the mainland and make it virtually impossible for Beijing to pursue its 'One China' policy of eventual reunification. While the just-passed referendum law appears to prevent Chen from holding a plebiscite on a new constitution, he may find alternative ways to carry out his goal.

A key concern for Beijing has been Chen's successful efforts in forcing the anti-independence opposition to grudgingly support his political reform efforts. The KMT has long advocated reunification with the mainland, but its decision to allow the passing of the referendum bill, even though it was a watered-down version of the DPP's more radical proposal, shows that the political winds within Taiwan are shifting increasingly towards greater separation and independence from China.

If Chen decides to rewrite the constitution, Beijing may finally decide that Taiwan has crossed the dividing line between supporting the principle of 'One China' to declaring independence and use force to resolve the situation across the Taiwan Strait.

The US Response

The US government has kept its distance from the Taiwan election dispute and will not send a message of congratulations to Chen under the legal challenge to the vote is resolved. The State Department's only official comment so far has been to praise the democratic process and express confidence that the island will remain calm.

In the run-up to the election though, the usually warm ties between Washington and Taipei became strained over the referendum issue. Chen had decided to push ahead with the matter because he thought he would have the backing of the US government. US-Taiwan relations have been close and strong in the past few years, especially in the military realm where the Pentagon has provided considerable assistance in helping the Taiwanese military to improve its defence capabilities against a rising Chinese military threat.

One reason for Chen's apparent confidence that he would have Washington's endorsement for his referendum and constitutional reform initiatives is that the White House had not previously criticised him or his supporters on these issues. When Chen announced his "anti-missiles" referendum proposal in last December though, the US government came out to strongly oppose his plans because it believed that the move would seriously undermine stability in cross-Strait relations. US President George W. Bush said that "we oppose any unilateral decision by either China or Taiwan to change the status quo."

Mr. Bush pointed out that "the comments and actions made by the leader of Taiwan indicate that he may be willing to make decisions unilaterally, to change the status quo, which we oppose." Bush's comment was intended as a strong signal to persuade Chen to drop his referendum plan. Senior Bush administration officials added that the referendum might reduce Taiwan's security by antagonising China.

White House officials said the administration had not shifted its policy toward Taiwan. But conservatives within the administration and China experts interpreted Bush's remarks as a significant change, designed to reward China for its assistance in the North Korean nuclear crisis. In the past few months, Washington back-pedalled in its opposition to the referendum, especially after Chen watered down its contents. This turbulence in US-Taiwan relations quickly faded, although the US administration's trust in Chen had been dealt a heavy blow.

Well-placed US diplomatic sources say that Chen's re-election is likely to pose a long term challenge for the US, especially if his actions precipitate growing military tensions across the Taiwan Strait. Washington is unlikely to be supportive of Chen's push for constitutional reforms, additional referendums or any other efforts to push the envelope of independence. This is because in the event of a military conflict, the US will almost certainly be drawn in.

Beijing's Reaction

Beijing had little immediate reaction to the re-election of Chen, but the Chinese government's Taiwan Affairs Office issued a statement welcoming the failure of the missile referendum, which had failed to garner the necessary 50 percent support to pass. While 80.3 percent of eligible voters cast ballots in the presidential election, only 45 percent cast ballots on the two referendum questions, after the KMT called for voters to abstain and the US criticized the holding of the referendums.

A Hong Kong newspaper also reported that the People's Liberation Army ("PLA") had been placed on alert immediately after the election, although this was denied by Chinese military officials. The Taiwanese Ministry of National Defence ("MND") did say though that PLA units stationed in Fujian across from Taiwan had been put on heightened alert in the run-up to the election, but that this had only meant the recall of personnel from leave and there was no unusual concentrations of troops that might indicate a prelude to military action. In response, the Taiwanese armed forces, which had been placed on combat alert during the election period, returned to its normal peacetime status after the election.

The authorities in Beijing are likely to take a wait-and-see attitude ahead of the judicial review of the election outcome and Chen's re-inauguration on 20 May. But the Chinese leadership will regard Chen's victory as a severe blow to its strategy to rein in the island's drift towards independence.

Beijing reacted angrily and forcefully in the run-up to the vote on the election and the referendums. Beginning in late November last year, civilian and military officials in Beijing made strongly-worded public threats against Taiwan.

These warnings included comments by a senior military officer that the island faced an "abyss of war", adding that China was willing to accept boycotts of the 2008 Beijing Olympics, reduced foreign investment and military casualties to prevent Taiwan from using referendums to move closer towards independence.

Beijing's strident rhetoric against Chen is in sharp contrast to its efforts over the past few years to downplay what it considers political provocations by Chen. After the sabre-rattling of the mid-1990s, Beijing focused its public attention since the late 1990s to courting Taiwanese businessmen and promoting economic integration between the two sides. But the leadership in Beijing has become increasingly alarmed in the past few months that this softer approach to cross-Straits diplomacy may have sent the wrong signals to Taipei.

Assessments by Chinese analysts and policy makers involved in Taiwan affairs is that Chen's efforts to draft a new constitution and put in place a referendum process that would allow it to be implemented by bypassing the legislative apparatus means that the island will sooner or later have crossed the threshold that Beijing considers amounts to a clear-cut act of independence. In their view, the establishment of the proposed new constitution by Chen would mean that the source of sovereignty would come from the inhabitants of Taiwan, rather than the Chinese people, which is what the present constitution dating to 1947 affirms.

During his election campaign, Chen had pledged to rewrite the charter to "fully reflect Taiwan's statehood". Among possible moves that Chen could take include:

- Change Taiwan's official name from the Republic of China to the Republic of Taiwan.
- Limit the geographical scope of the revised constitution to cover just Taiwan and outlying islands under its jurisdiction.

Such a move by Chen would render the principle of 'One China' and the peaceful settlement laid out in the Shanghai Communiqué obsolete, leaving Beijing with little choice but to use force to resolve the situation across the Taiwan Strait. In Beijing's view, Chen's intention is to use a legal act of self-determination through the holding of a referendum to establish independence while destroying the prospect of any of his successors to go back to the negotiation table and discuss reunification.

After Chen had first come to power in 2000, his self-imposed commitment to rein in the pro-independence aspirations of his party and supporters led to some cautious hopes in Beijing that the Cross-Strait status quo could be maintained and the issue of reunification could be put off for resolution into the longer-term future. But Chen's moves in the past year, and especially in the past few months, has convinced decision makers in Beijing that Chen only sought to abide his time and wait for the most opportune moment to launch his quest for independence.

Possible PLA Contingencies Against Taiwan

The gloomy political prognosis within Beijing about the dynamics and prospects for Cross-Strait relations in the near-to-medium term is shared by PLA decision makers, planners and strategists. The military has regarded the possibility of an eventual military conflict against Taiwan as high ever since the early 1990s when President Lee Teng-hui began to assert Taiwan's independence and move away from the 'One China' principle.

This has led to a large-scale build-up of Chinese military capabilities in the vicinity of Taiwan over the past decade. This has included the deployment of large numbers of ballistic missiles in provinces close to the Taiwan Strait. According to US and Taiwanese authorities, the PLA has stationed between 450 to 500 missiles in Fujian and other areas close to Taiwan. In addition, the PLA has purchased substantial numbers of fighter-aircraft, warships and other weapons systems that would be needed to conduct military operations.

This rapid military build-up by China could see the military balance tilting to Beijing's favour within the next 1-2 years, according to senior Taiwanese military officials. In mid-

January 2004, Taiwanese Deputy Defence Minister Lin Chong-Pin said that the 2.5 million PLA might gain the upper hand in the military balance across the Taiwan Strait by as early as 2005, but he added that Beijing would not have the confidence to attack for another five years in case it might not win. His view was that it would only be between 2010 and 2015 when the PLA would be confident of winning a war against Taiwan.

In an analysis of the nature of the PLA threat to Taiwan issued by the Taiwanese MND in mid-March, it said that there were 420,000 Chinese ground troops deployed in the Nanjing Military Region in Southeast China. Around 200,000 troops were deployed opposite Taiwan, with nearly 60,000 permanently stationed in Fujian.

The Chinese authorities have made a clear distinction, however, between provocative military demonstrations and the actual use of force. Beijing has stated that it would only consider using force if Taiwan were to declare formal independence or if foreign powers were to intervene to divide Taiwan from China.

The PLA can flex its military might in a number of ways:

- **Missile firings:** The use of missiles is relatively inexpensive and they are highly effective weapons of intimidation. The three rounds of missile firings by the PLA's Second Artillery off Taiwan's coast between August 1995 and March 1996 caused considerable panic in Taiwan, especially impacting the island's stock market. However, the political consequences of the actions appeared to backfire as support for pro-independence sentiments in Taiwan appear to have been boosted by this belligerency.
- **Military exercises:** PLA war games near Taiwan have become increasingly frequent in the past few years. Many of these exercises simulate possible military operations against Taiwan, such as amphibious landings.
- **Military deployments:** A major build-up of PLA forces around the Taiwan Strait would cause considerable nervousness in Taipei and heighten military tensions. While occasional reports have surfaced of redeployments of missile units from other parts of the country into areas within striking distance of Taiwan, there is little solid evidence so far to indicate any large-scale redeployment of military units into the so-called Nanjing War Zone.
- **Limited sea and air blockades:** One of the purposes of the missile firings and military exercises in March 1996 by the PLA was to show it could blockade key maritime and air access routes into Taiwan. Target areas for the missile tests were close to Keelung and Kaohsiung which are located in the north and south of the island

respectively. Chinese military analysts say that future missile drills could be expanded to cover a complete blockade of the island.

In the event that China decided to attack Taiwan, military chiefs would most likely press for an immediate and full-scale invasion. Massive surprise attacks have distinguished PLA opening campaigns in the past, such as in Korea in 1952, India in 1962 and Vietnam in 1979.

Although the PLA has little experience of mounting large-scale amphibious invasions and has limited dedicated sea-lift capabilities, military planners have publicly pointed out that the Taiwan Strait is not a major obstacle to a sea-crossing. PLA analysts have written that a sea crossing from Fujian Province to Taiwan would only take around five to six hours, which would offer little advance warning time to Taiwan.

The Business Implications From the Rising Tensions

The political uncertainties and deadlock arising from the election and Chen's re-election will have serious economic ramifications for Taiwan both in the near and long-term as well as fallout on other nearby stock markets such as Hong Kong. The Taiwanese stock market fell by nearly 7 percent immediately following the election because of the political chaos taking place. The ballot recount and the stand-off between the KMT and DPP will mean continuing short-term economic volatility in the short-term.

Over the longer term, political stability in Taiwan will remain fragile and there is likely to be increasingly bitter tensions between the KMT and DPP. If Chen proceeds with undertaking major constitutional and political initiatives, this could ignite more tensions not just with Beijing but also with the island's business community.

Other major risks include:

- **Crackdown on Taiwanese firms and business executives in China:** The Chinese authorities have reportedly been conducting a security crackdown on Taiwanese companies and business executives working on the mainland in the past couple of months and have arrested a number of Taiwanese businessmen for allegedly 'spying' offences. The Taiwanese authorities claim these arrests are part of an effort by Beijing to hurt Chen's election campaign, but news reports say that the crackdown was sparked by the Taiwanese President's detailed disclosure of Chinese missile deployments against Taiwan. This crackdown appears to be confined to the Taiwanese business community in China so far.

- **The investment climate in Taiwan and on China's East Coast:** Chen's re-election means that the political risks of making long-term investment decisions in Taiwan or along coastal regions of Eastern China in the vicinity of the Taiwan Straits could grow as relations between Beijing and Taipei are likely to further deteriorate.
- **Impact on Sino-US Relations:** Any major increase in tensions between Beijing and Taipei could also adversely impact on relations between China and the US, especially if Beijing were to conduct militarily provocative actions to influence the outcome of the Presidential election in Taiwan.

For more detailed analysis of the political and business risks arising from the turbulence in cross-strait relations, please contact Steve Vickers, President and CEO of International Risk in Hong Kong at (852) 3120-8688 or (852) 9196-2350.

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