



RASTÚCA EKONOMICKÁ ZÁVISLOSŤ TAIWANU NA ČÍNE: DÔVOD NA STRACH?

TAIWAN'S GROWING ECONOMIC DEPENDENCE ON CHINA: A REASON TO FEAR?

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V súčasnom svete sa bezpečnostná situácia stáva prvoradou. Je naplnený zmrazenými konfliktami, ktorých nové prebudenie by mohlo spôsobiť významnú nerovnováhu. Jedným z takých konfliktov je aj konflikt medzi Čínskou ľudovou republikou (ČĽR) a Čínskou republikou (ČR). V roku 2014 došlo pri podpisovaní zmluvy vedúcej k prehĺbeniu ekonomickej integrácie medzi týmito dvoma stranami k mohutným protestom. Cieľom tohto článku je zhodnotiť vzťahy medzi ČĽR a ČR a analyzovať vplyv rastúcej ekonomickej závislosti na bezpečnosť v Taiwanskej úžine. Dochádzame k záveru, že je nepravdepodobné aby Čína využívala rastúce väzby k presadzovaniu politických cieľov. Bude k tomu dochádza jedine v prípade, že budú politické ciele pre ČĽR natoľko dôležité, že bude ochotná za ne zaplatiť vysoké náklady, ktoré by prerušenie ekonomickej výmeny prinieslo.²
Kľúčové slová: Taiwan, Čína, ČĽR, ČR, vzťahy v Taiwanskej úžine, ekonomická výmena.

We live in a world in which security is becoming a priority number one. All around the world we can find frozen conflicts which, if awoken, could cause important imbalance. One of such conflicts is between the People's Republic of China (PRC) and the Republic of China (ROC). In the year 2014 massive protests were accompanying the signature of an agreement leading to higher economic integration between the two parties. The aim of this paper is to assess the relationship between the PRC and ROC and analyze the impact a growing economic dependence could have on security in the Taiwan Strait.

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Ing. Veronika Končíková pôsobí ako doktorandka na Katedre ekonomie Ekonomicko-správnej fakulty Masarykovej univerzity v Brne. Venuje sa primárne medzinárodnému obchodu, Číne a gravitačným modelom. V minulosti participovala na viacerých výskumných projektoch, vrátane spolupráce s Inštitútom ázijských štúdií. Mnohokrát pôsobila v zahraničí, absolvovala študijné-výskumné pobyty v Hong Kongu a na Taiwane.

² Príspevok bol vypracovaný v rámci projektu MUNI/A/1223/2014.

We find out that the deepening links are not likely to be used by the PRC as a leverage for political pressure unless the political goals are of such importance that PRC itself will be willing to pay high costs to which a disruption of economic links would definitely lead.

Key words: Taiwan, China, PRC, ROC, Cross-strait relations, economic exchange.

JEL: F50, F51

1 INTRODUCTION

For decades, the relationship between the People's Republic of China (PRC) and the Republic of China (ROC)³ was characterized by mutual hostility. Nevertheless, the changes inside their regimes and the integration of both economies into the global world brought new opportunities for the interactions across the Taiwan Strait. There was an immense shift from virtual non-existence of economic exchanges to the situation where China became Taiwan's biggest trade partner and number one destination for its investment flows (National Development Council 2013).

The growing economic interaction brought many questions concerning the security in the Taiwan Strait. Can deeper integration in the cross-strait relations bring more insecurity? Should Taiwan be worried about the economic leverage China is building by becoming Taiwan's most crucial economic partner? Or are the economic links going to bring more stability and peace into the relations between the PRC and ROC? This paper intends to answer these questions. The aim of this study is to analyze the impact of the deepening economic integration on the security in the Taiwan Strait. Using the methods of description and analysis we will first assess the state of the bilateral relations between the PRC and ROC. Later analysis will be used to answer the main research question: Does the deepening of economic relations between the PRC and ROC increase the incentives for China to use the economic links to threaten Taiwan and achieve political goals more easily?

In this paper we first present the historical development of relations across the Taiwan Strait. Later we describe the actual economic flows between the PRC and ROC and we analyze their relative importance for both countries. Finally, we try to ascertain what impact this economic dependence might have on the Taiwanese security.

2 THE STORY OF TWO CHINAS

The antagonism between the PRC and ROC goes back to the civil war between the Chinese Communist Party and Kuomintang. Fleeing of Chiang Kai-shek to Taiwan

³ By the People's Republic of China in this work we mean the territories under its control. Sometimes a simplified term China may be used. By Republic of China we mean the territory under its direct control and in some cases the simplified term Taiwan can be used in the text.

in 1949 meant the severance of economic and political exchanges. Ever since, important changes have happened on both sides of the Taiwan Strait, as well as on the global level.

First of all, in the 1960s the ideological schism between the PRC and the Soviet Union became obvious and shift in PRC's international policy could be observed. Second, from 1978 economic reforms were pursued by the PRC which put China on the growth path. Third, the position of Taiwan in international community started to deteriorate. From 1945 Republic of China was representing the whole China in the United Nations. In 1971 the PRC was accepted as member of the UN and ROC needed to release its UN seat to its biggest political rival. In the year 1972 Japan cut the diplomatic ties with Taiwan and in the following years many other countries followed. The biggest strike for Taiwan came in 1979 when it experienced severance of diplomatic relations with its most crucial ally – the United States of America. Finally, since the 1980s Taiwan has been undertaking democratic transition. All these changes contributed to the economic opening in the Taiwan Strait.

3 THE ECONOMIC INCENTIVES STRONGER THAN POLITICAL FEARS

The first important step to ease the Cross-Strait relations was the "Message to Compatriots on Taiwan" published in 1979 in which the PRC proposed a peaceful unification process. This message was later transferred into a more concrete nine-point proposal in which the emphasis lied on the opening of three linkages and four exchanges⁴ (Chen 2003). However, the answer from Taiwanese political representatives was cold. The reaction to this proposal was the policy of "three noes" – no to the contact with mainland, no to the negotiations with Beijing and no to compromises (Executive Yuan 2012).

The political gestures from Mainland were accompanied by economic incentives and the businessmen were reacting positively to the opportunities offered by the Beijing's government. For example, in 1989 two special economic zones in Fujian province were established and offered favorable tax policies for Taiwanese investments (Burdekin, Shen and Whited 2013). Yet, mere governmental incentives were not the only motivation for doing business in China.

In the 1970s Taiwan was facing growing costs of its production inputs while China was offering very low labor costs. China's opening to the world brings enormous opportunities once a company is well established on the world's most populous market. And most importantly, the cultural and linguistic proximity was of great advantage to the Taiwanese businessmen. Therefore, indirect trade and investment flows became

⁴ The three links are direct trade, transportation and postal links and four exchanges proposed by Beijing are exchanges of relatives, tourists, sports representatives and academic and cultural group exchanges (Cai 2011).

reality despite the unreceptive Taipei's policy. Sutter (2002) claims that when Taiwan's government carried out first steps to liberalize the Cross-Strait relations, it was only a method to legalize already existing flows.

Further motivation to cooperate with Mainland was brought by Plaza Accord⁵ in 1985. Due to this agreement New Taiwan Dollar appreciated and made Taiwanese exports more expensive to its main trading partners. To compensate and keep up with the competition, Taiwanese enterprises needed to adjust their prices by lowering their costs. Moving their production to China – where low wages were not exceptional – was a feasible strategy for many companies.

The government was not pleased to see the rapidly growing dependence on its main political rival and therefore it tried to offer incentives to invest in South Asia in the early 1990s (Drover and Leung 2001). This "Go South" policy was not very successful and most of the Taiwanese investments continued to flow in the Western direction.

The evolutions in the 1970s and 1980s worried Taiwanese representatives. They were concerned that economic interaction might be a path to future integration under the Communist Party rule. And they were not worrying without a reason. Chinese government itself claims that liberal approach towards Taiwan is a way how to achieve future unification. Tung (2003) suggests that this is underlined by two main Beijing's strategies toward Taiwan: "exploiting the public to pressure the officials" and "exploiting the business people to encircle the government".

Seeing the accelerating integration, the first democratically elected Taiwanese president Lee Teng-hui started a policy called "no haste, be patient" in 1996. This policy was mainly impacting Taiwanese investments as it posed further restrictions on them.

Interestingly enough, the Taiwanese policies started to change towards more integration after the election of the first opposition president Chen Shui-bian. Being a pro-independence president, Beijing's officials were not very happy to see him as the head of Taiwan. In order to calm the situation down, in his inauguration speech he proclaimed that unless China threatens Taiwan militarily, he will not attempt to prompt Taiwanese independence during his presidential office (BBC 2015). Shortly after assuming his office, Mainland Affairs Council⁶ claimed that it is leaving its "No haste,

⁵ Plaza Accord is an agreement signed in 1985 by US, UK, German, French and Japanese governments to depreciate the US dollar in relation to other currencies. After this agreement, Taiwan was forced to re-valuate its currency under the threat of economic sanctions from the United States.

⁶ MAC – Mainland Affairs Council is a government organization in Taiwan which plans and coordinates the relations between the Republic of China and the People's Republic of China. It was established in 1991.

be patient" policy and it's going to allow more trade and investments (MAC 2014a). The most crucial decision came when in 2001 the "Little Three Links"⁷ were allowed.

During Chen's presidency the mutual trade and investments boomed as shown for example in Končíková (2014) or Horák and Končíková (2014). Chen was re-elected in 2004 and the economic integration was deepening during his rule, but the political communication ceased.

In the year 2008 Ma Ying-jeou from Kuomintang was elected. It seems that Taiwanese did not appreciate the increasing political provocations of Chen Shui-bian towards mainland China (Kastner 2006). Ma's most important step was to sign a free trade agreement with China called "Economic Cooperation Framework Agreement" (Bush 2011). He was re-elected president in 2012 and has continued to implement policies which enhanced the economic transactions across the strait. In 2014 Ma proposed a new agreement concerning liberalization of trade in services known as the "Cross-Strait Service Trade Agreement". Signing of this agreement was accompanied by massive protests which came to be known as the "Sunflower movement" (Tiezzi 2014).

4 ECONOMIC FLOWS IN THE TAIWAN STRAIT

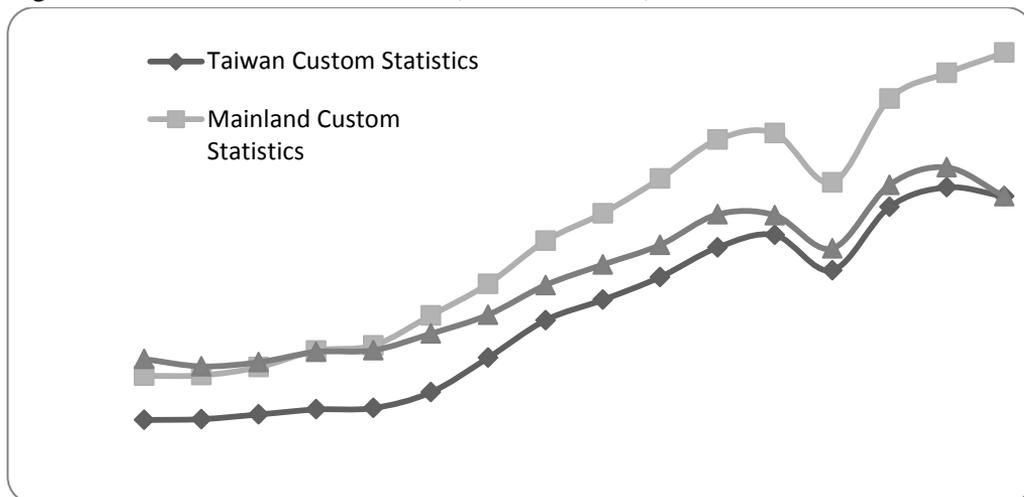
When analyzing economic flows in the Taiwan Strait, one must be aware of statistical discrepancies which occur during the data collection. As demonstrated by Figure 1, important differences between the trade flows reported by the Taiwan Custom Statistics and the Mainland Custom Statistics exist.⁸ The study by Rosen and Wang (2011) highlights that before the year 2000 the deviations between imports reported by China and exports reported by Taiwan could have easily reached over 500 percent.

As pointed by Semerák (2011) discrepancies in trade statistics are common and they occur due to: (a) the different methodology in pricing the export and import flows, (b) the difficulty in tracking the final destination in today's globalized world and (c) the mistakes and frauds.

⁷ Little Three Links is a term to describe a limited liberalization of flights, postal services and shipping. The little three links were introduced in the year 2001 and they allow trade, post and transportation between the cities in the Fujian province and Taiwan-controlled islands of Kinmen and Matsu.

⁸ The figure reports also the so-called adjusted statistics. The adjusted statistics are used by the Mainland Affairs Council and their purpose was to calculate exports to Mainland China more appropriately. They are calculated as follows: explicit direct exports plus 80 percent of Taiwanese transshipment via Hong Kong plus indirect exports to mainland China minus adjustments.

Figure 1: Differences in the statistics (in million USD)



Source: MAC (2014c), National Development Council (2013); author's calculations.

However, the differences in cross-strait exchanges are bigger than what is usually observed. The higher statistics provided by Mainland are due to the large indirect trade happening between the PRC and ROC via third countries. Tung (2005) explains that the trade between China and Taiwan includes direct trade, re-exports⁹, transshipment¹⁰, transit shipment¹¹ and smuggling.

In Figure 2 we can observe the adjusted exports from Taiwan to Mainland China and the imports of Chinese goods to Taiwan as reported by Taiwan Customs. We can see that both of these indicators grew rapidly. Imports from China were almost non-existent in the beginning of the observed period, but they were growing gradually during the 1990s. An important rise in imports from China was observed after the year 2001 when both the PRC and ROC entered the WTO and the Little Three Links were opened.

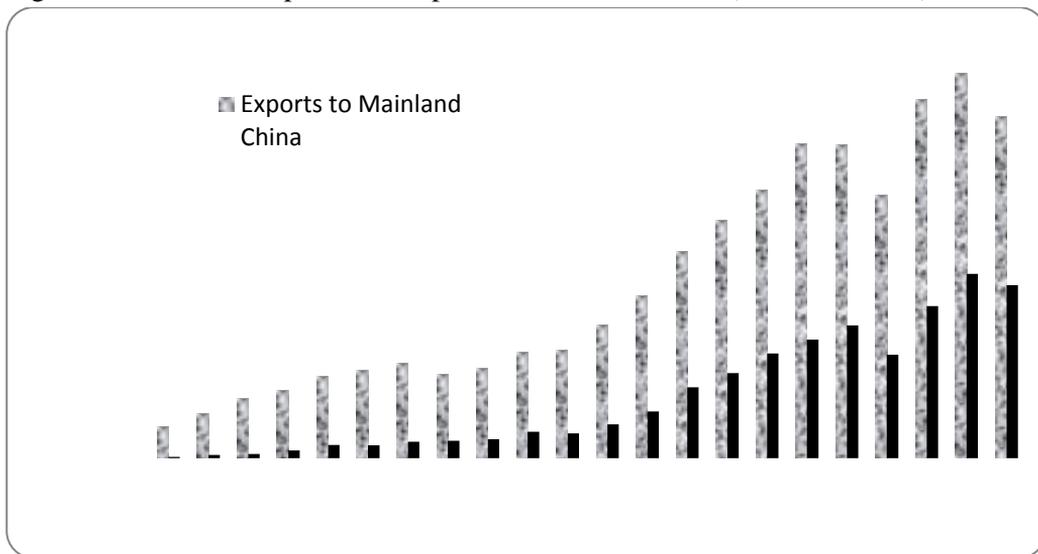
A similar pattern can be observed in the case of Taiwanese exports to Mainland China. The most significant rise happened in the early 1990s and after the year 2001. Chen (2003) claims that since 2002 China has become Taiwan's most important trade partner.

⁹ Re-exports are indirect exports via third parties.

¹⁰ Transshipment is a situation when goods are sold from Taiwan directly to a Chinese buyer but they are shipped via Hong Kong (Tung 2005).

¹¹ Transit shipment is similar to transshipment except that the goods do not need to change the vessels but the vessels must pass via Hong Kong territories on their way to mainland China.

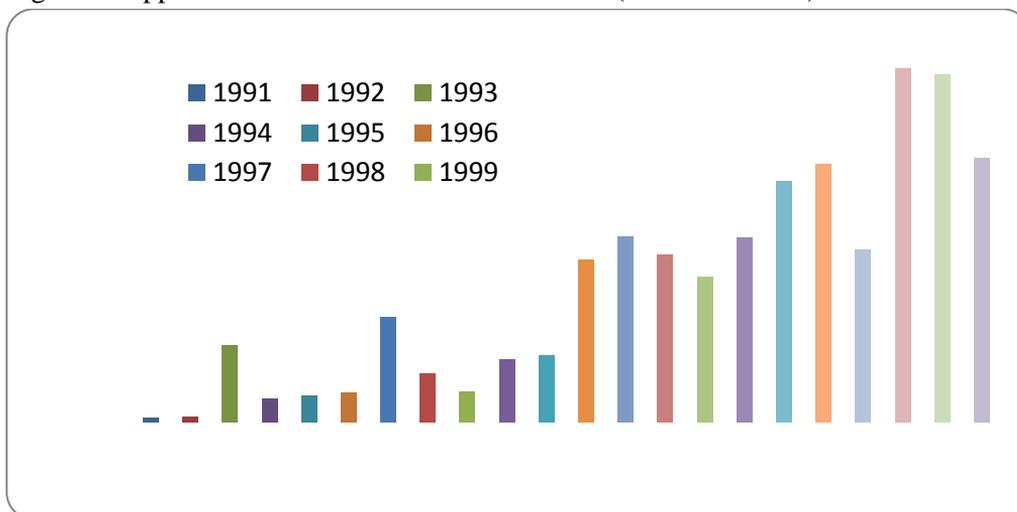
Figure 2: Taiwanese exports and imports to Mainland China (in million USD)



Source: National Development Council (2013); author's calculations.

The story behind the statistics of Taiwanese investments in Mainland China is similar to the one of its trade. The available statistics are highly inaccurate.

Figure 3: Approved investment in Mainland China (in million USD)



Source: National Development Council (2013), author's calculations.

Figure 3 shows the approved Taiwanese investments in Mainland China. However, the approved investments might be different from the executed ones. Some of the planned investments do not occur; others are not captured by statistics because

they are carried out via third parties such as Hong Kong, Singapore or tax heavens. Nevertheless, Figure 3 can still offer a basic idea on how China has become an important investment destination for Taiwan in only two decades.

5 THE IMPLICATIONS OF ECONOMIC DEPENDENCE

On one hand, many authors agree that the economic interactions across the Taiwan Strait make a war between the PRC and ROC less likely.¹² On the other hand though, some authors argue that the economic linkages might become a potential threat to Taiwan's national security.¹³ There are the two most common arguments against closer economic cooperation in Taiwan Strait:

- a) It is believed that an asymmetric dependence has developed in the Taiwan Strait. Taiwan is presumably very vulnerable to any sanctions imposed by China which creates an economic leverage on Taiwan.
- b) By investing in China, Taiwan is helping to spread its knowledge and know-how. In this way the ROC helps its potential adversary to grow faster (Roy 2004).

6 ASYMMETRIC DEPENDENCE

In this part we first argue that the trade flows in the Taiwan Strait are indeed asymmetric. Later we show the involvement of both countries in their bilateral trade, and finally we discuss the likeliness of China undertaking economic coercion measures against Taiwan.

Figure 4 shows the uneven distribution of export flows. Taiwanese exports generate larger proportion of the cross-strait trade. However, the Chinese exports have been gaining more importance over time.

Both the PRC and ROC are important trade partners for each other. As mentioned previously, China has been Taiwan's most important trade partner for a decade. Figures 5 and 6 illustrate Chinese and Taiwanese trade flows by partner countries in 2012. In 2012 China was ROC's biggest export destination and in 2013 China also became the number one country for Taiwanese imports (National Development Council 2013). It is clear that China plays a more important role for Taiwan's trade than the other way round. However, the role of Taiwanese trade for China should not be underestimated.

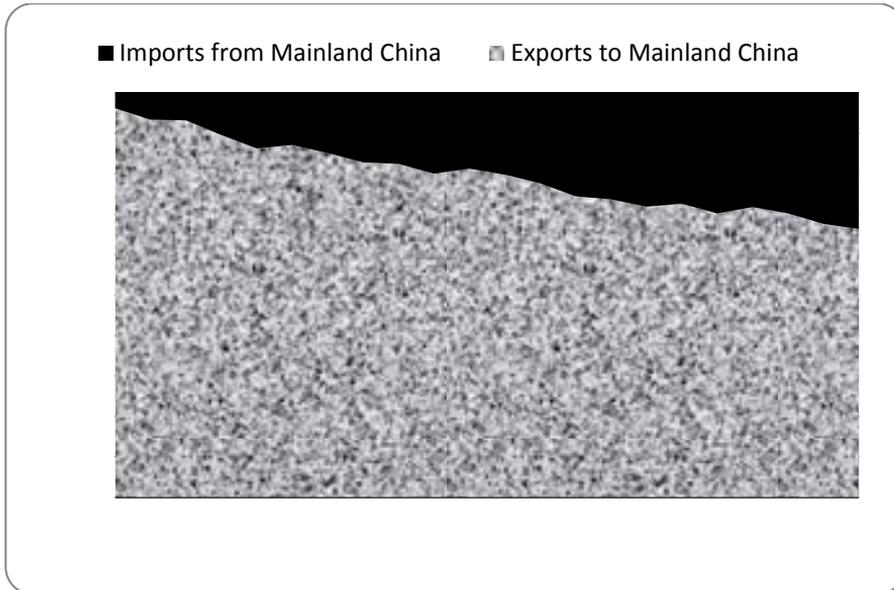
Sheu (2014) highlights that Taiwan is not the only country for which China has become the most crucial economic partner: when the trade links of Trans-Pacific

¹² For more arguments how economic interaction helps to prevent conflict in the Taiwan Strait see for example Chen (2009) or Končíková (2014).

¹³ For more details about these arguments see for example Leng (1996) or Tanner (2007).

Partnership¹⁴ countries are analyzed we find out that for six of these countries China is the most important trade partner and for another five it is the second biggest trade partner.

Figure 4: The proportions of exports and imports in the total trade



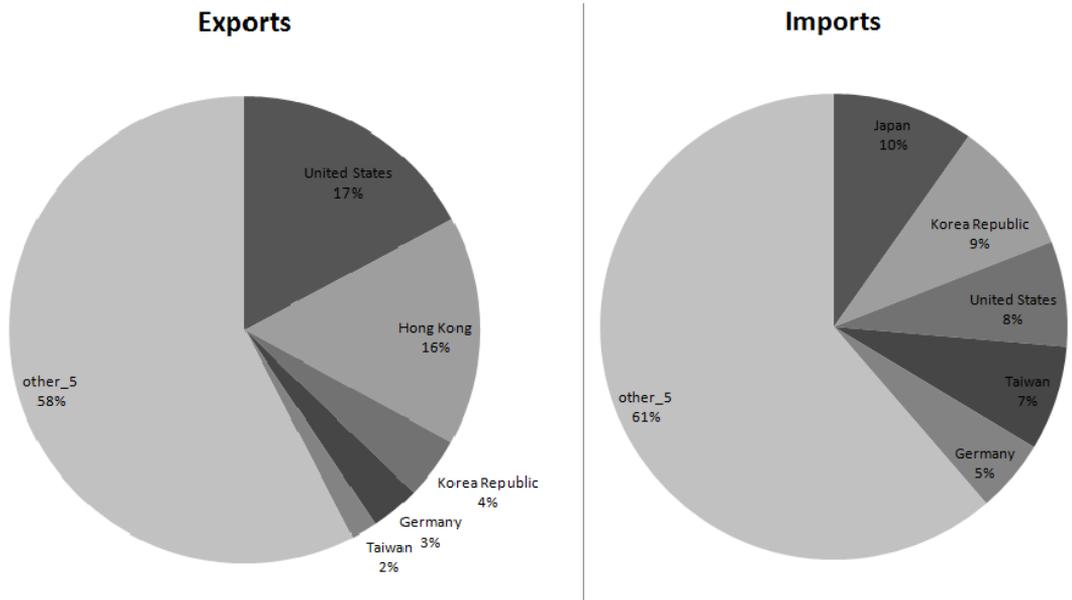
Source: National Development Council (2013), author's calculations.

Taiwan is the fifth most important trade partner of China. With 2 % of Chinese exports heading to Taiwan it occupies the eleventh place among Chinese export destinations. Imports from Taiwan are more important for China. Taiwan is the fourth biggest importer country to China importing up to 7 % of the entire trade. In comparison, Japan – the biggest importer to China – reaches 10% of the total value (National Bureau of Statistics of China 2014).

When comparing the figures we observe a higher diversification among Chinese trade partners. While the five most important Taiwanese import partners generate 52 % of total imports, for China it is only 49 %. The gap is even bigger when focusing on exports: 63 % of Taiwanese exports go to its five main export destinations, for China it is only 42 %. While 27 % of overall Taiwanese exports go to China, for China the proportion of exports going to Taiwan is only 2 %.

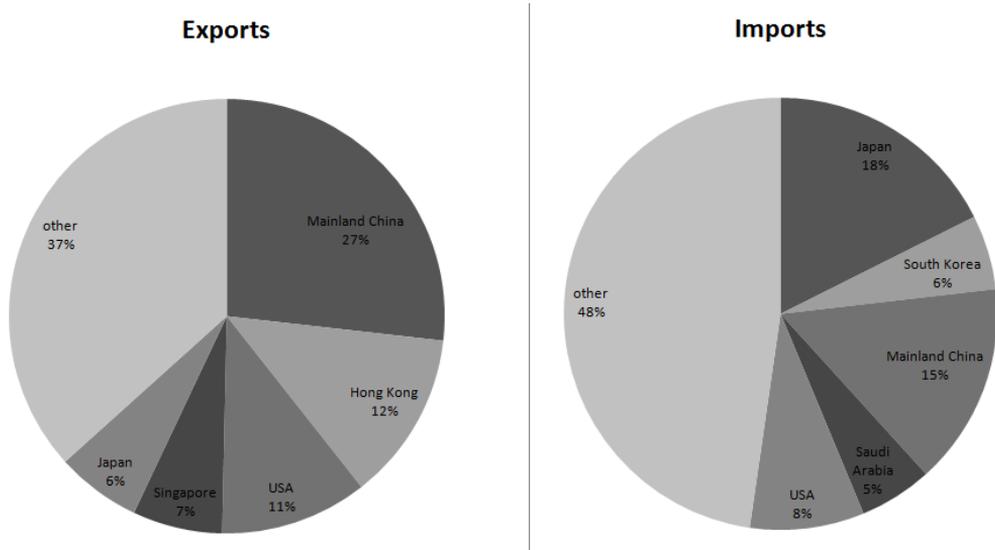
¹⁴ Trans-Pacific Partnership is a proposal for an international agreement on regulations and investments. The following countries are members of the agreement: Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam.

Figure 5: Chinese exports and imports by trade partners in 2012



Source: National bureau of Statistics of China (2014); author's calculations.

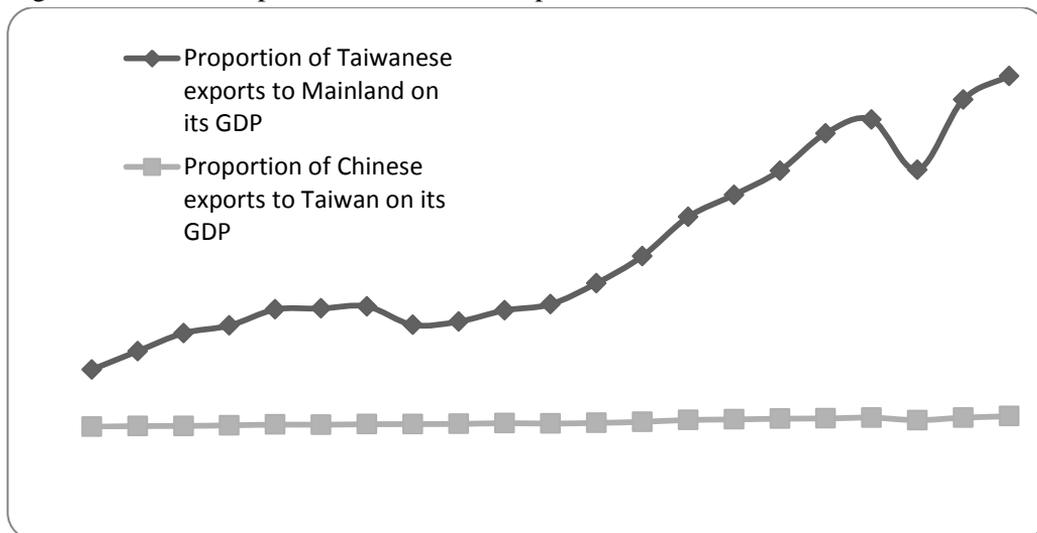
Figure 6: Taiwanese exports and imports by trade partners in 2012



Source: National Development Council (2013), author's calculations.

Figure 7 demonstrates that Taiwan is more dependent on its exports to mainland China than the other way round. This trend can be partly explained by their economic power, degree of openness and involvement in the global production networks.

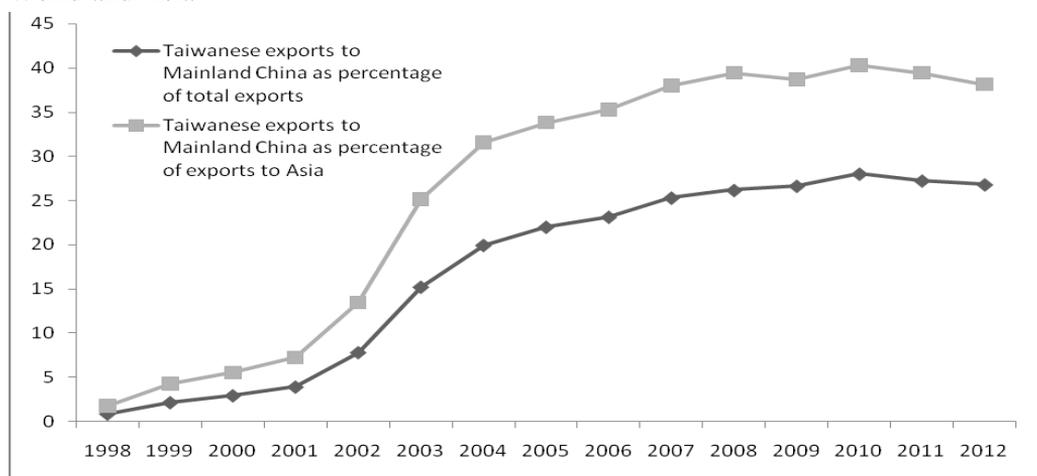
Figure 7: Relationship between countries' exports and their GDP



Source: National Development Council (2013), Feenstra et al. (2013); author's calculations.

Figures 8 and 9 show the growing dependence of Taiwan on China. The biggest growth is observed in 2001 and in the last couple of years the proportion of Taiwanese exports heading to China was relatively stable. Moreover, the growth between years 2001 and 2004 can be partly attributed to the entry of previously illegal trade relations into the official statistics.

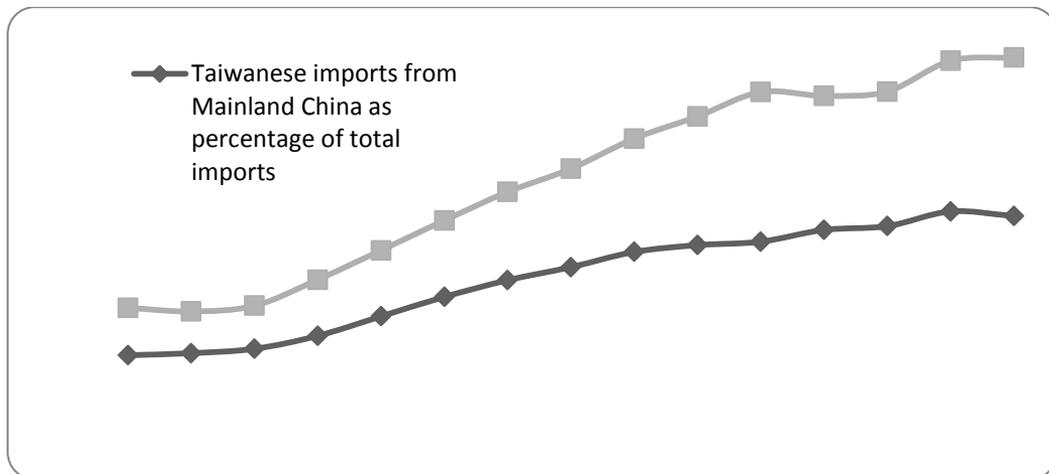
Figure 8: Taiwanese exports to Mainland China as a percentage of its exports to the World and Asia



Source: National Development Council (2013); author's calculations.

As for the Taiwanese imports from Mainland they continue to grow. Their importance, however, is still not as crucial as in the case of Taiwanese exports. Despite the observed asymmetry in trade relations between China and Taiwan, we cannot easily claim that China would be willing to use coercion measures against Taiwan.

Figure 9: Taiwanese imports from Mainland China as a percentage of its imports from the World and Asia



Source: National Development Council (2013); author's calculations

Tanner (2007) argues that there are several economic coercion methods China could take against Taiwan. One of them is import sanctions. Taiwan is more vulnerable to such a threat than China is. Even when we analyze the flows of Taiwanese exports to China as a proportion of its total exports we find a growing trend. Figure 8 shows that in 1998 the share of exports to Mainland was less than 1 percent of total trade, but in the year 2012 it reached almost 27 percent of Taiwanese exports. It is, however, doubtful to assume that China would opt for import sanctions despite the Taiwan's unfavorable dependence on cross-strait trade.

First of all, the exporting country is not the only beneficiary of bilateral trade. The disruption of trade impacts also the importing economy. Among other things, the ban on Taiwanese imports could raise prices of the imported goods in China.

More importantly, the Taiwanese exports to mainland China are connected with other parts of the economy. There is a link between Taiwanese exports and Taiwanese investments in mainland China. In 2003 it was estimated that 75 percent of the machinery and equipment and 54 percent of the materials used by Taiwanese businesses were imported from Taiwan (Chen 2003). Therefore, limiting Taiwanese exports would have a strong impact on production capacities in China which are run by Taiwanese enterprises.

Furthermore, the Taiwan-invested enterprises are heavily involved in the global production chains. Not only they import intermediate goods into China, but they also export their products from China. It was estimated that the Taiwan-invested companies might create around 14-18 percent of the Chinese exports (Tung 2003). Therefore, prohibiting imports from Taiwan might influence not only the Chinese exports to Taiwan, but also a huge proportion of its total exports to the World. It was calculated that a disruption of Taiwanese exports to mainland by 1 dollar could cause a decline in exports by 5 dollars (Tung 2003).

Another coercion measure mentioned by Tanner (2007) is export sanctions. Those could hurt Taiwan only if it was dependent on importing goods from Mainland China. Yet this is not the case. Despite the fact that Taiwanese imports of Chinese goods were only 4 percent in the year 1998 and nowadays they generate more than 15 percent of Taiwanese imports, it is likely that they could be easily replaced by imports from other Asian economies.

The other possible coercion measures mentioned by Tanner (2007) are related mostly to Taiwanese investments and businesses in China. He suggests that China could possibly impose the following sanctions: Financial and Investment sanctions, selective harassment or intimidation of Taiwan businesspeople, economic disruption, damage and sabotage, deliberate slowing or withholding of businesses. All these possible sanctions build on the assumption that an assault on Taiwanese investments is more harmful to Taiwan than to Mainland China.

Such assumption is difficult to prove. It is well known that investments have positive impact on the host economy. This might be one of the reasons why China was emphasizing during the Taiwan Crisis in 1995-1996¹⁵ that the interest and rights of Taiwanese investors in Mainland will not be affected despite the political tensions (Chen 2003). In addition, when it comes to Taiwanese investments many local interests are involved. According to Tung (2003) it was estimated that "about 36 to 38 percent of Taiwan entrepreneurs have broad partnership with local Chinese enterprises, local governments, and foreign enterprises". This means that any measures taken against Taiwan would cause dissatisfaction among numerous local and foreign partners.

7 TECHNOLOGY SPILLOVERS

Another concern is that by investing in China Taiwan is helping to improve the technology of its potential adversary. There is no doubt that foreign direct investments have positive effect on Chinese economy. However, these Taiwanese investments also

¹⁵ The Taiwan Crisis in the years 1995 and 1996 was a series of two main missile tests in the Taiwan Strait. The one taking place in 1995 was presumably a sing to the Taiwanese head of state Lee Teng-hui who was moving away from the traditional one-state declaration. The second one is believed to have been a tool of intimidating Taiwanese electorate in order not to vote for Lee Teng-hui in the first Taiwanese democratic elections.

help Taiwanese economy to develop. They provide opportunities for exports. Moreover, by investing in China, Taiwan can move its low-technology operations abroad and the economy can specialize in high-tech production.

The biggest fear from the investments in Mainland is that there might be investments in the high-tech sectors. First of all, if investment in research and development were attractive, investors would find ways to invest via third parties despite the prohibition in such sector. But in particular, this is not the most common investment strategy of Taiwanese businessmen. As proved by Rosen and Wang (2011) up to 70 % of Taiwanese exports to mainland China are of processing type and as such involve mostly assembling operations. This proves that the main goal of Taiwanese entrepreneurs in Mainland is to move the labor-intensive part of their production to China and hence exploit the cheap labor possibilities.

The last table shows us the structure of approved investments in Mainland China by industry. We can see that the biggest investments occurred in the electronic parts and components manufacturing, and in computer, electronics and optical products manufacturing. The majority of these investments could be investments in halls for assembly operations which would be too expensive in Taiwan given its cost of labor.

Tab. 1: Approved investments in Mainland China (in million USD)

<i>Industry</i>	<i>Value</i>	<i>Share</i>
Others	29377.0	21.3
Electronic parts and components manufacturing	25937.6	18.8
Computer, electronics and optical products manufact.	18646.0	13.5
Electrical equipment manufacturing	10004.3	7.2
Wholesale and retail trade	8551.4	6.2
Financial and insurance	6966.1	5.0
Chemical material manufacturing	6553.5	4.7
Fabricated metal products manufacturing	6095.6	4.4
Non-metallic mineral products manufacturing	5809.5	4.2
Machinery and equipment manufacturing	5560.1	4.0
Basic metal manufacturing	3585.1	2.6
Real estate	3587.5	2.6
Food manufacturing	3036.9	2.2
Motor vehicles and parts manufacturing	2390.9	1.7
Information and communication equipment	2141.8	1.5
Total	138243.2	100.0

Source: MAC (2014b).

8 CONCLUSION

In this paper we have analyzed the rising economic flows between Taiwan and Mainland China. We have shown that the economic motivation was stronger than the political hostility and therefore the trade, investments and migration have been growing.

However, the political fears are still present, as was demonstrated by the Sunflower movement in early 2014. Therefore we examined whether the fears of economic integration are reasonable. On one hand, we found out that there truly exists an asymmetry in the economic flows. On the other hand, this is not yet a reason to believe that there is an asymmetric dependence on these flows.

Generally, imposing sanctions is always harmful to both sides. Moreover, the cross-strait flows are highly integrated in the global value chains. Therefore, there is a striking connection between Taiwanese exports to Mainland and Mainland's exports to third parties.

Also, a big part of the operations performed in the Taiwan-invested enterprises in China is assembly. However, this does not exclude the possibility of positive externalities on Chinese companies. Both parties involved in mutual trade and investments profit from such arrangements.

To conclude, if China would intend to impose economic sanctions on Taiwan, it could be very harmful to the Taiwanese economy; but it could be as well (if not more) harmful to China itself.

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