

The Analysis of Taiwan Direct Investment in China

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Abstract

The concerns of Taiwan's economy over dependence on China reflect the political implication of unification with, and the military threat of annexation by, China that prompt this study. The objectives of the study are: To understand factors that attract Taiwan Direct Investment (TDI) in China; to identify the causative factors of rising unemployment in Taiwan; to learn if there is a negative impact of TDI in China on Taiwan's economy and security; and to offer some empirical-based strategies to alleviate the rising unemployment in Taiwan. The survey intends to conceptualize a Venn model that reflects empirical findings and to present major empirical statements derived from the study.

I. Introduction

Over the past five decades, Taiwan experienced phenomenal economic growth [1]. It transformed from an agricultural to an industrial economy. Taiwan's economy moved away from being in a labor-intensive light industry to being in a more capital-intensive and high-tech industry. Taiwan is a major leader in supplying the world with information technology products [2]. Taiwan controls more than 50 percent of the global market for computer hardware, semi-conductor, and other high-tech products. More than 70 percent of total manufacturing in Taiwan is in capital-intensive and high-tech industries [3].

Without any assistance of from the IMF and the World Bank, Taiwan successfully fended off the Asian Financial Crisis [2]. President Chen Shui-bian indicated that although Taiwan had been hit by the global trend of economic downturn, it still managed to achieve a growth rate of 3.3 percent in 2002. This was 0.6 percent, 0.9 percent and 1.1 percent higher than the growth rates of Singapore, the US and Hong Kong respectively for the same period [4]. Having gone through the SARS epidemic, the disastrous typhoons, and corporate scandals, Taiwan's economy still attained a growth rate of 3.2% in 2003. The strong export performance drove Taiwan's economy forward. Taiwan realized an economic growth rate of about 4.1% in 2004 [5].

The economy of China is significantly larger than that of Taiwan. China's economy is almost ten times larger than Taiwan's [6]. Taiwanese firms find it difficult time to stay away from the economic attraction of China's larger market and cheaper labor that gives rise to Taiwan Direct Investment (TDI) in China.

The exit of Taiwan business firms to China leaves Taiwanese jobless workers behind. Taiwan's unemployment rate in 2000 was 2.99%. It rose to 4.25% in 2001 and 5.2% in 2002 [7]. The unemployment rate climbed to 5.30% in 2003 [8]. It was 5.2% in 2004 [9]. Although the government has implemented economic plans to stimulate the economy, the unemployment condition has been persistent.

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II. Analysis

Literature review will be incorporated in the process of this analysis. The analysis of the present study will be related to the four words *attraction*, *causation*, *solution*, and *effect* as they are shown in the Venn model of Diagram 1. These words encompass four groups of factors, strategies, and impacts pertaining to the research. The analysis begins with the government that gave the green light for Taiwan direct investors to leave Taiwan for China.

Group 1. Attractive factors of TDI in China

1.1 Official liberation of the half-century ban on TDI in China

On November 7, 2001, the Taiwan government officially lifted the ban on TDI in China by replacing the old policy "no haste, be patient" with the new policy "active opening, and effective management." The former policy was implemented by the former President Lee Teng Hui to slow down the outflow of Taiwan capital to China. The "no haste, be patient" policy mandated a ceiling of the accumulated investment amount up to US\$50 million per project while the "active opening, and effective management" policy increased the ceiling of investment to US\$80 million per project [10]. The "active opening,

and effective management” policy also relaxed other investment regulations such as allowing Taiwan investors to invest in China without having to set up a subsidiary somewhere else and allowing industries other than those in the prohibition category to engage in TDI in China. Lifting the ban on TDI has expedited the outflow of Taiwanese capital to China. Consequently, the bandwagon effect of TDI in China has infected the Taiwan business community.

1.2 Market share

Increasing market share often is one of the strategic goals of an enterprise that hopes to grow in sales in the global economy. Taiwanese business firms do not behave any differently from other companies in maximizing their market share wherever possible. Taiwan direct investors have been magnetized by the giant market of the 1.3 billion Chinese people in the mainland. Motivated by an increase in market share, TDI in China continues to swell. For example, the Ministry of Economic Affairs of the Republic of China in Taiwan announced that as of the end of October 2000, TDI in China amounted to U.S\$. 2.1 billion, which was up by 98 percent from the same period in 1999 [11]. Incidentally, the unofficial volume of TDI in China is much higher. The capital outflow from Taiwan to China is increasing at an exponential rate.

1.3 Profit Maximization

In accordance with the concept of profit maximization, the goal of business firms is to maximize profit. Profit has been one of the major reasons for TDI in China. However, most Taiwan-financed business firms in China have earned less profit than they originally expected. A poll conducted by the Taiwan government confirms this fact. The government studies reveal that less than 50 percent of TDI in China made money. About 40 percent of TDI in China were profitable, 20 to 30 percent lost money and about 20 to 30 percent broke even [12].

1.4 Low cost of production

TDI in China is a typical example of the application of comparative advantages in economics and in business. Taking advantage of the relatively low cost of production on the Chinese mainland, Taiwan direct investors cross the Taiwan Strait to exploit their competitive edge in pursuit of higher profitability in China. They foresee low production costs in China. The goal is Profit Maximization as well as Profit Satisficing.

1.5 Common language

Different languages are a barrier to effective communication. Translations cannot avoid the problem of different perceptions across communication. As the use of translation increases, so does the potential for misunderstanding. On the other hand, communication in

the same language tends to enhance the mutual understanding of communicators.

The vast majority of people in Taiwan speak Taiwanese that is similar to Fujianese spoken in the Fujian Province of China. However, Mandarin is the official language in Taiwan as well as in China. The Taiwan direct investors share the same medium of communication, Mandarin. In China, Taiwan Direct investors experience no significant language barriers and feel at home. In written language, Taiwan uses the traditional form and China adopts the simplified version. With a reasonable effort, Taiwanese investors are able to communicate with the mainlanders in writing. Therefore, communication between the Taiwanese and the Chinese results in positive effects on business operations in the host country.

1.6 Similar culture

Cultures provide ways of thinking, perceiving, behaving, seeing, and believing in life and work. The same word or phrase may have different connotations to people with different cultural backgrounds. People with different cultural backgrounds have different business practices. Cross-culture communication tends to encounter perception barriers. The similar cultural environment in China attracts Taiwanese investors who do not have to cope with cultural shocks.

1.7 China's Incentives

Like other less developing countries, China puts forward a variety of incentives to woo foreign direct investors to invest in its territory. China has been soliciting Taiwanese investors to be part of its strategic effort of economic development. A dynamic market along with a variety of incentives offered by the Chinese government reflects a powerful force that the Taiwanese investors cannot resist. Examples of Chinese incentives include funds transfer, favorable investments in infrastructural facilities, opening of high-tech projects, different industrial zones, favorable tax rates, extended visa, and the liberalization of investment restrictions.

Group 2. Causative factors of unemployment

2.1 Global economic slowdown

Prior to the September 11, 2001, terrorist attack, American economy had already shown signs of slowdown [13]. After the terrorist attack, American airlines nosedived along with the collapse of high-tech industry. The contraction of financial markets and investment activities intensified. America, the largest dynamic economy in the world, experienced rising unemployment. The economic downturn infected an integrated global economy. The bandwagon effect was reflected in a global recession. [14]. A global recession [15] cannot be mitigated immediately. It lingers on. Therefore, the rise of

unemployment in Taiwan was in part caused by the global economic slowdown.

2.2 Westward investment policy

In 2001, Taiwan authorities formulated a “westward investment policy” encouraging Taiwanese investors to invest in China. In the same year, the Taiwan government lifted the official ban on TDI in China. This policy action brought about a massive capital flight from Taiwan to China.

2.3 Structural unemployment in industrial transitions

Some scholars have attributed the aggravation of unemployment in Taiwan to structural unemployment in industrial transitions from labor-intensive to capital-intensive industries. Others have attributed it as a side effect of industrial development brought about by the slow upgrade of the economy and its industrial base. Thus, structural unemployment became a major causative factor.

2.4 Outflows of Taiwan capital into China

In the past ten years, the outflows of Taiwan capital into China are estimated to amounts about \$100 billion. Continual capital outflows lead to a decrease in investment activities at home. Consequently, a fall in investment in Taiwan gives rise to unemployment among Taiwanese workers.

2.5 Relocations of businesses in China

Business firms close plants in Taiwan and relocate in China and other countries. In the process, Taiwanese firms let go most of their employees. Most Taiwanese business firms, which relocate, move their operations to China. Since the ban on TDI in China lifted, labor-intensive companies (such as shoes and factories) concentrate their operations in the Chinese mainland.

2.6 Lack of law on the employment security system

There is no comprehensive employment security system to protect laid-off employees once their employers relocate abroad. Employees are not fully protected by labor unions, which lack collective bargaining power and shun strike. If there were strong unions in Taiwan, employers would not have laid off their employees at will, the way they have done.

2.7 Legislative gridlock on economic issues

Ever since the Democratic Progressive Party (DDP) became the ruling party in Taiwan, the legislature has resulted in two political blocks. The Kuomintang joined the People First Party to become the one political force while DDP allied with the Taiwan Solidarity Union to form the opposing camp. The legislative gridlock between

the two camps keeps important issues mired in divisive partisan politics. The legislative gridlock does not help lessen unemployment.

Group 3. Empirical strategies to alleviate unemployment in Taiwan

3.1 Enforcement of “effective management”

In response to the pressures of the business sector to lift the official ban on TDI in China, the government adopted a policy “active opening and effective management.” The execution of the first part of the policy “active opening” has been a success. However, the second part “effective management” that should have minimized the negative side effects of TDI in China has failed to protect employment in Taiwan.

3.2 Priority financing for domestic firms

Financing business firms at home should be given preference over financing abroad. Domestic investment creates employment opportunities in the home country; TDI in foreign countries does not. This policy action should be part of a comprehensive stimulant package during a period of rising unemployment.

3.3 Improvement of domestic investment environments

One approach to creating employment opportunities is to improve domestic investment environments along with competitive incentives. Incentives should aim to attract employment-generating investments in Taiwan. However, the government must see to it that the incentive package is not overly burdensome for the taxpayers.

3.4 Tax cut or interest rate reduction

The purpose of a tax cut or interest rate reduction is to stimulate consumption and encourage local investments. A tax cut complemented by a reduction in interest rates tends to create employment opportunities. The government may consider a cut in corporate tax and capital gain tax with a provision that business firms should reinvest the funds saved from tax cuts in employment opportunities in Taiwan.

3.5 Public works programs for the unemployed

During a period of rising unemployment, the government may launch a series of public projects to create employment opportunities. Both the legislature branch and the executive branch should focus on national interests in targeting job creation for the unemployed. Therefore, public works programs for the unemployed are another approach to easing unemployment in the short run.

3.6 Slowdown of the approval process of TDI in China

At a time of rising unemployment in Taiwan, it would be appropriate strategy to slow down the process of exporting jobs. At the same time, finding “ways and means” to expedite the upgrade process of the economy and industries cannot be over emphasized. A synergetic effort of the government, workers, capitalists, and political parties is needed to take the edge off unemployment in Taiwan.

3.7 Removal of legislative gridlock on economic issues

Formulating an economic stimulant package and resolving the problem of structural employment require collaborative supports from the Legislative Yuan in Taiwan. The continual legislative gridlock promotes political interests rather than national interests. It is an unfortunate stalemate at the expense of the unemployed.

Group 4. Effect of TDI in china on Taiwan's economy and security

4.1 Volume of TDI in China on the rise

Taiwanese companies that have invested in China are on the rise. There are more than 50,000 Taiwanese-invested firms on the mainland and more than half a million Taiwanese living there. As of March 19, 2005, Taiwanese Investors have invested about \$100 billion in China and have employed about \$100 million worth of work force in the Chinese mainland [16].

4.2 Economic sinicization

Taiwan's economic integration with China could backfire. A small economy sooner or later would be totally merged with the big economic system. It would be swallowed by the larger economy. In the end, Taiwan's economic integration would become “economic sinicization.” The outcome could result in Taiwan losing its economic and political freedom.

4.3 Over dependence on China's market

The rising TDI in China leads Taiwan's economy into a dangerous zone of over dependence on China's Market. The United States used to be the primary country for Taiwanese exports. China now is the primary market for Taiwan's goods and services. There are 37 percent of Taiwanese exports now headed for China and its territory, Hong Kong [16].

4.4 Taiwan direct investors being forced to support China's political goals

TDI investors have put most or all of their eggs in one basket. They are exposed to business risks. The Chinese government could use tax audit as an excuse to harass

Taiwanese business people in China until they succumb to its political manipulations. For example, Mr. Hsu Wen-Lung, the retired Board Chair and Founder of Chi Mei Group that was an ardent supporter of the Taiwan government suddenly made a public statement: “Taiwan and the mainland belong to one China” [17]. The four societies of Taiwan responded: “We therefore do not find it strange when Hsu becomes a hostage and betrays both himself and the nation. We do find it regrettable” [18].

4.5 Transfer of technology to China

Technology transfer is accompanying “the westward flood of capital” to China. In 2002, statistics revealed that Taiwan direct investors on the mainland produced seventy-three percent of China's total information technology output [19]. Taiwan Semiconductor and United Microelectronics have exported the advanced technologies of both 10-inch and 12-inch waferfabs to China. It is ironic that Taiwan transfers its “crown jewels” of computer and semiconductor technologies to help “China's advanced technology industries, which support modernization of China's People's Liberation Army” that threatens Taiwan's security (Tkacik Jr., 2003).

4.6 TDI in China negatively affecting Taiwan's security

If the outflows of TDI in China continue at their current rate, Taiwan's economy will become a subset of China's economy. If Taiwan's economy overly depends on China's economy, this situation will give rise to the concern of Taiwan's security. The transfer of technology to China from Taiwan could also have a negative impact on Taiwan's security.

III. Methodology

The methodology of the survey was, in part, similar to that of earlier studies [2] [20] [21] [22]. The survey was created to shed additional light to the extensive literature review.

Subjects

Four types of subjects — Taiwan direct investors, business firms in Taiwan, business professors, and labor unions participate in the survey.

The names and email addresses of twelve hundred subjects were lifted from four sources: (1) a directory of government organizations and personnel published by the Government Printing Office in Taiwan, (2) a directory of professors in higher education compiled by the Ministry of Education, also in Taiwan, (3) a compilation of domestic firms in Taiwan and Taiwanese firms in China, published by the Direct Investment Evaluation Committee of the Ministry of Economic Affairs, and (4) the search engines of Google, Openfind, and Yahoo.

Instrument

The instrument used in the study was an e-questionnaire. The e-questionnaire was designed to derive the attractive factors of TDI in China, causative factors of unemployment, empirical-based strategies to alleviate unemployment, and the effect of TDI in China on Taiwan's economy and security. A second purpose was to identify the relative importance of each of the four group surveyed items. Another purpose was to derive some empirical statements as an addition to the existing literature. The e-questionnaire was set up according to a 5-point Likert Scale ranging from "1" meaning "strongly agree" to "5" meaning "strongly disagree." Open ended "comments" were also included in the questionnaire.

Procedure

The questionnaire and a cover note were e-mailed to the subjects. Subjects were asked to respond to the questionnaires promptly.

Ninety-seven questionnaires were returned as being undeliverable due to incorrect e-mail addresses or other unknown reasons. Of the remaining 1103 questionnaires, a total of 437 subjects completed and returned the questionnaire within one week. The response rate of the survey (39.62%) was almost four times better than the average mail response rate of about 10% [23] [24]. This rather high return rate was possibly due to short written reminders e-mailed a few days after the original mailing.

Venn Model

"One picture is worth a thousand words." A Venn model of Diagram 1 derived from the empirical findings consists of four interactive groups of surveyed items. The top circle shows Group 1 of the attractive factors. The circle on the right exhibits Group 2 of the causative factors. The circle on the left indicates Group 3 of the solution strategies for unemployment. Group 4 of the effect on Taiwan's economy and security as positioned in the center or the common intersection area of the three circles symbolizes the consequential concerns of the TDI in China. There are seven surveyed items in Group 1. Each of Groups 2 and 3 also is composed of seven surveyed items. The fourth group is comprised of six surveyed items. The discussion of these surveyed items has been done in the section of Analysis.

Factor, strategy, and effect rankings

The surveyed subjects judge each of the grouped items with a Likert Scale ranging from "1" meaning "strongly agree" to "5" strongly disagrees." Each sum of the surveyed items in each group is ranked in terms of the agreeable intensity in an ascending order. Hence, the lower the sum of a surveyed item in a group, the higher is

its agreeable intensity. The higher the sum of a surveyed item in a group, the lower is its agreeable intensity. Group 1 of Table 1 consists of seven surveyed factors, which are ranked in a range from "1" meaning "the highest agreeable intensity" to "7" meaning "the lowest agreeable intensity." Analogously, the surveyed items of Groups 2, 3, and 4 are ranked and shown in Tables 2, 3, and 4, which are self-explanatory.

Diagram 1.
The Venn Model of Taiwan Direct Investment in China

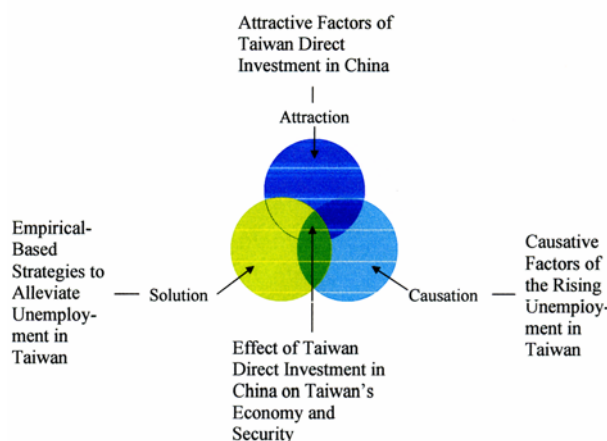


Table 1. Factor ranking

| Group 1. Attractive factors of TDI in China | |
|---|---|
| Rank | Name of Factors |
| 1 | Official liberation of the half-century ban on TDI in China |
| 2 | Low cost of production |
| 3 | Market share |
| 4 | Profit maximization |
| 5 | Common language |
| 6 | Similar culture |
| 7 | China's incentives |

Table 2. Factor ranking

| Group 2. Causative factors of unemployment | |
|--|--|
| Rank | Name of Factors |
| 1 | Outflows of Taiwan capital into China |
| 2 | Legislative gridlock on economic issues |
| 3 | Westward investment policy |
| 4 | Relocations of businesses in China and other countries |
| 5 | Structural unemployment in industrial transitions |
| 6 | Global economic slowdown |
| 7 | Lack of law on the employment security system |

Table 3. Strategy ranking

| Group 3. Empirical strategies to alleviate unemployment in Taiwan | |
|---|--|
| Rank | Name of Factors |
| 1 | Improvement of domestic investment environment |
| 2 | Removal of legislative gridlock on economic issues |
| 3 | Financing priority for domestic firms |
| 4 | Tax cut or interest rate reduction |
| 5 | Public works programs for the unemployed |
| 6 | Enforcement of effective management policy on TDI in China |
| 7 | Slowdown of the approval process of TDI in China |

Table 4. Effect ranking

| Group 4. Effect of TDI in China on Taiwan's economy and security | |
|--|---|
| Rank | Name of Factors |
| 1 | Volume of TDI in China on the rise |
| 2 | Taiwan direct investors being forced to support China's political goals |
| 3 | TDI in China negatively affecting Taiwan's security |
| 4 | Transfer of technology to China |
| 5 | Over dependence on China's market |
| 6 | Economic sinicization not economic integration |

IV. Empirical statements — a concise summary

The present study has derived a number of invaluable empirical-based statements. These statements provide interested researchers, policy makers of the government, students, and others with some insights shown in Tables 1 to 4. The statements could serve as an additional reference to the existing literature.

The first attractive factor (ES₁), the official liberation of the half-century ban on TDI in China, energizes the westward migration of Taiwanese investors who are motivated by the low cost of production and market share in the Chinese mainland.

In ES₂, the first three-top causative factors of unemployment are “outflows of Taiwan capital into China,” “Legislative gridlock on economic issues,” and “Westward investment policy.” Structural unemployment considered by economists as the major cause of unemployment in theory ranks fifth. One interpretation about this ranking is that people are more sensitive to the

short-term as opposed to the long-term business or economic activities and policy executions that cause unemployment.

In ES₃, the improvement of domestic investment environment is the first strategy to alleviate unemployment in Taiwan. The implementation of this strategy cannot take place without the removal of legislative gridlock on economic issues such as financing priority for domestic firms, tax cuts, and public works programs. This suggests that the Executive Yuan and the Legislative Yuan hold the key to lessen unemployment.

In ES₄, with regard to the effect of TDI in China on Taiwan's economy and security, “the volume of TDI in China on the rise” ranks at the top of the list. It leads to a dangerous scenario that Taiwanese investors are being compelled to support China in its political desire. Consequently, TDI in China negatively affects Taiwan's security.

V. Conclusion

The current study postulated a Venn model that examined a number of attractive factors, causative factors, empirical solutions, and economic and security effects pertinent to TDI in China. The survey derived empirical statements that warrant further research. This study ultimately concludes that TDI in China does have an adverse effect on Taiwan's security.

VI. Appendix

E-Questionnaire

Please type in Column 1 corresponding to each survey item with a range from “1” = strongly agree... to... “5” = strongly disagree.

| Column1 | Group 1: Attractive Factors of TDI in China |
|---------|---|
| | Official liberation of the half-century ban on TDI in China |
| | Market share |
| | Profit maximization |
| | Low cost of production |
| | Common language |
| | Similar culture |
| | China's incentives |
| | Others (Please specify): |
| | |
| | Comment: |
| | |
| | Group 2: Causative factors of the rising unemployment in Taiwan |
| | Global economic slowdown |
| | Westward investment policy |
| | Outflows of Taiwan capital into China |
| | Relocations of business in China and other countries |
| | Lack of law on the employment security system |
| | Legislative gridlock on economic issues |
| | Structural unemployment in industrial transitions |
| | Others (Please specify) |
| | |
| | Comment: |
| | |
| | Group 3: Strategies to improve unemployment in Taiwan brought about by TDI in China |
| | Enforcement of effective management policy on TDI in China |
| | Financing priority for domestic firms |
| | Improvement of domestic investment environment |
| | Tax cut or interest rate reduction |
| | Public works programs for the unemployed |
| | Slowdown of the approval process of TDI in China |
| | Removal of legislative gridlock on economic issues |
| | Others (Please specify): |
| | |
| | Comment: |
| | |
| | Group 4: Effect of TDI in China on Taiwan's economy and security |
| | Volume of TDI in China on the rise |

| | |
|--|---|
| | Economic sinicization not economic integration |
| | Over dependence on China's market |
| | Taiwan direct investors being forced to support China for achieving its political aim |
| | Transfer of technology to China |
| | TDI in China negatively affecting Taiwan's security |
| | Others (Please specify): |
| | |
| | Comment: |
| | |

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