

BTI 2014 | Taiwan Country Report

Status Index	1-10	9.58	# 1 of 129	
Political Transformation	1-10	9.65	# 3 of 129	➔
Economic Transformation	1-10	9.50	# 1 of 129	➔
Management Index	1-10	7.68	# 1 of 129	
	scale	score	rank	trend

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2014. It covers the period from 31 January 2011 to 31 January 2013. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

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Key Indicators

Population	M	23.3	HDI	-	GDP p.c.	\$	20328.3
Pop. growth ¹	% p.a.	0.4	HDI rank of 187	-	Gini Index		34.5
Life expectancy	years	79.3	UN Education Index	-	Poverty ³	%	-
Urban population	%	59.7	Gender inequality ²	-	Aid per capita	\$	-

Sources: Asian Development Bank (ADB), Key Indicators for Asia and the Pacific 2013 | International Monetary Fund, World Economic Outlook 2013 | UNDP, Human Development Report 2013. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$2 a day.

Executive Summary

Throughout the period under review, Taiwan has remained a high performer in terms of democratic consolidation and market institutionalization. It continues to enjoy a high degree of stateness, meaningful elections, the absence of undemocratic veto actors, stable democratic institutions and a vibrant civil society. The judiciary remains something of a weak point, as there are concerns over the politically motivated selection of judges for high-profile cases, the quality of the disciplinary system and a number of controversial rulings in child-abuse cases. But a consensus prevails within society that the country's legal institutions operate reasonably well.

The 2012 parliamentary and presidential elections were characterized by much political polarization as the Democratic Progressive Party (DPP) conducted a campaign that targeted the Chinese Nationalist Party's (KMT) China policy, decrying the selling out of Taiwan's sovereignty and economic well-being. However, the electoral outcome confirmed that the incumbent Ma administration enjoyed a rather solid mandate to launch more cross-strait initiatives, though with cautiousness. Between 2008 and January 2013, 23 accords were signed by which cross-strait direct communication, trade and transport were reinstated; a quasi-FTA (the Economic Cooperation Framework Agreement, ECFA) was put firmly in place; and a number of additional measures to deepen economic and social cooperation were formalized. Meanwhile, its second electoral defeat after losing power in 2008 caused the DPP to engage in some serious soul-searching and started an intraparty debate on its China strategy. The DPP walks a fine line, however, as it must come to terms with reconciling its identity as the party of Taiwan independence and the realities of a changing cross-strait relationship that is determined as much by policymaking as by migration.

Economically, Taiwan was hit hard by the global financial crisis of 2008 – 2009, but steered through it remarkably well because of resolute and efficient government crisis management. Consequently, Taiwan's economy bounced back rather quickly with a growth rate of more than 10% in 2010. However, weak global and domestic demand, combined with low domestic investment, have reduced exports and led to declining GDP growth; it stood at only 1.25% at the

end of 2012. Inflation has increased as well, though unemployment became less prevalent and sunk to 4.24% at the end of 2012, down from 5.85% in 2009 at the height of the global financial crisis. Taiwan's financial sector still suffers from a number of structural problems, such as market overcrowding with banks and a rather low degree of internationalization. However, the financial sector was further strengthened over the review period in terms of transparency, capitalization and control of nonperforming loans, resulting in a reasonable level of steering capacity in times of crisis.

History and Characteristics of Transformation

In Taiwan, political transformation has long taken a backseat to economic transformation. The foundations of a sound market economy were laid in the 1950s under the authoritarian leadership of the ruling Kuomintang (KMT) party and its chairman, Chiang Kai-shek. During that time, the state intervened with a strong hand in economic affairs, regulating and protecting domestic markets. In the four decades of authoritarian rule that followed the Chinese Civil War in 1949, Taiwan moved gradually toward a social market economy and established rudimentary social insurance systems. Democratic transition began with the illegal founding of the Democratic Progressive Party (DPP) on 28 September 1986 – a move tolerated at the time by the ruling Chinese Nationalist Party (KMT) regime – and the lifting of martial law on 14 July 1987. More reforms followed, most importantly the legalization of new political parties in January 1991. In 1991 and 1992 respectively, Taiwan saw free elections to its central parliamentary bodies, the National Assembly and the Legislative Yuan, for the first time, marking the end of the transition process. During the 1990s, democracy matured by successive constitutional reforms that, along with other changes to Taiwan's political system, paved the way for the first direct presidential election in early 1996. The incumbent president and KMT party leader Lee Teng-hui won this election and gained himself the epithet of Taiwan's "father of democracy." Successful democratic consolidation had already been achieved when Chen Shui-bian, an experienced DPP politician and stout advocate of Taiwanese independence, unexpectedly won the March 2000 presidential election and sent the KMT to the opposition for the first time since 1949, when the KMT had fled the Communist revolution on the mainland. The following eight years were dogged by severe legislative inefficiency as the partisan conflict between the ruling DPP and the KMT-led opposition, which commanded a majority in parliament, paralyzed the political process. Cross-strait relations further soured as the new president pursued an agenda of assuring Taiwanese sovereignty against Beijing's "one China principle" and pushed for a referendum law and a new constitution.

Politically paralyzed and delegitimized by corruption charges against himself, a number of family members and close advisors, Chen Shui-bian became a "lame duck" toward the end of his second administration and caused the DPP dramatic losses in the 2008 parliamentary and presidential elections. With President Ma Ying-jeou, the KMT returned to power, and was able to gain a two-thirds majority in the Legislative Yuan, the country's single-chamber parliament. Chen Shui-bian

was pursued through the courts on various corruption charges after he stepped down in mid-2008, provoking accusations of KMT revenge and a return to authoritarian politics, but the judiciary – despite mistakes in handling the case – operated according to the law and was widely perceived as maintaining its independence. Immediately after the election, the Ma administration made good on its promises and embarked on a proactive China policy to restart cross-strait negotiations that, to date, have produced 23 accords, including the establishment of direct trade, transport and communication links across the Taiwan Strait and the signing of a quasi-free trade agreement, the Economic Cooperation Framework Agreement (ECFA) in mid-2010. Relations between Taiwan and China have become more stable, a major factor in ensuring the incumbent KMT government victory in the January 2012 national elections. However, the sovereignty dispute between Taipei and Beijing remains unresolved and China's military threat continues unabated. Increasing economic integration across the Taiwan Strait is expected to benefit economic growth, but there are considerable worries in some parts of society and the political system that the increasing economic dependence on China could be used for political blackmail. In political terms, the Taiwanese overwhelmingly opt for the maintenance of the status quo in the Taiwan Strait and uncompromisingly stick to Taiwan's de facto independence. The percentage of those among the populace identifying as exclusively Taiwanese has increased continuously over the last 20 years, to almost 55%, while those identifying as Chinese have become a tiny minority. Nevertheless, the majority of Taiwan's citizens embrace further measures to develop and institutionalize interaction and integration across the Taiwan Strait.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

Transformation Status

I. Political Transformation

1 | Stateness

Although Taiwan's status under international law is contested, the Taiwanese state (officially called the Republic of China, ROC) enjoys effective power and authority over its territory, including the islands of Taiwan, Penghu, Matsu and Kinmen.

The conflict over Taiwan's political future as an independent nation-state or as part of a new and unified China remains to be resolved. The large majority of Taiwanese support the status quo in the Taiwan Strait, which best serves their security interests. However, most studies show that Taiwanese national identity has been strengthening steadily since the early 1990s, deepening the people's identification with their state and their desire for sovereignty. This trend has not changed since the KMT retook the government from the DPP and initiated a new dialogue with the Beijing authorities, resulting in more stable cross-strait relations, more intensive economic interaction, and more people-to-people exchange.

In Taiwan, state legitimacy is fully derived from a secular constitution. Religious dogmas play no role.

Taiwan's civilian administration is differentiated, professional and provides sound and reliable public services throughout the country. The judicial system, law enforcement and the taxation bureaucracy are well established and functional. Access to water, education and health services is secure and the existing, highly developed communication and transport infrastructure continues to be upgraded.

2 | Political Participation

All relevant political offices are subject to competition in regular, universal and secret-ballot multiparty elections that are usually undisputed and are widely covered by the media. There are no restraints on the electoral process, which is fair and

Question
Score

Monopoly on the
use of force
10

State identity
10

No interference of
religious dogmas
10

Basic
administration
10

Free and fair
elections
10

transparent. However, vote-buying in local elections is still quite rampant and has so far weathered all legal attempts to curb it.

All elected rulers have effective power to govern, and there are no veto powers or exclusive political domains that might negatively affect democratic participation.

Effective power to govern

10

The freedoms of association and assembly are constitutionally guaranteed, generally unrestricted and extensively exercised. The right to strike is established by law. The restrictive Assembly and Parade Act was redrafted in mid-2009 as a result of the late-2008 student protests against police violence and alleged legal abuse during demonstrations responding to the visit of a People's Republic of China (PRC) official to Taiwan. Revisions to the Act drafted by the government in May 2009 continue to give state police substantial veto powers over the content and location of citizen rallies. The draft has been countered by alternative proposals for revisions by different civil-society groups since then. It has not yet passed the legislative process and continues to be hotly debated in Taiwan.

Association / assembly rights

10

Although trade unions are independent, government employees, soldiers and defense-industry workers remain barred from joining them. On the positive side, amendments to the Labour Union Act, the Collective Bargaining Agreement Act and the Settlement of Labour Management Disputes Act came into force in May 2011, strengthening the rights of private-sector workers. According to the new rules, workers at different firms are now permitted to organize unions, thus giving them more collective bargaining power. Foreign workers are allowed to serve as union leaders, and teachers can now establish their own unions.

Freedom of opinion and freedom of the press are well established and are exercised without restrictions, with vigorous and diverse reporting on government policies and alleged official wrongdoing. There are no clear instances of systematic media harassment or violence against reporters. Instances of "embedded marketing," in which government entities pay for the presentation of promotional items presented as news, have been countered by an amended Budget Law in 2011 that prohibits using public funds for the practice. However, news originally published by the Chinese state-run media does occasionally appear in Taiwanese papers without proper citation. Worries about an increasing media concentration in the hands of tycoons with large-scale business interests in China, to the detriment of objective reporting and press freedom, intensified over the review period. A number of renowned intellectuals initiated a movement against the piecemeal erosion of press freedom by pro-Chinese capitalist infiltration of the media market, entailing selective reporting and self-censorship.

Freedom of expression

9

In July 2012, Taiwan's media regulators granted conditional approval for the purchase of the second-largest cable TV provider by the Want Group, a conglomerate with significant media holdings and an owner known for his pro-Beijing stance. In

November, the Hong Kong owner of Next Media Group agreed to sell his Taiwan assets to a consortium of Taiwanese businessmen, some of whom also have significant stakes in the mainland market. A final regulator approval of the sale was pending at the end of the year. However, these developments indicate that media concentration in the hands of pro-Chinese interests is an issue. This may have contributed to a slightly lower ranking in the World Press Freedom Index 2013 – rank 47, compared to 45 the previous year.

Taiwan has been ranked a free country by Freedom House continuously over the last years, with 1 out of 7 for political rights in 2011, and 2 out of 7 for civil liberties in 2012. There are some 2100 newspapers and 8100 periodicals, 171 radio stations and 107 satellite broadcasting program providers that secure a plurality of opinions. The use of the Internet, to which more than 80% of Taiwanese households are connected, is unrestricted. Foreign media have free access to Taiwan and can work unimpeded. This includes journalists from mainland China who can visit Taiwan for up to three months at a time and are free to travel anywhere without giving prior notice to the Taiwanese authorities.

3 | Rule of Law

The separation of powers into executive, legislative and judicial branches is well established and there is no extralegal execution of governmental power. The government system is structurally handicapped by the constitutional relationship between the president and parliament in times of divided government: While the popularly elected president appoints the head of the Executive Yuan (the premier) without the consent of parliament (the Legislative Yuan), the latter has the authority to dismiss the cabinet by a vote of no confidence against the premier. Since the president can dissolve the legislature in such a case, the powers of the parliament are limited and there are almost no institutional guards against political stalemate in cases of divided government (i.e., when the president and the legislative majority belong to different parties). This happened during the eight years of DPP government (2000 – 2008). However, since the KMT was voted back into power in 2008 and its government reelected in 2012, there has been no observable setback for the separation of powers.

Separation of
powers
10

Judicial independence is well established in Taiwan and court trials are generally fair. On various occasions, the DPP opposition has accused Taiwan's courts of being too closely allied with the KMT government, engaging in the "political persecution" of former president Chen Shui-bian and being susceptible to KMT backstage pressure. Civil society groups have supported this criticism. Partly in response, a Judges Law passed in 2011 that went into effect in 2012 created a complaint and removal mechanism for incompetent judges. Along the same lines, the Special Investigation Division of the Supreme Prosecutors' Office, which falls under the jurisdiction of the

Independent
judiciary
10

Ministry of Justice, has been targeted repeatedly by DPP-leaning critics for its political bias and allegiance to the ruling party. There are constant pledges for further judiciary reform in Taiwan to ensure judicial independence, underscoring the lasting impact of the authoritarian era, when the judiciary was dominated by KMT power politics.

A range of sunshine laws regulate political donations, declarations of income for public servants, and the rules for political lobbying. Political corruption receives a great deal of attention in the mass media. It is an important issue on the platforms of all relevant political parties, and is prosecuted rigorously under criminal law. An official “Agency Against Corruption” was established in June 2011, mimicking similar institutions in Hong Kong and Singapore. Vote-buying in local elections remains a problem in Taiwan as it is established practice since the early days of democratization and regarded as inevitable by most politicians. However, the judiciary is prosecuting vote-buying activities and punishes those found guilty.

Prosecution of
office abuse

10

Taiwan enjoys a very good human rights record, according to all relevant international observer groups, and there are no reports of unlawful or arbitrary use of state power against the population. Civil rights are constitutionally guaranteed and well protected, and those who violate them are taken to court. The judicial system provides ample opportunities to seek redress for rights violations. Court trials follow due process and there are no reports of physical abuse of prisoners. The police largely respect the ban on arbitrary detention, and attorneys are usually allowed to monitor interrogations to prevent abuses. Improvements have been made concerning the legal position of Taiwan’s 440,000 migrant workers, most of them coming from Southeast Asia. Contract workers are now covered by the provisions of the Labour Standards Law, though some 200,000 foreign household workers still lack institutional protection from abuses by employers.

Civil rights

10

4 | Stability of Democratic Institutions

All government institutions are democratically legitimized, work according to legal procedures and are sufficiently controlled by a working system of mutual checks and balances. Since interparty coalition-building has yet to be exercised and Taiwan lacks a solid political culture of compromise, the existing semi-presidential system of government is prone to deadlock in times of divided government. Since the KMT’s return to power in 2008 after eight years of DPP minority rule, which confirmed the danger of paralyzed politics, Taiwan’s democratic institutions function without major frictions. However, the KMT-dominated Legislative Yuan suffers from a longstanding reputation for poor efficiency. It has long been criticized by informed observers for its clandestine informal mechanism of party-to-party negotiations

Performance of
democratic
institutions

9

headed by the legislative speaker, which forego the regular legislative process and disempower the party caucuses in parliament.

All relevant political actors accept the democratic institutions as legitimate and there are no attempts to realize political goals outside of the legally defined democratic channels.

Commitment to
democratic
institutions
10

5 | Political and Social Integration

The party system is stable, socially anchored and enjoys broad popular support. Diverging opinions within the populace and societal interests are reflected and aggregated reasonably well. The system still suffers from some degree of polarization, as the two opposing party alliances – the “blue camp” of KMT, People’s First Party (PFP) and New Party (NP), and the “green camp” of DPP and the Taiwan Solidarity Union (TSU) – take contending stances on Taiwan’s best policy approach to China and the issue of unification. At the same time, however, the two party camps do not diverge very much when it comes to other substantive policy fields, such as anticorruption policy, environmental protection, social welfare or industrial upgrading. Moreover, since the KMT regained power in 2008, and particularly after its government was confirmed in the 2012 national elections, the cleavage within the party system seems to be narrowing. Although the DPP sticks to its stance on Taiwan independence, it has acknowledged that the KMT’s China policy approach enjoys majority support in Taiwan. Consequently, the DPP has initiated an internal debate on how to adjust its China strategy. This may lead to more similar agendas of the major parties concerning dialogue across the Taiwan Strait. Many voices demand interparty cooperation to strengthen Taiwan’s bargaining power vis-à-vis China, though it remains doubtful if such a step can be taken any time soon.

Party system
9

Taiwan is home to a wide variety of civil society groups, including unions, professional and business organizations, social and environmental movements, and other associations representing a broad range of societal interests. This network of interest groups is close-knit, politically influential and operates independently of the state. There are no attempts by non-state interest groups to abandon democracy or organize political violence, and no group can dominate others. However, parts of Taiwan’s civil society remain focused on ideological issues related to cross-strait policy and the unification/independence split, sometimes resulting in factional strife and public clashes.

Interest groups
9

Overall approval of democracy remains very high in Taiwan, and there are no deeply entrenched reservations about the democratic system. Voter turnout has consistently been between 60% and 80% in national and local elections since the 1990s, but has declined slightly in recent years. In the 2012 presidential and parliamentary elections, turnout dropped only marginally, to 74.38 from 76.33 in 2008, which still suggests

Approval of
democracy
9

robust citizen consent to democratic norms and procedures. A broad range of regular surveys indicate that the overwhelming majority approve of democracy in principle and find it suitable for their country. Satisfaction with the way democracy works has suffered, however, and there is much skepticism concerning the efficiency and trustworthiness of Taiwan's democratic institutions and their personnel, including government officials and lawmakers. This has led some political observers to worry about the stability of the democratic consensus in Taiwan, though comparable cleavages can be found in established Western democracies as well.

Social self-organization has gained momentum since Taiwan's democratic transition. A variety of organizations, including an outspoken environmental movement, social groups and lively religious communities, have contributed to the consolidation of democracy by supporting nonviolence, tolerance and a democratic culture. Based on the latest World Value Survey data for Taiwan (2006), interpersonal trust is fairly high when compared with other new democracies. Social tensions over ethnic identity (the mainlander/Taiwanese divide) and the major ideological cleavage (the independence/unification divide) within the elite and civil society come to the fore before important national elections. However, they have lost their saliency and are increasingly replaced by a less ideologically grounded dispute on the best policy approach to safeguard Taiwan's de facto sovereignty. Other survey data shows that there is a continuous trend among the populace to self-identify as Taiwanese, suggesting the formation of a strong national identity stretching across "ethnic" boundaries and political frontlines.

Social capital
9

II. Economic Transformation

6 | Level of Socioeconomic Development

Taiwan is a highly developed market economy. The country's level of socioeconomic development permits adequate freedom of choice for all citizens. Fundamental social exclusion due to poverty, gender, religion or ethnicity is qualitatively minor to nonexistent and is not structurally embedded. Taiwan's poverty rate, which is very low in international comparison, rose to 1.51% at the end of 2012, up from 1.35% one year earlier, confirming pressure on the lowest strata of society that has built for some years now. Income distribution – as measured by the Gini coefficient – is relatively equal and remained stable during the review period (2010, 2011: 0.342). In the latest Human Development Report (2011), the island republic ranked 22nd globally, and third in Asia behind Japan (12th) and South Korea (15th).

Question
Score

Socioeconomic
barriers
10

The most socially excluded group is made up of Taiwan's 440,000 foreign workers, who suffer from low salaries and social discrimination, but also enjoys increasing support from civic groups and social organizations. Moreover, legal protection of foreign workers' rights was strengthened during the review period, and there is a rising awareness in Taiwan that the economy depends on a constant inflow of foreign workers.

Economic indicators		2009	2010	2011	2012
GDP	\$ M	377568.0	428221.0	464026.0	473971.0
GDP growth	%	-1.8	10.8	4.1	1.3
Inflation (CPI)	%	-0.9	1.0	1.4	1.9
Unemployment	%	5.9	5.2	4.4	4.2
Foreign direct investment	% of GDP	-	-	-	-
Export growth	%	-8.9	25.3	5.1	0.0
Import growth	%	-13.1	27.7	-0.5	-2.1
Current account balance	\$ M	42923.0	39872.0	41230.0	49550.0
Public debt	% of GDP	38.0	38.3	40.1	40.9
External debt	\$ M	81963.0	101581.0	122528.0	-
Total debt service	\$ M	6079.0	3630.0	7581.0	4531.0
Cash surplus or deficit	% of GDP	-3.6	-2.7	-1.5	-
Tax revenue	% of GDP	8.4	8.0	8.8	-
Government consumption	% of GDP	13.0	12.1	12.4	12.4
Public expnd. on edu.	% of GDP	-	-	-	-
Public expnd. on health	% of GDP	-	-	-	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	2.4	2.1	2.1	2.3

Sources: Asian Development Bank (ADB), Key Indicators for Asia and the Pacific 2013 | International Monetary Fund (IMF), World Economic Outlook 2013 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2013.

7 | Organization of the Market and Competition

Taiwan's market economy is institutionally sound, with clearly defined and state-guaranteed rules for ensuring fair competition and largely equal opportunities for all market participants. Business freedom is high and, generally speaking, market actors face neither entry nor exit barriers. China's access to Taiwanese markets, which is politically contested on the island, has been gradually liberalized since direct cross-strait trade was legalized in late 2008. Investment in a number of strategic sectors like LED, solar cells and display panels remains capped for mainland investors at less than 50%. In non-strategic sectors of Taiwan's manufacturing industries, however, mainland Chinese capital can increase its ownership to more than 50%.

Market-based
competition
9

Even though the state maintains its monopoly over certain basic utilities and services (e.g., electricity, water supply and postal services), market competition is well established and legal frameworks exist to combat cartels. The Fair Trade Law that took effect in 2002 ensures a coherent and effective approach to combating monopolistic structures or predatory price fixing. Taiwan ranked 15th out of 144 countries in the Economic Freedom section of the World Annual Report 2012 (presenting figures for 2010), with high scores in the categories of foreign ownership and investment restrictions, business regulations, bureaucracy costs, government consumption, and state-run enterprises and investment. The report also maintained its ranking (13th) on the Global Competitiveness Report 2012-13, pointing at Taiwan's strong approach to market freedom and antimonopoly policy.

Anti-monopoly
policy
10

Taiwan enjoys a high degree of trade freedom as its economy is heavily reliant on trade. The country is one of the world's principal exporters of information and telecommunications technology and other electronics. Since Taiwan entered the WTO, it has lowered its agricultural duties by more than 30%. Tariff rates on industrial products have also been sharply reduced and are comparable to those found in industrialized nations such as Japan and the United States. With the exception of cross-strait economic relations, the state refrains from intervening in investment planning and foreign trade. Intervention in the former mainly takes place in order to control the level of Taiwan's high trade dependency on China, but also to restrict mainland investment in the sensitive sectors of real estate and finance, and in a number of strategically important industries. Trade across the Taiwan Strait amounts to some 40% of Taiwan's exports, and 80% of its outbound investment have gone to the Chinese mainland in recent years, though in 2012 there was a sharp decline of 17% due to slowing economic growth and weakening demand in China, as well as the global economic downturn related to the euro zone debt crisis. The review period saw follow-up negotiations on the Economic Cooperation Framework Agreement (ECFA) with China, signed in mid-2010, which significantly reduced tariffs on a wide range of products and services. In August 2012, a new agreement was signed

Liberalization of
foreign trade
10

on protecting cross-strait investment and customs cooperation, expanding and deepening the liberalization of trade in goods and services across the Taiwan Strait, despite strong opposition in Taiwan by those concerned the agreement was too hastily concluded.

Taiwan has a tightly regulated and transparent banking system, effectively supervised by the Financial Supervisory Commission (FSC) and an independent central bank. The capital and stock market is reasonably developed and in principle open to foreign participation. Banks benefit from a high proportion of stable customer deposits and good flexibility to access domestic capital markets. Also, the system's low use of cross-border funding makes it less vulnerable to contagion risks during periods of turbulences in the foreign capital markets like the 2008 – 2009 global financial crisis.

The overall asset quality of Taiwan's banking system has been enhanced by stricter control mechanisms for private and corporate lending introduced since the early 2000s. The official nonperforming loans (NPL) ratio at the end of 2011 was considered manageable at 0.5%. The capital adequacy ratio of Taiwan's bank stood at 12.06% at the end of 2011 and 12.37% by September 2012, well above the regulatory requirement of 8%. However, this ceiling will be gradually lifted to 12.5%, starting in January 2013, to meet the Basel III Accord.

The Taiwanese banking sector remains dominated by state-owned banks, with the five largest institutions controlling some 40% of total system assets. State-owned banks have a market share of more than 50%. At the same time, the banking sector is highly fragmented, with 20 banks accounting for less than 1.5% of total system assets. Consequently, the banks' ability to take pricing differentiation leadership and charge proper risk premiums on core lending business is impaired. Participation and influence of foreign banks remains low, although it has increased since deregulation started in 2005.

Under the ECFA agreement, Taiwanese banks can open branches in mainland China. Future expansion on the mainland market will contribute to a further strengthening of the banking sector in Taiwan, which is still overcrowded (402 banking institutions at the end of 2010) and must shrink by more mergers in the future.

8 | Currency and Price Stability

Taiwan had low inflation levels during the review period, though there was upward pressure, with consumer prices rising by 1.42% in 2011 and 1.93% in 2012. The value of the New Taiwan Dollar (NTD) fell against the U.S. dollar during the review period, standing a 30.29 NTD at the end of 2011 and 29.26 NTD in October 2012. Taiwan's government and central bank pursue a prudent forex policy that has been consistently

Banking system

9

Anti-inflation /
forex policy

10

linked to the goal of financial and economic stability and steered the county rather well through the 2008 – 2009 global financial crisis.

Taiwan has a long track record of prudent fiscal policymaking and resolute debt control as part of its overall economic policy, suggesting effective crisis management and macroeconomic stability. Taiwan's public debt (measured as the cumulative total of all government borrowings, less repayments that are denominated in a country's home currency) hit record highs between 2008 and 2010 (2010: 39.7%), but decreased to 36.3% of GDP at the end of 2011, and an estimated 36.0% in 2012, reaching pre-crisis levels. Taiwan's cash deficit also shrank, to -2.2% in 2011 and about -1.6% in 2012, down from -2.7% in 2009 and -3.6% in 2010, indicating fiscal recovery. Its external debt (the total public and private debt owed to nonresidents repayable in foreign currency, goods or services) rose to \$125.8 billion in 2012, the highest figure ever but still low in comparison to most states in Asia. Taiwan's foreign exchange and gold reserves stood at \$390.6 trillion at the end of 2011, the highest value recorded so far.

Macrostability
10

9 | Private Property

Taiwan's property rights regime is well established and enforced by the judiciary.

Property rights
10

Taiwan's economy is mainly based on small- and medium-sized private companies (around 90% of all companies), which are adequately protected by the state. The state continues to be directly involved in a number of strategic economic areas (shipbuilding, petroleum, steel, sugar, tobacco and liquor, banking, insurance and railway transport), and basic utilities (electricity, water supply and postal services). Between 1994 and 2008, 10 national corporations were privatized. Eventual privatization of all remaining SOEs is targeted but controversial because of economic considerations and regulatory difficulties. Taiwan ranks 16th (out of 185) in the World Bank's Doing Business Index 2012, confirming its liberal market regime.

Private enterprise
9

10 | Welfare Regime

With social welfare net expenditures accounting for 3.2% of GDP in 2011, Taiwan has one of the most comprehensive and well-developed welfare regimes in Asia. The social safety net is close-knit and provides for substantial protection against poverty and other social risks. The state provides compulsory health insurance for employed citizens and farmers, unemployment insurance, voluntary labor pensions with portable retirement accounts, and mandatory coverage by a national pension scheme, including the unemployed, nonworking spouses and freelancers. Financial support is also given to the disabled and to disadvantaged households, including living cost allowances, healthcare and special subsidies. Amendments to the Public Assistance

Social safety nets
9

Act that came into force on 1 July 2011 stipulate the conditions of short-term assistance to lower- and middle-income households by providing living subsidies covering different areas of threatened well-being. However, for some years now Taiwan has had one of the world's lowest birthrates, which, together with the increasing number of pensioners, who enjoy significantly longer life expectancies, has put the pension system under pressure.

Rated one of the best in Asia, Taiwan's health insurance scheme has been underfinanced since its establishment in 1995, causing two adjustments of the premium (2002 and 2010). Premiums are currently set at 5.17% of monthly salaries. Employees pay 30% of that amount, while the employer pays 60% and the government 10%. A supplementary charge of 2% is placed on non-payroll income from stock dividends, interest earnings, rents and bonuses exceeding four months' salary. This is one of several measures, introduced in early 2011, to balance the structural deficit that plagues the scheme.

According to the constitution, all citizens are equal before the law "irrespective of sex, religion, race, class, or party affiliation."

Equal opportunity

9

Women's rights have been strengthened in recent years, with a focus on preventing and legally condemning domestic violence and sexual assault, but also on protecting women's labor rights. A cabinet-level Department of Gender Equality was installed in 2011. The Gender Equality and Employment Act stipulates that the principle of equal pay for equal work must be respected, while adequate mechanisms to prevent sexual harassment are implemented in every workplace. The act also ensures women the right of eight weeks of paid maternity leave. Taiwan ranks first in Asia and fourth in the world in the 2011 U.N. Gender Equality Index (calculated index value: 0.061), trailing only the Netherlands, Denmark and Sweden. In 2011, 46% of employees on payrolls were women. The wage gap between men and women has fallen steadily over the years. However, in 2011 women still earned 17.6% less than men on average. Of national legislators, 33.6% were women in 2012, up from 30.1% in 2008.

The rights of immigrant spouses, some 460,000 at the end of 2011, have been strengthened by the provision of increasing public funds for counseling services, medical subsidies and educational assistance. However, they still do not enjoy the same rights as Taiwanese spouses in that their rights to work and inheritance are legally restricted. The government faces much pressure by an outspoken mainland and foreign spouses' movement supported by domestic NGOs to liberalize its restrictive immigration policies. However, deep-rooted security concerns make this a protracted process.

Taiwan's indigenous peoples, who account for about 2% of the total population, have access to a number of social welfare programs based on specific laws to protect their rights. These include low-interest housing loans and rent subsidies, privileged access

to senior high schools and universities, a 1% quota within the workforce at government agencies, public schools and state enterprises with 100 or more employees, and the protection of their language and culture. The social gap between these native groups and the Taiwanese Han-majority has narrowed over the years, but inequality still exists.

11 | Economic Performance

Taiwan saw a robust economic rebound in 2010, with 10.7% GDP growth, but faced decreasing growth rates in 2011 (4.07%) and 2012 (estimated 1.25%) due to shrinking demand from its major export markets, and weak domestic consumption and investment activity. Exports grew by 12.3% in 2011, but fell -2.3% in 2012. The island republic's overall trade surplus stood at \$26.3 billion in November 2012 and has in fact increased during the crisis, highlighting the overwhelming significance of mainland China's market as the major destination for Taiwanese goods. Inflation rose significantly, from 0.96% in 2010 to 1.42% in 2011 and 1.93% in 2012, but remains under control. Unemployment, which soared in the crisis years and stood at 5.2% in 2010, fell to 4.4% in 2011 and 4.2% in 2012, approaching pre-crisis levels. Tax revenues totaled 12.9% of GDP at the end of 2011, which meant an 8.8% increase over the years before. Tax revenue in 2012 again increased slightly (0.8%). The fiscal deficit is small and fell in the review period, from 3.0% in 2010 and 1.9% in 2011 to 1.6% in 2012, while Taiwan's current account showed a solid surplus of \$41.3 billion.

Output strength
9

12 | Sustainability

Environmental awareness has been on the rise in Taiwan since the 1980s, mainly because of a strong social movement that pushed the government to make environmental protection a major concern in economic policy planning. Today, environmental protection is institutionally integrated at the government level, both independently (by the Environmental Protection Administration, EPA) and at the departmental level within different government entities, resulting in systematic environmental policy planning and a decreasing externalization of costs over the years. The development of green technologies and mechanisms for raising energy efficiency is an important part of government's Master Plan of Energy Conservation and Carbon Mitigation, approved in May 2010. In June 2009, the government passed the Renewable Energy Development Act to increase Taiwan's renewable power generation capacity. Instruction on environmental protection in the public sector and Taiwan's primary and secondary schools has been made mandatory by the Environmental Education Act, passed in May 2010. Hence, Taiwan has in place a quite sophisticated regulatory framework for environmental policy, and there is a broad consensus on the island that economic development must be ecologically

Environmental
policy
9

sustainable. This is reflected in the rise of Taiwan's rank in the 2012 Environmental Performance Index to 29 (from 40 in 2008).

Taiwan has a very well-developed education system with high-quality secondary and tertiary education as well as vocational training, reflecting the importance given to education in a society still heavily imbued with Confucian values. In 2011, 83.4% of all high school graduates enrolled in higher education, which is high compared with international figures. School curricula undergo continuous revision to keep the education system in line with international developments. Compulsory tuition-free education is to be extended from nine to 12 years by 2014 in order to strengthen the global competitiveness of Taiwan's workforce. Public expenditure for education stood at 20.35% in 2011, which tops the list of all transformation countries.

Overall expenditure on R&D stood at 2.90% of GDP in 2010, which is very high by international standards as well. The Taiwanese government manages 13 science parks throughout the island that offer infrastructural hardware and services to high-tech firms. It focuses its resources on the development of cutting-edge technologies like nano-science and nanotechnology, intelligent electronics, cloud computing, genomic medicine and biotechnology.

However, given the slowing of Taiwan's economic performance in recent years and considerable growth in unemployment, there is increasing concern about the brain drain of significant numbers of well-educated young Taiwanese to the mainland, where employment chances are seen to be better.

Education policy /
R&D
10

Transformation Management

I. Level of Difficulty

Taiwan enjoys few structural constraints on governance thanks to the following factors: Its high level of socioeconomic development; its sound market economy and good economic performance; a well-developed education system and research environment; a well-qualified labor force; a capable bureaucratic apparatus; low social disparities in terms of income and status; a lack of serious ethno-religious conflicts; and an unchallenged state monopoly on the use of force. Social movements and social interest organizations of all sorts are firmly embedded within society and play an essential part in the daily exercise of democracy. However, Taiwan is handicapped by a high exposure to natural calamities, as typhoons and earthquakes hit the island every year and tax the government's administrative capabilities and financial resources. Taiwan's main structural constraint, its diplomatic isolation and China's de facto veto power concerning Taiwan's participation in the international community as a sovereign state, has been mitigated to some extent by cross-strait rapprochement since 2008. However, it still significantly impedes on Taiwan's self-determined management of international relations.

Structural
constraints

2

Taiwan's civic engagement has strengthened continuously since the end of the authoritarian era in the mid-1980s, when social movements played a major role in the transition to democracy and then contributed substantially to democratic consolidation. Today, Taiwan has one of the most vibrant civil societies in Asia, characterized by numerous NGOs engaged in all sorts of public activity. However, ideological polarization and division still play a role when issues of national identity are at stake, impacting negatively on the state-society relationship.

Civil society
traditions

4

There is no politically motivated violence in Taiwan. The old conflict between mainlanders and native Taiwanese has evolved into a cross-cutting cleavage among all citizens who disagree on the island republic's national identity and the most sensible approach to secure sovereignty, long-term security and prosperity. The ideological confrontation between those leaning toward independence and those favoring reconciliation with China (while maintaining Taiwan's sovereignty and de facto independence) has to some degree limited institutional efficiency in the government. Still, the cross-strait rapprochements made since the KMT's return to power in mid-2008 are supported by the majority of the populace and have triggered

Conflict intensity

2

much thought within the DPP opposition on how to refine its China policy. Though the ideological stand-off between the political camps will not disappear anytime soon, political polarization over the issue has continued to decline with the DPP's search for a new approach to China.

II. Management Performance

14 | Steering Capability

China's de facto veto power is a serious constraint on the free and effective setting of political priorities in Taiwan's international relations and foreign policy. China also plays an important role in domestic politics. Since there is no overarching consensus in Taiwanese society on the issues of national identity and cross-strait relations, politics is conceived of as a zero-sum game between the opposing party camps, and the island republic's political elites are very much driven by electoral competition. As the cross-strait relationship remains the most controversial issue in Taiwan, this impinges on the capacity of any government to take a longer-term political perspective and to garner cross-party consensus and compromise in the realm of policymaking with respect to China. Given Taiwan's system of government, this can lead to deadlock in times of "divided government." On the other hand, when the president has a robust parliamentary majority, political prioritization and wide-ranging reforms are possible even in this contested policy arena. This is shown in the significant changes in cross-strait relations following the KMT's return to power in mid-2008. Moreover, as cross-strait economic and social integration proceeds, Taiwan's major opposition party now accepts that dialogue and cooperation with the Chinese government is inevitable. If broad societal and political approval of more cooperation across the Taiwan Strait is brought about in the coming years, it will allow for more long-term government initiatives vis-à-vis the Chinese mainland. Furthermore, in other policy fields, political competition is considerably less severe and interparty compromise is possible. Additionally, there is a strong consensus among the political elites that constitutional democracy and a socially responsible market economy must not be jeopardized by the conflict over Taiwanese independence. This consensus helps to prevent government policy from becoming too volatile, even in stormy electoral campaigns.

As Taiwan's market economy and democratic order are already well developed, any assessment concerning the implementation efficiency of the government's priority policies starts from an advanced vantage point. After regaining power in 2008, the current KMT government was quickly able to realize its most important political project of normalizing cross-strait ties, most notably by the establishment of direct

Question
Score

Prioritization
9

Implementation
10

links between China and Taiwan, and the signing of a quasi-free trade agreement with the PRC. After winning the 2012 legislative and presidential elections, the Ma administration has continued to pursue its agenda of deepening cross-strait dialogue and interaction. Since it dominates the legislature by an absolute majority, the KMT can easily implement most of its national policies and connected legislation. But it must be careful to not be labeled undemocratic by an opposition that still enjoys legitimacy from its former struggle against authoritarian KMT rule and its stern position on Taiwanese sovereignty. The greatest structural constraint on policy implementation remains the PRC's effective veto power over Taiwan's foreign relations, which severely limits the Taiwanese government's ability to implement foreign policy.

Generally speaking, political learning in Taiwan often takes place in economic and social policymaking, thanks to the leadership's close ties to well-established social organizations and interest groups that keep it informed of the need for policy adjustments and new initiatives. By launching a new China policy, the current KMT government has not acted primarily for ideological reasons, but in response to increasing demands from society to facilitate access to mainland China's markets and to ease cross-strait tensions. At the same time, it has been cautious enough to respond to the public's desire to protect Taiwan's sovereignty, dignity, and economic well-being in the process of reshaping cross-strait relations. This has influenced the way that specific policy initiatives have been formulated, for instance the content of the ECFA agreement with its particular concern for the protection of Taiwan's agricultural products and labor market. Similarly, the DPP's painful losses in the 2008 and 2012 presidential and parliamentary elections have prompted the party to start a debate on its China approach to better synchronize its ideological stance and policy positions with public expectations.

Policy learning
9

15 | Resource Efficiency

Taiwan has a postwar history of efficient bureaucratic policymaking, which earned it the label of a successful development state. Against this background, and compared to most countries in Asia, the Taiwanese government makes efficient use of available economic and human resources to pursue its policies. While the top positions in Taiwan's government and administrative bodies are filled with political nominees, sometimes without expertise in the relevant field, the rank and file are recruited according to established rules and qualification levels. A special constitutional organ, the Examination Yuan, is responsible for the education, recruitment and evaluation of the country's public officials. Serious cases of corruption in Taiwan's bureaucratic apparatus are rare and mostly involve politically nominated public officials, not professional civil servants. In the 2012 World Competitive Yearbook, published by the Switzerland-based International Institute for Management and Development

Efficient use of
assets
9

(IMD), Taiwan ranked fifth in government efficiency (and seventh in overall competitiveness) among the 59 nations surveyed, a rise of five ranks from the previous year, thanks to better business legislation, reasonable fiscal policy and sound public finances. In Asia, only Singapore ranked higher. Rising levels of external debt since 2009 (reaching \$125.8 billion in 2011) and worries concerning the government's budgetary reserves to refinance the various national pension fund schemes, however, qualify the positive picture of Taiwan's resource efficiency and must be systematically tackled by the government in the immediate future.

Taiwan's political system is shaped by both personalist ties and bureaucratic networks stretching across all government tiers, which ensure effective policy coordination. It is strongly influenced by the president, who not only determines the foreign and China policy agenda, but is also expected to decide on the broad outlines of policy, and to manage conflicting policies and competing interests within the government apparatus. Since the president nominates the prime minister without parliamentary consent, there is usually a high degree of cooperation and agreement on policy goals between the presidential and prime ministerial offices, which ensures coherence of government policy. Moreover, the current KMT-majority caucus in the legislature is usually loyal to the president and the government, such that legislative initiatives passed down by the Executive Yuan are scarcely contested. Consequently, government policies are quite coherent, as has been shown by the Ma administration's management of cross-strait relations since mid-2008. Even if policies are highly contested among the populace, for instance the government's proposals to raise prices on electricity and to implement a capital gains tax, they are usually not an issue of intra-government strife.

Policy
coordination
9

Taiwan's anticorruption policies are very strict. A series of sunshine bills have been passed since the early 1990s to combat political corruption. One example is the Public Functionary Assets Disclosure Act of 1993, which requires the declaration of all income and assets by high-ranking officials and elected representatives. The 2004 Political Contribution Act limits political donations and makes campaign financing more transparent. A lobbying act took effect in August 2008, requiring lobbyists to register their activities and local government officials and elected representatives to inform their responsible agencies of their communications with lobbyists. Building on the examples of Hong Kong and Singapore, Taiwan established an Agency Against Corruption in July 2011 under the Ministry of Justice to implement the prevention, investigation and prosecution of corruption. Furthermore, Taiwan's media and public are very sensitive to political corruption and play an important role in exposing officeholders who have been charged with misbehavior. The legal system prosecutes corruption resolutely. The Control Yuan, a specific constitutional body to supervise government and public officials, partakes in the effort to curb political corruption, and its Ministry of Audit is responsible for ensuring that public resources are spent efficiently. Local vote-buying remains a problem in Taiwan but is

Anti-corruption
policy
9

considered more an integral component of local political culture than a manifestation of political corruption. Nevertheless, offenders of regulations related to vote-buying and political donations are prosecuted.

16 | Consensus-Building

All major political actors agree on maintaining and strengthening Taiwan's market-based democracy. There is still disagreement on the scope and speed of economic interaction and integration with the Chinese mainland, which is critical for the sustainability of Taiwan's economic well-being. However, the latest national elections, in January 2012, won by the incumbent KMT government, showed that a majority supports Taiwan's proactive cross-strait approach, forcing the DPP opposition to make strategic adjustments in its positioning vis-à-vis China. Hence, there is much interparty consensus on the inevitability of opening up toward the mainland.

There are no anti-democratic veto actors in Taiwan.

The most serious domestic cleavage, between advocates of Taiwanese independence and Chinese unification, is reflected in the ongoing division of the party system into two rival ("pan-blue" and "pan-green") camps. In recent years, however, this ideological confrontation has increasingly turned into a conflict on the scope, context and strategic timing of pragmatic cross-strait policies, a development that continued during the review period. The current government is well aware that ignoring the political opposition is politically costly, as a sizeable part of the populace is highly critical of President Ma's China policy. At the same time, the government's leeway to actively expand consensus is limited, and efforts to launch any kind of dialogue between the ruling KMT and the DPP have not yet born fruit. In that sense, the Ma administration is unable to depoliticize the China policy cleavage and must wait for the DPP to adjust to a reality in which the majority of the Taiwanese people support close cross-strait cooperation.

Generally speaking, civil society in Taiwan has meaningful access to political decision-making and is considered an important contributor to the formulation and evaluation of policies. The government sponsors regular meetings with civil society leaders and invites them to national conferences on particular problems regarding economic and social development, environmental protection or educational reform. However, there is a difference between the former DPP government and the now ruling KMT: The DPP, which is itself very much a result of civic engagement during the authoritarian era, strongly appreciates civil-society input into the governing process. The KMT, for its part, is more bureaucratic, and its authoritarian past makes it more difficult for the ruling party to communicate to civic groups and their leaders.

Consensus on goals
10

Anti-democratic
actors
10

Cleavage /
conflict
management
9

Civil society
participation
9

However, strong links exist between the KMT and professional and business organizations. At the same time, ideological polarization divides many movements and groups, thus making it difficult for them to speak to politicians from rival camps. Consequently, civil society participation is still conditioned by who is governing, though it is institutionalized at a high level.

Reconciliation has not been a major political issue during the review period, as the most important cleavages in Taiwan's postwar society – the conflict between mainlanders and Taiwanese and the crimes of the “White Terror” era in the 1950s and 1960s – have already been addressed by the former KMT government under Lee Teng-hui and under the DPP administration of Chen Shui-bian. However, in Taiwan's highly politicized society, the KMT's authoritarian past remains a sensitive issue often invoked by the pan-green camp to mobilize against the KMT and against China's claim to sovereignty over the island. Some academics promote the idea of “transitional justice” and the setup of a truth commission for clarifying political responsibility and helping those who were victimized during the White Terror tell their stories and gain compensation from the government. The KMT remains reluctant to discuss the negative sides of its authoritarian past, especially with respect to huge party assets accumulated during this era that the opposition wants to recoup for the national treasury. However, this is a long-term debate that is slowly losing steam.

Reconciliation
8

17 | International Cooperation

Increasing Taiwan's integration into the international community has been one of the cornerstones of the Ma administration's foreign policy. Its international leeway is, however, severely constrained by China's strict stance on denying the island republic access to international organizations out of fear that international membership may strengthen the republic's status as a sovereign nation in international politics. Nonetheless, under various euphemisms for its national title, Taiwan participates in a large number of international organizations. Taiwan's reputation for adapting to new circumstances and learning from its international environment has been well known since the days of the “Taiwan miracle.” Within the international community, it has earned high credibility and a reputation for reliability in implementing necessary market reforms. Since its accession in 2002, Taiwan has smoothly integrated in the WTO framework to facilitate global trade. It implements WTO rules well. Problems result from Taiwan's obstinacy concerning issues related to nomenclature in international organizations, where it often feels marginalized or discriminated against by China.

Effective use of
support
10

Since China prevents Taiwan's entry into most international and regional organizations and bodies in state capacity, it is particularly important for Taiwan to demonstrate credibility, reliability and generosity in the international arena. By

Credibility
10

convincing the world's public that it rightfully claims sovereignty and that its diplomatic isolation deprives the international community of full use of Taiwan's expertise and financial might, Taiwan enjoys a good reputation as political partner and engaged donor of development aid and humanitarian assistance. In recent years, it has largely abandoned "dollar diplomacy" as a means to trade financial support for international recognition, both for reasons of low effectiveness, severe public criticism and, most notably, because of more amicable cross-strait relations. However, early hopes for expanded "international space" did not materialize much over the review period, and there is no guarantee that Taiwan's foreign policy will not get more volatile in the future.

Taiwan cooperates actively and successfully as a full member in 31 regional and international intergovernmental organizations, for example the Asian Development Bank (ADB), the Asia-Pacific Economic Cooperation (APEC) and the WTO (though not under its official state name of "Republic of China"). In addition, it has observer status in 20 organizations, including United Nations-affiliated bodies such as the World Health Assembly. Taiwan is a strong advocate of regional integration and cooperation. After the change of government in mid-2008 and the return of the KMT to power, it embarked on a strategy of controlled economic and social integration with the Chinese mainland, thus considerably easing cross-strait tensions. The Ma administration also has engaged in high-level political exchanges with the People's Republic at meetings of regional organizations such as APEC and the Boao Forum. However, the government's hope that this would pave the way for its future inclusion in more free trade regimes in the region, most notably the ASEAN Free Trade Zone, has so far been disappointed as China does not show any signs of changing its conservative approach to Taiwan's "international space."

Regional
cooperation
10

Strategic Outlook

The single most important factor that will affect Taiwan's future political and economic development is its relationship with the PRC. Since the KMT regained power in 2008, Taiwan is seeing more stable cross-strait relations and the political will on both sides of the Taiwan Strait to maintain peace and intensify bilateral cooperation. However, there is a continuous debate in Taiwan on the risks of accelerated cross-strait integration and, increasingly, on the danger of Chinese capital penetrating the Taiwanese economy, thus facilitating market control and political blackmail. Also, the promise of the Economic Cooperation Framework Agreement (ECFA), signed in June 2010 to ease Taiwan's access to other regional free trade regimes and international organizations, has not been fulfilled, and there is no indication that China is going to change its restrictive behavior toward Taiwan's attempts to expand its "international space." The ultimate objectives of China and Taiwan are certainly different: Whereas the former seeks eventual unification, the latter wants to maintain sovereignty (or de facto independence), at least under the present political conditions on the Chinese mainland. This is a fundamental contradiction that makes the Taiwan Strait a perennial hotspot in the regional security architecture, not least in light of China's massive military build-up and increasingly assertive behavior in regional conflicts.

At the same time, cross-strait dialogue is getting more institutionalized, and even Taiwan's biggest opposition party is adjusting its China policy to accommodate public expectations that cooperation across the strait should develop further. At the same time, however, China has made it clear repeatedly that it wants political talks in the near future and will remain adamant in its ultimate goal of unification, something that immediately touches upon the sovereignty issue. Current patterns of cross-strait dialogue and cooperation certainly stand a fair chance of easing tensions across the Taiwan Strait in the long-term. They might even bring about an overarching consensus between the contending political camps in Taiwan on the country's China policy. However, much depends on developments in China, where a "fifth generation" of party leaders took over in 2012. While it is reasonable to assume that they do not want to rock the boat of cross-strait relations, they will not accept Taiwan's claim to sovereignty or even allow the island republic substantial "international space."

Meanwhile, cross-strait migration is making headway, with a steady flow of Taiwanese capital to the Chinese mainland and increasing numbers of Taiwanese – businessmen and their families, white-collar workers and students – leaving the island to live and work in China. More Chinese capital will come to Taiwan in the next few years, as will people – not only as tourists and students but also as journalists, academics, entrepreneurs, and mainland spouses and children of Taiwanese. Both official and "subofficial" integration will shape Taiwan's economy and society, influence the domestic identity discourse and soften interparty ideological polarization. Beyond the fact of an ongoing dispute over sovereignty and over the controversial question of how to respond

adequately to China's military threat, cross-strait relations will be increasingly influenced by direct people-to-people contact in the future.

Next to cross-strait relations, the most important problem that Taiwan will have to address in the near future is the potentially dramatic effect of demographic change, as a now decades-long slump in birthrates combines with senior citizens enjoying significantly greater life expectancy, which puts stress on a pension system that is widely believed to be too generous to be sustainable. This is especially relevant for the retirement scheme for former public servants, who enjoy particularly generous pensions. However, the problem is on the agenda of both political camps, and in early 2013 there were signs that the KMT and DPP might work together in reforming the welfare system.