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Prospects for a U.S.-Taiwan Free Trade Agreement

by Merritt T. ('Terry') Cooke
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Terry Cooke is a Senior Fellow at FPRI and the Founder and CEO of GC3 Strategy, an international consultancy and investment firm focused on Greater China and India opportunities (www.gc3s.com). Previously, Mr. Cooke served as a U.S. Senior Foreign Commercial Service Officer with postings in Taipei, Taiwan; Berlin, Germany; Tokyo, Japan; and Shanghai, China. The views in this article are of a private capacity and non-official.

Ever since Taiwan's accession to the World Trade Organization in January 2002, speculation has risen steadily about the possibility of concluding a U.S.-Taiwan Free Trade Agreement (FTA) during the Bush administration's term of office. Until recently, that speculation had little grounding in the reality that matters most—the bureaucratic and political process that determines FTA outcomes in Washington.

A sea change took place in May 2006, however, with the visit to Taiwan by Deputy U.S. Trade Representative Karan Bhatia and the resumption of U.S.-Taiwan Trade and Investment Framework (TIFA) talks on May 25-26. These events cleared a major obstacle from the path and now present Taiwan and the U.S. with their best shot ever at the FTA goal. Prospects for a successful outcome, though, remain in delicate balance: while the merits of a U.S.-Taiwan FTA have never been stronger, the window is closing fast for substantive consideration of an FTA under this administration's Trade Promotion Authority (TPA). Here are key issues to track as the process is forced to resolution in the months ahead. Looming behind all these issues surrounding the bilateral U.S.-Taiwan FTA are the political complexities of the three-way U.S.-Taiwan-China context.

Resuming the TIFA: Necessary, but Insufficient

Prior to Representative Bhatia's visit last month, the major impediment to progress towards a U.S.-Taiwan FTA were the stalemated TIFA talks. Initially established in September 1994 as a high-level forum for consultation on a broad range of trade, investment and economic issues, the TIFA talks were subsequently suspended in October 1998. Suspension was due principally to U.S. dissatisfaction with Taiwan's slow progress in protecting a broad range of intellectual property rights, as well as with a mixed (and changing) bag of more sector-specific concerns, including agricultural licensing and import requirements; pharmaceutical testing, labeling and certification; telecommunications market barriers; and financial service constraints. Despite the boost provided by Taiwan's WTO accession and several later near-breakthroughs, the TIFA forum remained stalled until Representative Bhatia's visit to Taipei last month. While in no sense a predictor of FTA outcomes, the resumption of TIFA talks means that a necessary box has now been checked to at least make possible consideration of a U.S.-Taiwan FTA within the U.S. government interagency process.

Tallying the Economic Scorecard: Modest But Telling Gains

The starting point for any successful FTA candidacy has to be a strong economic argument based on demonstrable benefits for both signing parties. In the specific instance of Taiwan's candidacy, that argument has been expertly analyzed and presented by Nicholas Lardy and Daniel Rosen in their 2004 publication for the International Institute of Economics entitled "Prospects for a U.S.-Taiwan Free Trade Agreement."

Among their chief conclusions:

- While overall welfare gains from a U.S.-Taiwan FTA would be modest in absolute terms, they ranked third in terms of relative importance in a comparative study of 12 prospective FTAs.
- For the U.S., the biggest anticipated gains from an FTA with Taiwan would accrue in the auto sector (and reflect trade-diversion more than trade-creation).

- The short-term economic impact of an FTA for Taiwan would likely be negative, drawing labor and other resources from Taiwan's "sunrise" IT industries in favor of apparel and other "sunset" industries.
- Finally, a U.S.-Taiwan FTA would likely bolster economic trade liberalization within the rest of Asia by helping encourage other economies in the region to expand their trade relations with Taiwan. This would be a significant long-term benefit to Taiwan and, not incidentally, the U.S. (A corresponding, non-economic impact that would need to be factored into this equation for the U.S. is the intense political pressure Beijing could be expected to bring to bear to stop a U.S.-Taiwan FTA from happening.)

Reaching Key Milestones: A Race Against Time

So far we have seen that, in considering a potential U.S.-Taiwan FTA, the balance sheet of economic gains/losses is broadly positive for both sides. Moreover, the resumption of TIFA talks indicates that the U.S. once again sees Taiwan as contributing to the bilateral trade relationship with in terms of its commitment to resolving outstanding trade problems.

What other passing grades are needed for a successful candidate to graduate to a formal FTA with the U.S.? Generally speaking, three additional considerations are crucial. In Taiwan's case, each of these three tests represents a successively higher hurdle.

First, is the candidate espousing free-trade principles and working together with the U.S. to further the global trade agenda in Doha? Despite some serious differences over agriculture earlier in the Doha round, Taiwan has a generally satisfactory performance in this area.

Second, how broad a degree of domestic support is evident for an FTA with a particular candidate economy? This test is proving more challenging for Taiwan than it actually deserves to be. One reason is the "silencing effect" that the PRC government has on U.S. firms active in the greater China region. Firms eyeing market share in the mainland economy do not want to attract negative attention from market regulators or government auditors as a result of their speaking up on behalf of their global suppliers or technology partners from Taiwan.

Another factor is the paradox of Taiwan's position as the indispensable Original Equipment Manufacturing (OEM) partner to the U.S. innovation economy in information technology. Few consumers or businesses outside the tech sector are even aware that Taiwan is the world's leading supplier of notebook computers, modems, scanners, LAN cards, motherboards and other IT products. Since, for the most part, these OEM products are usually sold under a U.S. or Japanese brand-partner's name, Taiwan's role in supporting these segments of the economy are invisible to consumers and most non-tech businesses.

Additionally, there is Taiwan's underappreciated role as the leading foreign direct investor in China. It is commonplace for U.S. observers (e.g., reporters in the industry press, organizers of major industry shows like CeBIT, and spokespeople for federal and state-level government delegations visiting China) to misidentify market-leading companies on the mainland as China-owned, when they are in fact Taiwan-owned.

This leads to a diminished appreciation of the important role which Taiwan investors play in supporting U.S. regional interests through the scale of their employment on the mainland and through their role stabilizing key sectors of the Chinese economy and guiding global integration of those sectors.

The third consideration is, how do considerations of timing (e.g. election cycles) affect the prospects for completing the FTA process? In Taiwan's case, U.S. election-cycle issues are now looming large. The timeline for completing all legislative requirements of formal notification and substantive negotiation now verge on exceeding the time remaining under the administration's current TPA. While an extension of this administration's TPA is not entirely unimaginable, prospects for an extension become increasingly remote as the politics of an intensifying presidential campaign season kick into gear.

The Broader Case for a U.S.-Taiwan FTA: the "Globalization Stakes"

While the U.S. Trade Representative is limited in its mandate to a circumscribed set of economic criteria, the U.S. government has a broader interest in the “globalization stakes” of Taiwan’s FTA candidacy. From this more global perspective, the advantages of a U.S.-Taiwan FTA are particularly decisive.

First, Taiwan plays a vital but indirect role in support of U.S. global prosperity. One aspect is its role as the OEM and the Original Design Manufacturing (ODM) partner to virtually the entire brand-name tier of the U.S. IT industry. A separate but related aspect is Taiwan’s prowess in sourcing, manufacturing, and management in China. This, combined with its front-running position in FDI on the mainland, means that Taiwan is effectively leading the global integration of China’s high-tech economy into established global supply chains. Second, Taiwan is the only major economic power in Asia not to be supported by a complex web of bilateral and regional trade agreements. In fact, Taiwan is the only economy in the region without a single strand of support from bilateral trade agreements. This is a reflection of politics, rather than economics--namely, the success of Beijing’s strategy of international marginalization for its purported “renegade province.” It is hardly in the United States’ interest to allow its top technology partner and a top-ten trading partner to be so thoroughly marginalized by a resurgent China for purely political reasons.

While the FTA process led by the U.S. Trade Representative is based on stringent economic-performance criteria, the process is not designed to exclude important political and strategic criteria as well. As stated in the CRS Issue Brief for Congress of January 19, 2005, “Traditionally, regional and bilateral trade agreements have been negotiated for a mixture of economic, political, and development reasons.”

The U.S. Trade Representative criteria necessarily focus on narrow economic criteria and explicitly exclude considerations such as the “knock-on effect” a U.S.-Taiwan FTA might have in encouraging other trade partners, such as Japan and Singapore, to enter into FTA negotiations with Taiwan, but there is more to the picture. From the global perspective, there is probably no stronger candidate for U.S. FTA consideration than Taiwan. If Taiwan continues to muster the will to accelerate progress in the specific areas of economic concern to the U.S., the U.S. should likewise muster the will to support a politically marginalized but long-time partner who has consistently and vitally supported U.S. domestic, regional and global interests through its global supply chain performance. On top of this, there is Taiwan’s vigorous commitment to the free-market and democratic values that have underpinned its global economic performance.