
US-Taiwan Free Trade Agreement Prospects

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In Asia and elsewhere, the United States is contemplating many free trade agreements, for both economic and noneconomic reasons. This chapter explores the prospect of a US-Taiwan FTA, focusing primarily on its economic implications.¹

A possible US-Taiwan FTA differs from other pairings because current political realities make it difficult for Taiwan to join in “competitive liberalization” in the Asia Pacific. Political objections from the People’s Republic of China, rooted in the complex history of China and Taiwan since 1949, make its neighbors hesitant to begin negotiations with Taiwan.² A US-Taiwan FTA therefore might be significant primarily because it could facilitate Taiwan’s further integration into the global economy.

Taiwan meets many of the criteria set by US trade policy leaders for deciding which countries should be given high priority as potential partners in FTAs. Taiwan is democratic; US-Taiwan economic relations are significant; the government is willing to negotiate on a broad spectrum of issues; and Taiwan enjoys political support within both US political parties in Washington. An FTA could promote further domestic eco-

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1. In a forthcoming policy analysis to be published by the Institute for International Economics, we will examine more closely such an FTA’s geopolitical context.

2. A review of this history is outside the scope of the analysis here. For the US Congressional Research Service background on Taiwan, see Dumbaugh (2001); the most recent book-length treatment of Taiwan’s 20th-century history is Roy (2003).

conomic reform within Taiwan, provided its justification is economic and not simply political. Because US-Taiwan trade is already quite open, Taiwan's economic success would be better served through further integration with Asia, including mainland China, rather than with the United States. Other states in the region, however, are reluctant to enter into bilateral trade negotiations with Taiwan. A US-Taiwan FTA might help to overcome this reluctance. The effects of a US FTA are not necessarily all positive for Taiwan or its neighbors, *but on balance they might offset losses that would occur if everyone else in Asia negotiates FTAs while Taiwan is left on the sidelines.*

The introduction of this chapter provides background on the Taiwanese economy and US-Taiwan economic relations. We then examine, in turn, the quantitative evidence on the likely impact of a US-Taiwan FTA and a qualitative analysis of the FTA (with a focus on key sectors). The final section draws conclusions.

Taiwan's Economy

For the past five decades Taiwan has been one of the world's most successful economies. Its long-term growth—just over 8 percent annually in real terms—has been more rapid than that of any other economy, propelling its GDP above \$280 billion by 2002. In the process, the structure of the economy has been transformed. Agriculture initially was the most important sector, but by the early 1970s its share of output fell to under 10 percent; it now accounts for less than 2 percent of GDP. Manufacturing expansion drove Taiwan's growth for three decades, from the early 1950s into the early 1980s, when its contribution to output peaked at a little more than two-fifths. In the past decade services have become the major source of growth and now account for two-thirds of GDP.

Although in the early 1950s Taiwan restricted imports to promote the development of the industrial sector, by the end of the decade it began to adopt trade and exchange rate policies that transformed it into a major trading economy. Exports grew annually by an astounding 25 percent and 30 percent, respectively, in the 1960s and 1970s, making Taiwan a leading trading economy by 1980.

Trade expansion continued in the 1980s even after Taiwan lost its membership in the United Nations and related bodies such as the World Bank. Following its entry into the World Trade Organization (WTO) in 2002, its leaders decided to further enhance Taiwan's international economic status by seeking to negotiate FTAs with several of its trading partners, including the United States. That China has directly and indirectly signaled strong opposition to Taiwan's negotiating FTAs is, from a US perspective, not a deterrent.

Table 8.1 Value of US-Taiwan trade, 1985–2002
(millions of dollars)

Year	Exports	Imports	Balance
1985	4,699.8	16,396.3	-11,696.5
1986	5,524.2	19,790.8	-14,266.6
1987	7,412.7	24,621.8	-17,209.1
1988	12,129.1	24,713.9	-12,584.8
1989	11,334.6	24,312.7	-12,978.1
1990	11,490.8	22,665.9	-11,175.1
1991	13,182.4	23,023.0	-9,840.6
1992	15,250.3	24,596.0	-9,345.7
1993	16,167.8	25,101.5	-8,933.7
1994	17,108.8	26,705.8	-9,597.0
1995	19,289.6	28,971.8	-9,682.2
1996	18,460.2	29,907.3	-11,447.1
1997	20,365.7	32,628.5	-12,262.8
1998	18,164.5	33,124.8	-14,960.3
1999	19,131.4	35,204.4	-16,073.0
2000	24,405.9	40,502.8	-16,096.9
2001	18,121.6	33,374.5	-15,252.9
2002	16,950.9	29,447.6	-12,496.7

Source: US Census Bureau, www.census.gov/foreign-trade/balance/c5830.html.

US-Taiwan Economic Relations

Taiwan is an island a little larger in area than Maryland and a little larger in population than Texas. Relative to Taiwan's size, US-Taiwan economic relations have taken on disproportionate importance, due to the countries' long-standing political and security relationship. Taiwan is the eighth-largest trading partner of the United States, ranking just ahead of North Atlantic Treaty Organization allies Italy and France, and just behind South Korea. Taiwan's per capita income in 2002 purchasing power parity terms was \$18,000.

Both the United States and Taiwan are "industrial" democracies, though both are services dominated—services are 80 percent of GDP for the United States, 66 percent for Taiwan. The trend away from industry and toward services in Taiwan has been unwavering since the mid-1980s. In the last 10 years, labor-intensive manufacturing has shifted out of Taiwan (largely to China), much as it left the United States in earlier decades, and today Taiwan is an information technology powerhouse.

Table 8.1 shows US trade with Taiwan from 1985 to 2002. The United States currently exports goods and services valued at about \$17 billion to Taiwan (only Japan exports more) and imports more than \$29 billion from Taiwan. The United States is now Taiwan's second-largest export market after mainland China. The United States has long maintained a trade deficit with Taiwan—\$12.5 billion in 2002, well below historic highs. Two-

way trade has declined almost 30 percent since 2000: information technology trade sagged more than most sectors in the downturn in high-tech manufacturing and brought Taiwanese exports down, while a good deal of indigenous Taiwanese manufacturing and manufacturing by foreign-invested enterprises in Taiwan migrated to mainland China. US agricultural exports to Taiwan dropped by \$1 billion between 1995 and 2001 as well, from \$3.3 billion to \$2.3 billion (USITC 2002a).

The stock of US foreign direct investment (FDI) in Taiwan stood at \$7.7 billion at the end of 2000, with a flow of \$1.1 billion that year. Also in 2000, \$186 million of Taiwanese investment to the United States contributed to a stock of \$3.2 billion, while \$2.6 billion flowed from Taiwan to mainland China.³ The flow of US FDI into China was \$4.4 billion in 2000.

The United States and Taiwan have a significant record of economic disputes, as is typical when countries have sizable trading relationships. The Office of the US Trade Representative (USTR) is critical of the continuing sales of counterfeit goods and other intellectual property problems in Taiwan, which Taiwanese authorities have been lax in deterring. Among other areas of dispute that stand out in the 2003 *National Trade Estimate Report* are access to agricultural markets and telecommunications (USTR 2003a). The US-Taiwan Business Council highlights seven issues Taiwan must address before FTA negotiations can begin: reform of financial institutions, tightened protection of intellectual property rights (IPR), strengthened anticorruption efforts, rice import quotas, unfair agricultural goods labeling requirements, lack of openness in the telecommunications market, and problems in the health care market, including market-restricting regulatory reforms and lack of IPR protection for pharmaceuticals. Another US business advocacy group, the American Chamber of Commerce in Taipei, publishes an annual *Taiwan White Paper*, which details key problems affecting US firms. In it, the chamber documents industry-specific concerns that businesspeople often deem more pressing than an FTA (American Chamber of Commerce 2003).

Trade Barriers and Concerns

Trade barriers between Taiwan and the United States are modest. Taiwan's nominal average tariff is currently 7.1 percent and is to be further lowered as part of its WTO commitments, to 4.2 percent by 2007. Even after Taiwan has fully implemented its WTO obligations, tariff peaks will remain in certain product areas. Three models (discussed below) forecast that the removal of those tariffs, particularly on agriculture and vehicles, would lead to major gains in US exports following enactment of an FTA.

3. The \$2.6 billion figure, supplied by the Ministry of Economic Affairs in Taipei, substantially understates the magnitude of investment by Taiwanese firms in China.

US nominal average tariffs are an even lower 2.8 percent, with peaks in agriculture (poultry and juice) and various goods (apparel and textiles; steel and steel products, including fasteners; and trucks). The removal of apparel and textile tariffs is responsible for the bulk of gains in Taiwanese exports under an FTA. Taiwan also has nontariff barriers (NTBs) to the imports of agriculture and vehicles. Likewise, the United States uses NTBs in addition to tariffs in certain agricultural sectors.

Some matters already negotiated but not implemented must be addressed before FTA talks can begin. The USTR has effectively ruled out any discussion of an FTA with Taiwan until concerns over what it regards as Taiwan's failure to implement its WTO obligations are addressed. The key actions include protecting intellectual property rights, liberalizing telecommunications, and improving market access for agricultural products (USTR 2003a).

Broader Context of US-Taiwan Relations

The value of US-Taiwan economic relations cannot be separated from their unique foundation in security and political concerns. The United States' security interest in Taiwan dates from the Cold War, and it expressed its commitments to Taiwan in the Taiwan Relations Act of 1979. As a proponent of democratization, the United States continues to view Taiwan as an important model of democratic transition in a region where less liberal philosophies have generally held sway. Taiwan's recent human rights record stands out positively, and Taiwan has been supportive of US security interests.

National security and foreign policy considerations should argue in favor of arrangements that further sustain Taiwan's economic welfare. The question is whether an FTA would in fact strengthen Taiwan—the issue we now address.

Quantitative Analyses

This chapter draws on three quantitative assessments of a possible US-Taiwan FTA. The US International Trade Commission (USITC) assessed US-Taiwan FTA prospects in general and sectors of interest in particular (USITC 2002a). The USITC model considers the elimination of tariff barriers and quotas, but not other nontariff barriers more difficult to convert into tariff equivalents. Taiwan's Chung-Hua Institution for Economic Research (2002) also did a GTAP (Global Trade Analysis Project) assessment, summarized below. The Chung-Hua report uses a similar methodology, though it provides more detail on services. Finally, John Gilbert (2003) estimated the effects of a US-Taiwan FTA alongside 12 other US FTAs cur-

rently under negotiation or discussion. All use the GTAP 5 computable general equilibrium model to estimate trade regime changes.⁴ The overview of quantitative effects presented below is based on the USITC study except where otherwise specified.

Total Welfare Gains and GDP

The USITC estimates that the total US welfare gains from an FTA with Taiwan—assuming that all the anticipated sectoral effects come to pass—would be \$200 million. This is trivial relative to US GDP of \$7.95 trillion in the 1997 baseline.⁵ For Taiwan the gains are somewhat greater in both absolute and relative terms: \$1 billion in total welfare gains, or 0.3 percent of 1997 GDP, which is 100 times more significant in percentage terms than the US gain. Table 8.2 summarizes welfare effects from the studies we consider.

According to the USITC estimate, for both the United States and for Taiwan, welfare gains result from improvement in terms of trade rather than from allocative efficiency gains.⁶ The USITC estimates that US allocative efficiency gains are zero—terms-of-trade gains make up the whole welfare gain; the pattern is much the same in Gilbert. The distribution of welfare gains for Taiwan is similar in both studies, though in Gilbert the allocative efficiency effects for Taiwan are slightly negative. In contrast, the Chung-Hua study predicts much larger gains for both Taiwan and the United States, attributing them largely to improvements in allocative efficiency. Indeed, in the case of the United States the Chung-Hua study estimates that the terms-of-trade effect is negative.

Because the absolute impact on the United States of an FTA with Taiwan would be so modest, the USITC assumed that it would not induce US total factor productivity (TFP) gains. Given the more significant impact on Taiwan, it estimated that TFP in Taiwan might increase by 0.38 percent should an FTA be enacted by 2005.⁷ If that were the case, then the modest

4. The GTAP Web site is www.gtap.agecon.purdue.edu. These three studies are hereafter cited in the text only by their names (USITC, Gilbert, and the Chung-Hua study).

5. USITC (2002a) finds \$200 million in welfare gains for the United States, or 0.003 percent of 1997 GDP. Gilbert (2003) yields a higher result: \$760 million, or 0.01 percent of GDP.

6. “Terms of trade” refers to the prices of a country’s exports relative to the prices of its imports. If the tariff changes following enactment of an FTA have the effect of making a given amount of a country’s exports worth a greater amount of the country’s imports, then the country’s terms of trade are said to improve. “Allocative efficiency” refers to how well an economy’s available resources (factors, or inputs) are assigned to production. By reducing distortions in a country’s trade environment, an FTA might improve its allocative efficiency.

7. The TFP gains for 2009 and 2013 of 0.35 percent and 0.30 percent, respectively, are predicated on the assumption that an FTA is not implemented until those dates; the USITC is not adding those gains to the earlier TFP gains.

Table 8.2 Welfare gains predicted by the US-Taiwan FTA studies (millions of 1997 dollars)

Study	United States	Taiwan
USITC		
Allocative efficiency	0	0
Terms of trade	200	1,200
Total welfare	200	1,000
Gilbert		
Allocative efficiency	108	-23
Terms of trade	653	1,066
Total welfare	760	1,043
Chung-hua Institution		
Allocative efficiency	1,550	1,629
Terms of trade	-480	1,004
Total welfare	1,070	2,633

Sources: USITC (2002a), Gilbert (2003), Chung-hua Institution (2002).

\$1 billion Taiwanese welfare gains could increase to \$4.2 billion—the equivalent of a 1.5 percent increase in GDP. This TFP component for Taiwan is not quantitatively derived in the USITC report, and it is contingent on the basic gains in welfare predicted by the model. Liberalizing service trade by eliminating NTBs could conceivably produce enough additional gains for the United States to improve total factor productivity, although probably not by very much. This possibility is discussed below in light of the Chung-Hua report (which addresses nonquota NTBs, a more important factor in limiting service trade).

Trade Effects

Bilaterally, the USITC study forecasts an increase in US exports to Taiwan of 16 percent, or roughly \$3.5 billion annually, under an FTA. US imports from Taiwan are expected to increase by 18 percent, or \$7.0 billion; thus the bilateral trade deficit of the United States with Taiwan increases by \$3.5 billion.

US exports globally would increase 0.2 percent over base-year levels, or by \$2.4 billion; globally US imports would rise only \$3.2 billion—less than half of the value of the increased imports from Taiwan alone. In this model, Taiwanese imports displace imports from other countries in the US market for one of two reasons. First, with the advantage of tariff-free entry into the United States, Taiwan firms may displace the goods of more efficient producers elsewhere. This is referred to as trade diversion. Second, under an FTA, the mix of imported inputs needed by the United States to make finished goods may change, and Taiwan may be the most efficient producer of these goods. This displacement effect is reflected in

Table 8.3 US and Taiwan sectors benefiting most from bilateral export growth, 2005 (millions of 1997 dollars)

United States		Taiwan	
Sector	Growth	Sector	Growth
Other machinery and equipment	868	Textiles, apparel, and leather	3,104
Motor vehicles, parts	629	Other machinery and equipment	836
Other foods	520	Metals and metal products	666
Electronic equipment	307	Electronic equipment	599
Chemicals, rubber, plastic	300	Other transportation equipment	504
Other transportation equipment	199	Chemicals, rubber, plastic	414
Vegetables, fruits, nuts	164	Other foods	182

Source: USITC (2002a).

the USITC forecast that a US-Taiwan FTA would increase the global US trade deficit by only \$800 million, not by the \$3.5 billion added to the bilateral deficit with Taiwan. Similarly, Taiwan's *global* exports increase by 2 percent or \$2.8 billion and imports by 2 percent or \$2.6 billion, for an increased net surplus of \$200 million.

Would the US-Taiwan FTA create more trade than it diverted? As table 8.3 shows, the preponderance of Taiwanese export growth is in a single commodity group—textiles and apparel—in which poorer economies might seem to be lower-cost producers; this result gives us reason to question the balance-of-trade creation and diversion in the Taiwan FTA case (see below). Gilbert's simulation also indicates trade diversion. His expected reduction in US tariff revenue from trade with third parties under a Taiwan FTA is \$281 million—the second largest for the United States (after Indonesia) among the 13 FTAs he looks at. In Taiwan, tariff revenue in trade with the non-US world falls by \$498 million. While nonmember tariff revenues decline in a US-Taiwan FTA, tariff revenues from members' trade decline more. Gilbert predicts that total American exports to Taiwan rise by \$6.6 billion, and exports to the rest of the world fall by \$2.4 billion; imports from Taiwan rise by \$7.2 billion, while imports from the rest of the world fall by \$2.3 billion. The biggest percentage declines in value of exports to the United States and Taiwan occur for China (−0.16 percent) and for the Philippines, Central America, Indonesia, and Singapore (all between −0.15 and −0.10 percent).

As Gilbert notes (2003, 5), "Negative terms-of-trade consequences of an FTA for non-member economies are another measure of trade diversion, since the changes in trading prices reflect the reduction in imports by members from non-member sources." His study includes terms-of-trade effects for other countries and regions resulting from a US-Taiwan FTA: as is true of other FTAs he examines, they are negative. In our next section, we look at the textiles and apparel sector and conclude that diversion is indeed predominantly responsible for Taiwan's export gains. This

outcome would be mitigated (but not eliminated) by fuller inclusion of service trade induced by removal of NTBs, as suggested by the Chung-Hua study.

Sectoral Effects

Though the welfare and trade (global and bilateral) effects of a US-Taiwan FTA are very modest—indeed, almost insignificant in the case of the United States—some sector-specific effects would be more pronounced. In terms of exports to Taiwan for the United States, motor vehicle and parts exports increase by almost 400 percent (\$629 million) and by a bit more than 100 percent in fish, processed rice, and other foods. The largest winner in dollar terms is “other machinery and equipment,”⁸ at \$868 million or 17 percent. Though US exports to the world in this sector rise \$709 million, that is only a 1 percent increase on a global basis. In just a handful of sectors is the increase in exports to Taiwan equivalent to as much as a 1 percent increase globally, and only in vegetables, fruits, and nuts is the \$164 million increase as much as a 2 percent worldwide export gain. Table 8.3 ranks winners on both sides based on growth in bilateral exports.

In a few Taiwanese sectors, the increase in bilateral exports due to the FTA would exceed 100 percent, but their baselines are insignificantly low. The exception is textiles and apparel, where the 126 percent increase in exports to the United States generating \$3.1 billion would be a 21 percent increase on *global* 2001 exports of \$14.7 billion. More is said about this sector below because it is the main source of Taiwanese gains and because impending changes in global textile trade make the analysis of benefits for Taiwan complicated. The other big bilateral winners for Taiwan, with over \$400 million in export gains, are other machinery and equipment (\$836 million), metals and metal products (\$666 million), electronic equipment (\$599 million), other transportation equipment (\$504 million), and chemical, rubber, and plastic products (\$414 million). In none of these sectors is the increase in total US imports from the world greater than 1 percent.

Table 8.4 ranks the most affected sectors in the United States by *output* in 2005. Sectoral output gains greater than 0.1 percent occur only in a single grouping: vegetables, fruits, and nuts; and output losses greater than 0.1 percent occur only in a single grouping: textiles, apparel, and leather. These are small effects.

Table 8.5 orders winners and losers by an FTA’s effects on the bilateral trade balance, not just on exports, producing a different ranking. When an

8. This is a broad commodity category in the GTAP model: it includes computer and office equipment, engines and turbines, communications equipment, appliances, and a variety of other manufactures.

Table 8.4 US sectors most affected by sectoral output, 2005
(percent)

Increased output		Decreased output	
Sector	Output	Sector	Output
Vegetables, fruits, nuts	0.3	Textiles, apparel, and leather	-0.4
Fishing	0.1	Other crops	-0.1
Other foods	0.1	Processed rice	-0.1
Motor vehicles, parts	0.1	Other manufactures	-0.1
Electronic equipment	0.1		
Other machinery and equipment	0.1		

Source: USITC (2002a).

Table 8.5 US sectors most affected by US-Taiwan bilateral trade balance, 2005 (millions of 1997 dollars)

Contributors to surplus		Contributors to deficit	
Sector	Sector X-M	Sector	Sector X-M
Motor vehicles, parts	441	Textile, apparel, and leather	-3,187
Other foods	322	Metals and products	-629
Services	175	Other transportation equipment	-332
Vegetables, fruits, nuts	163	Electronic equipment	-303
Meat products	56	Other manufactures	-174
Livestock	28	Chemicals, rubber, plastic	-141

X = exports

M = imports

Source: USITC (2002a).

FTA is viewed through this lens, support could come from US motor vehicle and parts producers, service industry interests, and those engaged in numerous food and agricultural categories. The sectors facing the most import pressure are textiles and apparel, metal and metal products industries, nonvehicle transportation equipment manufacturers, electronic equipment manufacturers, those in the general category “other manufacturers,” and the chemical and rubber industries. In the sectoral output table, textiles and apparel saw the biggest impact—a 0.4 percent decline. This hit is evident in the bilateral trade figures as well: no other industry comes close to losing \$3.2 billion.

Table 8.6 shows global trade balance changes, which differ in several ways. The category “other machinery and equipment,” which is a mere \$2 million gainer in bilateral terms, here becomes a \$249 million story. Electronic equipment manufacturing swings from \$300 million in new deficits bilaterally to \$42 million in export gains net of imports on a worldwide basis. Most dramatically, the service industry moves from the third-biggest gainer to the second-biggest loser in global terms—a shift of more

Table 8.6 US sectors most affected by global trade balance, 2005
(millions of 1997 dollars)

Contributors to surplus		Contributors to deficit	
Sector	Sector X-M	Sector	Sector X-M
Motor vehicles, parts	369	Textiles, apparel, and leather	996
Other foods	335	Services	353
Other machinery and equipment	249	Metals and metal products	296
Vegetables, fruits, nuts	123	Wood paper products	84
Electronic equipment	42	Other transportation equipment	79
Coal, gas, etc.	27	Other manufactures	59

X = exports

M = imports

Source: USITC (2002a).

than half a billion dollars. Finally, the \$3 billion textile and apparel loss suffered by the United States bilaterally is reduced to \$1 billion on a worldwide basis.

Chung-Hua Institution Report

The aggregate results of the Chung-Hua Institution study (2002) are broadly similar to those of the US International Trade Commission.⁹ At the sectoral level, however, there are some important differences.

The Chung-Hua model estimates total welfare gains to a free trade area of \$2.6 billion for Taiwan and \$1.07 billion for the United States. These numbers are substantially larger than the estimate of the USITC, presumably because the Chung-Hua study models an elimination not only of tariff barriers and quotas but of other nontariff barriers as well. For Taiwan a substantial portion of the welfare gain is due to improvements in terms of trade, whereas for the United States the Chung-Hua model estimates that the terms-of-trade effect is adverse.

Under a free trade agreement bilateral trade expands, with Taiwan and the United States increasing their exports to each other by \$6.4 billion and \$3.4 billion, respectively. These estimates are almost identical to those of the USITC. US global imports and exports are estimated to increase very slightly—about one-third and two-fifths of a percentage point, respec-

9. The Chung-Hua study estimates four scenarios. Scenario 1 is based on free trade in goods; 2 adds to that a 25 percent mutual reduction in the tariff equivalent of the bilateral barriers to trade in services; 3 adds to scenario 2 the assumption that there are productivity gains of 0.5 percent in each productive sector in the Taiwan economy; and 4 adds to scenario 2 the assumption that there are productivity gains of 1.0 percent in each productive sector of the Taiwan economy. Except where elsewhere specified, we cite the results from scenario 1, which is the most directly comparable with the USITC study in its methodology and assumptions.

tively. Despite the slightly larger boost to US exports than imports in percentage terms, the initial large US global trade deficit will lead to an additional increase in the deficit of about \$230 million. The global trade effects for Taiwan are several times larger, and its positive trade balance in this model will increase by \$340 million.

The Chung-Hua Institution's estimate of the FTA's effect on the composition of exports and imports, and thus on the production structure in each country, is also similar to that of the USITC. It predicts that Taiwan's exports of garments will increase by 152 percent or \$3.3 billion, all going to the United States. To achieve this increase, domestic production of garments must rise by 63 percent, which in turn requires an upsurge in textile production of \$1.7 billion or 8.6 percent. On the other hand, the effects on US exports and domestic production structure are quite modest. The biggest gain is in the export and production of autos, estimated to be up \$1.6 billion and \$1.4 billion, respectively. (The estimates of the Chung-Hua Institution for autos are much higher than those of the USITC study.) The largest US losses are in production of garments and textiles, which drop by \$1 billion and \$500 million, respectively.

Quantitative Effects Relative to Other FTAs

The economic gains described in the preceding section are modest. It is useful to compare them to the expected effects of other FTAs now contemplated by the United States. Table 8.7 presents a range of forecasts for a US-Taiwan FTA alongside forecasts for FTAs with South Korea, Singapore, and New Zealand. Because each of these results was obtained from the GTAP 5 model, they are comparable to a degree (though the scope, initial assumptions, industry disaggregation, and time dimensions may differ).

Even in proportion to the difference in their GDPs (\$300 billion for Taiwan versus \$446 billion for South Korea in 1997, the baseline numbers in the GTAP model¹⁰), the effects of a US-Korea FTA far surpass those of a US-Taiwan FTA. Most significant, the former agreement leads to \$20 billion in increased exports to South Korea and US welfare gains of that magnitude. The first reason for the difference is that initial Korean trade barriers are greater—in many cases considerably higher—than Taiwanese barriers (in 12 of 18 categories). Second, the size of the South Korean economy is almost half again as large as Taiwan's. Both these factors are associated with greater potential for gains in allocative efficiency and in welfare from trade creation. (More gains from a particular FTA do not mean that that partner economy is "better"; on the contrary, they may well

10. Both the \$300 billion for 1997 noted here and the \$280 billion for 2002 given for Taiwan's GDP earlier in the text are nominal figures. Despite a modest decline in Taiwan's real GDP in 2001, real GDP in 2002 was substantially higher than in 1997.

Table 8.7 Welfare and trade effects predicted by FTA studies for US and partner

Study/ FTA partner	USITC: Taiwan		Gilbert: Taiwan		Chung-hua: Taiwan		USITC: Korea		Gilbert: Korea		Gilbert: Singapore		Gilbert: New Zealand	
	Percent	Billions of US dollars	Percent	Billions of US dollars	Percent	Billions of US dollars	Percent	Billions of US dollars	Percent	Billions of US dollars	Percent	Billions of US dollars	Percent	Billions of US dollars
Welfare effects														
Total welfare, United States ^a	0.0	0.20	0.01	0.76	1.07	0.23	19.62	0.03	2.69	0.00	-0.08	0.00	0.00	0.02
Allocative efficiency ^a		0.00		0.11	1.55				-0.17					0.01
Terms of trade ^a		0.20		0.65	-0.48				2.86					0.01
Total welfare, partner	0.3	1.00	0.35	1.04	2.63	0.69	3.85	0.37	1.64	0.43	0.34	0.25	0.16	
Allocative efficiency		0.00		-0.02	1.63				1.74					0.01
Terms of trade ^a		1.20		1.07	1.00				-0.10					0.15
Global trade effects														
US exports	0.2	2.40	0.49	4.20	3.20	0.8	7.40	0.78	6.7	0.05	0.43	0.05	0.43	0.43
US imports	0.2	3.20	0.48	5.00	0.35	1.0	12.50	0.69	7.1	0.05	0.51	0.05	0.51	0.41
US trade balance ^a		-0.80			-0.23		-5.10							
Partner exports	2.0	2.80	2.88	3.90	1.75	3.5	8.00	3.57	5.33	0.45	0.57	1.44	0.25	
Partner imports	2.0	2.60	3.71	4.12	2.86	6.2	10.60	5.79	9.18	0.47	0.64	2.13	0.35	
Partner trade balance ^a		0.20			0.34		-2.60							
Bilateral trade effects on United States														
Exports to partner	16.0	3.50	29.28	6.60	3.40	54.0	19.20	48.16	14.57	0.97	0.20	17.50	0.47	
Imports from partner	18.0	6.60	19.89	7.20	6.40	21.4	10.30	23.39	6.08	6.24	1.42	33.64	0.74	
Balance with partner ^a		-3.50					8.90							

a. Negative numbers indicate increased deficit.

Sources: USITC (2002a), Gilbert (2003), Chung-Hua Institution (2002), John Gilbert generously supplied data for South Korea, Singapore, and New Zealand omitted from his final draft.

indicate that it has been a more protected and thus a poorer trading partner, on which liberalization will have a much greater effect.)

Regional Quantitative Modeling and Implications for Taiwan

There is reason to wonder whether shifting trade patterns in East Asia are adequately captured by US-Taiwan FTA analyses. The region is very dynamic, and assumptions vary as to the baseline trends from which the future of Asia will unfold. Different GTAP models focusing on different questions can help to illuminate the context of changing trade in the Asia Pacific within which a US-Taiwan FTA would take place.

A GTAP modeling exercise by the Asian Development Bank Institute (ADB) looks at the effect of Chinese economic development on East Asian trade patterns to 2020 (Roland-Holst 2002). The ADBI model shows an increase in Chinese exports to the world, resulting merely from WTO implementation, of \$374 billion over the non-WTO baseline by 2020, and an increase in imports of \$257 billion (1997 dollars). The exports go primarily to the developed world (25 percent to the United States), and the imports come primarily from newly industrialized economies (NIEs) of Asia, including Taiwan and South Korea (28 percent).

To what extent are Chinese imports and exports *constrained* by the agreed schedule of tariff reductions (in the model)? That is, is the revealed level of Chinese trade protection already much lower than the bound levels, as has been the case in the past? In many sectors Chinese tariffs are indeed lower than bound levels, as discussed in the following section with regard to textiles and apparel. These factors could throw into question the projected benefits for the United States and Taiwan from an FTA. Even in agriculture, Chinese comparative advantage is mounting in labor-intensive, higher-value crops, and better Taiwanese integration in the region would mean shifting further out of agriculture (Rosen, Rozelle, and Huang, forthcoming).

Further, the USITC study does not anticipate two hypothetical shocks considered in the ADBI study that would further augment Chinese imports and exports, and hence divert trade effects from a US-Taiwan FTA. (Again, it is worth looking at the side effects of China on Taiwan and the United States because Taiwan is so intimately connected to patterns of Chinese trade, and because the benefits of a US-Taiwan FTA are often couched in terms of the US-Taiwan-China value chain.) The first of these is an AFTA (ASEAN, or Association of Southeast Asian Nations, Free Trade Area) + PRC scenario (a pan-Asian free trade agreement), which would increase the sum of Chinese exports and imports from the \$631 billion added to the baseline from WTO implementation to only \$645 billion. In the second, a “global trade liberalization” scenario, the number rises more dramatically to \$828 billion. As this chapter was prepared for press,

significant steps toward an ASEAN + China arrangement were announced. China will allow Southeast Asian nations lower agricultural tariffs in an “early harvest” of benefits starting January 2004, en route to manufacturing tariff cuts within the proposed free trade area starting in 2005. With these commitments China demonstrates seriousness and leadership on regional trade, while the global agenda flounders.

The ADBI study predicts that China will be Asia’s largest importer by 2005 and largest exporter by 2010, and that it will simultaneously run structural trade *surpluses* with western members of the Organization for Economic Cooperation and Development (the United States and the European Union in the ADBI model) and trade deficits with East Asia.¹¹ US Trade Representative Robert Zoellick recently pitched the Free Trade Area of the Americas (FTAA) initiative as a tool to help countries such as Mexico compete with China for the US market.¹² This thinking probably informs support for a Taiwan FTA as well. But if the ADBI model is right, Taiwan is among the countries with the greatest incentive to focus on supplying China; an FTA with the United States is less urgent in that scenario, and could be a distraction from more critical policy initiatives.

Analysis: How Dependable Is the Quantitative Evidence?

The GTAP 5 model relies on 1997 economic data. To update it, USITC inserted into the model parameters for the lower trade barriers in Taiwan and China required by their WTO accessions. All other trade barrier data for countries and regions remain as in 1997. One might well ask, however, if other tariff changes that have occurred elsewhere since 1997 might affect the expected new flows between Taiwan and the United States. The Caribbean Basin Initiative (CBI), Andean Trade Preferences Act (ATPA), and African Growth and Opportunity Act (AGOA) all date from this period, and all pay significant attention to textiles and apparel.

The shortcomings of the GTAP model in dealing with nontariff barriers have significant implications for the results of the exercise in the service sector as well. USITC does not disaggregate services at all, nor does Gilbert; the Chung-Hua study does to a greater extent. The GTAP baseline data do not include trade barriers in services because of the perceived difficulty of estimating values correctly; therefore, the shock of freeing up service trade—though qualitatively estimated by USITC to be significant—is missing from their results.

11. See Roland-Holst (2002, 30). Unlike the western OECD nations, Japan is in near balance in its China trade. The Asian NIEs see exports to China rise \$73 billion over the baseline in 2020, while imports rise just \$38 billion. ASEAN is a slight winner in this scenario.

12. Statement of USTR Zoellick before the US Senate Finance Committee, March 5, 2003, www.ustr.gov/speech-test/zoellick/2003-03-05-testimony-finance.pdf.

Qualitative Analysis

This section offers a qualitative check on the forecasts made by economic models. While the total welfare effects of a US-Taiwan FTA may be small, specific sectors may enjoy or suffer concentrated gains or losses. We examine the sector expected to deliver 90 percent of Taiwan's global export gains (textiles and apparel); two sectors forecast to benefit US exports most importantly (agriculture and autos); one characteristic US loser (industrial fasteners); and one ought-to-be-winner for the United States that underperforms in the USITC report, probably because of shortcomings in the model (services). Finally, we discuss the cross-cutting issue of intellectual property protection.

Textiles and Apparel

Textiles and apparel loom so large in all estimates of the effects of a US-Taiwan FTA that they warrant further examination and analysis. Table 8.8 summarizes the estimates of the US International Trade Commission and the Chung-Hua Institution for Economic Research of the increase in Taiwan's textile and apparel production and exports.¹³ For exports, the table shows the estimated increase in exports both bilaterally to the US market and globally.

The forecast increases of Taiwanese textile and apparel exports to the United States under an FTA are \$3.1 billion and \$3.9 billion, respectively, in the USITC and Chung-Hua studies. In each study textiles and apparel account for most of the estimated increase in Taiwan's exports to the United States. Textiles and apparel are even more important from the perspective of Taiwan's global export expansion resulting from an FTA. The sectoral breakdown available in the Chung-Hua study makes it clear that the increase, both global and bilateral, is made up overwhelmingly of increased apparel exports. The estimated expansion of production of textile and apparel—particularly the latter—is so large that it pulls resources out of the production of other goods, reducing both their output and exports. Thus the USITC and the Chung-Hua Institution estimate, respectively, that the global expansion of textile and apparel exports will account for

13. The two studies are not fully comparable because the USITC sectoral breakdown aggregates textiles, apparel, and leather goods into a single category while the Chung-Hua study treats textiles and apparel separately. Since the economics of textile and apparel production are quite different—the former is much more capital intensive than the latter—separate treatment of the two sectors seems more appropriate. Leather, which is a much smaller industry than either textiles or apparel, appears to be included in the category “other manufactures” in the Chung-Hua study.

Table 8.8 Estimated increases in Taiwan's textile and apparel production and exports

Model	Garments		Textiles		Total	
	Millions of dollars	Percent	Millions of dollars	Percent	Millions of dollars	Percent
Production						
USITC	n.a.	n.a.	n.a.	n.a.	n.a.	8
Chung-hua	3,280	63	1,665	8.6	4,945	n.a.
Global exports						
USITC	n.a.	n.a.	n.a.	n.a.	2,476	11
Chung-hua	3,227	152	260	2	3,560	n.a.
Exports to United States						
USITC	n.a.	n.a.	n.a.	n.a.	3,104	126
Chung-hua	3,281	n.a.	613	n.a.	3,894	n.a.
<i>Memorandum: Estimated increase in all Taiwan's exports</i>						
	Global	To United States				
USITC	2,831	6,645				
Chung-hua	3,405	6,422				

n.a. = not available

Sources: USITC (2002), Chung-Hua Institution (2002).

almost 90 percent and more than 100 percent of the projected expansion of Taiwan's global exports under a US FTA (see table 8.8).¹⁴

Global trade in textile and apparel is grossly distorted by the quantitative restrictions imposed under the Multi-Fiber Arrangement, due to be phased out pursuant to the Agreement on Textiles and Clothing negotiated in the Uruguay Round. As shown in table 8.9, Taiwan's share of the global market in apparel is expected to fall by about three-quarters, from its initial 1.5 percent down to 0.4 percent; China's share is expected to increase dramatically, from its initial 18.9 percent to 45.9 percent. The decline in Taiwan's share of the US apparel market is even sharper, from an initial 3.8 percent down to 0.3 percent. Both Taiwan and China are expected to increase their share of world trade in textiles, however.

Under the multilateral liberalization that will eliminate textile and apparel quotas at the beginning of 2005, Taiwan is forecast to lose about three-quarters of its existing global market share in apparel but to gain a substantial additional share of the global market for textiles. Its estimated increase in apparel exports, when an FTA with the United States is combined with the phaseout of MFA quotas, would thus appear to be entirely

14. The Chung-Hua study estimates that global exports of textiles and apparel will increase by \$3.56 billion, 104 percent of the estimated increase of \$3.41 billion in Taiwan's total exports.

Table 8.9 Textile and apparel trade of Taiwan and China: Estimated effects of the MFA phaseout (percent)

Year	Share of US market				Share of global market			
	Apparel		Textiles		Apparel		Textiles	
	China	Taiwan	China	Taiwan	China	Taiwan	China	Taiwan
1997	13.5	3.8	8.1	5.2	18.9	1.5	10.8	6.1
2007	20.5	0.3	22.3	3.8	45.9	0.4	18.9	10.0

MFA = Multi-Fiber Arrangement

Source: Ianchovichina and Martin (2001). We are indebted to Dr. Martin for supplying the data for Taiwan, which, while generated in the model used, were not reported in the published article.

at the expense of lower-cost producers, most notably China. The reason is that even after the MFA quotas on apparel are eliminated, the United States will continue to restrict imports of apparel by relatively high tariffs—typically 16 to 17 percent (the average US manufacturing tariff is only 2.8 percent). In a bilateral FTA with the United States, Taiwan’s apparel producers will escape this import tariff while China, India, and many other lower-cost producers will not. Thus all the export gains Taiwan would achieve under a bilateral FTA with the United States come at the expense of other lower-cost producers of apparel, suggesting that trade diversion dominates trade creation in a US-Taiwan FTA.

In addition, a bilateral FTA with the United States would cause domestic resources in Taiwan to be reallocated away from sectors of comparative advantage to apparel, in which Taiwan has a comparative disadvantage in production.¹⁵ This shift would not be good for Taiwan itself.

Finally, Taiwan’s gains in this sector could be fleeting. Either further multilateral trade liberalization or the establishment of FTAs between the United States and other lower-cost garment producers would undermine Taiwan’s gains. We are thus left with the following question: Should Taiwan reallocate resources out of sectors in which it has a true global comparative advantage in order to reap modest and probably transitory gains

15. These reallocation effects are reminiscent of (though distinct from) the “Dutch disease” phenomenon, in which booming exports in one sector (usually though not always an extractive industry export like oil) make production in other desirable industries too costly. In the mid-1980s the appreciation of Taiwan’s currency threatened to undermine its competitiveness in labor-intensive goods. To avoid a total loss in these industries, Taiwan invested in China, distributing labor-intensive activities there while keeping value-added work at home. A similar transfer now taking place in higher-tech industries would likely be augmented by a textiles miniboom. But it is not clear that Taiwanese leaders want to encourage further migration of manufacturing to China with its lower wages. See Lin (1996) for an analysis of Taiwan and the Dutch disease.

from the production and export of a product in which it is not globally competitive?

Agriculture

Agriculture should yield mutual gains in a US-Taiwan FTA, especially if areas where tariff peaks and technical barriers exist are included in the agreement. In Taiwan, agriculture has shrunk today to less than 1.9 percent of the economy; agriculture is not an area of comparative advantage for Taiwan, which runs a growing trade deficit in agriculture and expects this trend to continue. For those 800,000 Taiwanese households still involved in agriculture, 70 percent of income comes from nonagricultural activities (USITC 2002a, 2-9); they thus resemble Japanese hobby-farmers, who maintain farms more to qualify for entitlements than as a primary vocation.

Major US export winners are sellers of goods for which current tariffs in Taiwan are high, including citrus (25 to 50 percent tariffs), deciduous fruit (19 percent), fish and shellfish (25 percent), poultry (25 percent under the quota, prohibitive above), beef and pork (15 percent), and processed food (12 percent). Overall, a 0.3 percent sectoral output gain is predicted in the vegetables, fruits, and nuts category—the greatest sectoral gain for the United States. Bilaterally, all but two of the agricultural categories examined by USITC enjoy net trade gains (oil seeds and processed rice decline trivially); globally, 7 of the 13 categories enjoy net trade gains, while the others decline slightly.

Taiwan has a rice import quota of 145,000 metric tons and tariffs of 20 to 30 percent for processed rice products within the quota, while apparent annual consumption is 1.4 million metric tons (USITC 2002a, 4-2). Imports are not permitted outside the quota. Although the USITC report shows little absolute growth in US exports in rice, including this sensitive sector would enhance economic welfare for Taiwan. For its part, the United States maintains high protection of sugar, with absolute quotas on imports. If these were removed, Taiwanese sugar exports to the United States could leap: despite Taiwan's low competitiveness in sugar, prices are so inflated in the protected US market that it could profit with preferential access. However, in the just-completed US-Singapore FTA, US sugar imports remain an exception to free trade, with very small tariff rate quotas of 15 to 22 metric tons for 10 years.¹⁶ One imagines that a similar carve-out of sugar would be sought by US interests in a Taiwan negotiation.

16. That Taiwan is not a major sugar-exporting nation will not deter American sugar industry interests from seeking to exclude sugar—and probably processed foods containing sugar—from a potential US-Taiwan FTA, as they did in the US-Singapore negotiation (see American Sugar Alliance 2002).

Because Taiwan has thus far taken a permissive stand on genetically modified foods, this issue is unlikely to present a major stumbling block to negotiating an FTA. More generally, the USITC report noted (and the US-Taiwan Business Council highlighted) that there are inconsistencies in the labeling requirements imposed by the Taiwanese government regarding the bulk packaging of food and beverages. To the extent that these inconsistencies are definable technical barriers to trade, FTA negotiations would likely address them and thus facilitate US exports to Taiwan in this sector.

Motor Vehicles and Parts

The motor vehicles and parts sector is the big export winner for the United States in an FTA with Taiwan, according to the GTAP models. US exports to Taiwan rise by \$441 million in 2005, and by \$369 million worldwide in the USITC study.¹⁷ Though reflecting only 0.1 percent output growth in the sector overall, this increase is significant in the US-Taiwan FTA context.

US-Taiwan motor vehicle trade has been shrinking for some years, a contraction due less to Taiwanese trade protection than to shifting market trends. Japanese and South Korean vehicles have taken US market share, apparently by better anticipating the tastes of Taiwanese consumers regarding interior detailing, size, and style. Discussions with two major US auto manufacturers revealed uncertainty as to whether US duty-free treatment in vehicles would be enough to offset this trend. Taiwanese view autos imported from the United States as being of lower reputation and quality, and this problem extends even to Japanese-brand vehicles manufactured in the United States. Another issue is whether the Taiwanese market is served more naturally by the rapidly proliferating assembly lines in mainland China. At present, however, production costs at these Chinese facilities remain higher than in the United States (by as much as 30 percent, according to the chief global economist for General Motors). Furthermore, vehicles are among the 25 percent of all products currently banned from importation into Taiwan from the mainland; the economics are thus secondary until Taiwan dismantles these import bans, an action they are under some pressure from major automakers to take.

Yet even after Taiwan applies most favored nation (MFN) auto treatment to China, significant tariffs and quotas will remain (under the WTO, Taiwan is permitted to maintain auto quotas until 2011). Under an FTA, US exports would enjoy an exception to these tariffs, and that preference combined with the advantageous US cost of production could bolster US exports serving the Taiwanese vehicle market for some years—if we as-

17. In the Chung-Hua study, US bilateral exports increase \$1.4 billion, more than three times as much as the USITC estimate.

sume that other countries do not negotiate similar preferential access to the Taiwanese market. If Taiwan joined an ASEAN + 3 FTA or signed an FTA with Japan, then the US advantage would be eliminated (as it would in other product areas). The bottom line is that the US sector that will enjoy the greatest gains, according to the economic models, is hampered by a three-way tug-of-war between market forces, consumer preferences, and preferential trade arrangements. Major US firms in this industry cannot be relied on to fight hard for such an agreement, unless they clearly grasp how Taiwan fits into their global production and supply chains (for instance, through liberalization of Taiwanese prohibitions on auto imports from mainland China).

Fasteners

Representatives of the US fastener industry filed hearing statements strongly opposing a US-Taiwan FTA—at least one that does not exclude metal fasteners. They argue that existing duties on Taiwanese fasteners are not enough to protect US industry; free trade in the sector therefore would be *prima facie* bad. They observe that protection upstream from them in the US steel industry increases their input costs, making them less competitive (they fail to note that a similar regime for fasteners would simply put the same input cost disadvantage on US manufacturing downstream from them). Most provocatively, they suggest that for the fasteners industry free trade with Taiwan would *de facto* mean free trade with mainland China.

This raises the question of rules of origin. Responding to this US hearing filing, the Taiwan Industrial Fasteners Institute responded that Taiwan would uphold the terms of the FTA on transshipment, but in any case “Taiwan . . . does not permit fastener imports from Mainland China” (USITC 2002b). Taiwanese industry asserts that industrial fasteners, like products composing 25 percent of Taiwan’s tariff code (such as autos, discussed above), cannot be imported into Taiwan from China.

Services

As we note in the quantitative analysis, the GTAP modeling used to estimate the effects of a US-Taiwan FTA does not forecast service trade well, because it does not build in initial barriers. The Chung-Hua study, by contrast, does include a second scenario that models a one-quarter reduction in barriers to trade in services. In that scenario, the total welfare gains to the United States are about 40 percent larger than in the baseline scenario. In terms of production effects, the output of services in the United States expands by \$2 billion versus \$1.5 billion in the baseline scenario; the largest share and proportionately largest gains are in industrial and financial services.

Service industries ought to provide US businesses with some of their best opportunities in Taiwan if reforms lower barriers to trade. This prediction is supported both by the attempt to model service liberalization in the Chung-Hua report and by anecdotal evidence. Financial services and telecommunications services are considered in the discussion below because they are areas of US comparative advantage and of observed Taiwanese weakness.

In a number of service industries, Taiwan's WTO entry led to the scheduling of market openings that should be well in place. In insurance, for example, US interests applaud the commitments made by Taiwan and are more concerned with implementing them than with negotiating new arrangements in an FTA. Many other service-sector issues are regulatory in nature or deal with competition policy, areas unlikely to be directly addressed in a bilateral FTA.

Financial and Insurance Sectors

US industry has lately emphasized a number of negotiating goals in FTAs, including the removal of bans on 100 percent ownership, national treatment, regulatory transparency, elimination of economic needs tests, and improvements in the dissemination of permits and in the processing of financial information. The models for these objectives are the US-Singapore and US-Chile FTAs. The 2003 *National Trade Estimate Report* from the USTR reports that Taiwan has reformed its financial sector significantly in recent years, in some respects more quickly than required (USTR 2003a, 362). Most remaining issues have to do with financial reforms rather than national treatment or market access, and such reforms are not the subject of FTAs.

Within financial services, insurance is often a focus of US negotiators. Sources at US firms consulted for this study indicated that Taiwan has made considerable progress on insurance-sector market access as part of WTO accession and that an FTA negotiation would not provide a major opportunity for US industry. One US insurance representative pointed out that Taiwan not only accepted the "model schedule" for insurance put forth by the United States for WTO accession, but was the first to embrace extended commitments under the schedule, including regulatory procedures for product approval. In short, Taiwan is considered to be in the vanguard in its commitments to market access for international insurance, and thus an FTA with Taiwan is not a priority for this industry.

Telecommunications

Not all Taiwanese commitments in telecom made in WTO accession talks have been fully implemented, and industry and USTR both identify barriers to market access. These are largely problems of regulations and competition policy. The American Chamber of Commerce in Taipei points to foreign ownership caps, dominant carrier regulations, and the indepen-

dence of the regulator as priority issues (American Chamber of Commerce 2003). In Type I telecom services (basic service), a 60 percent direct plus indirect ownership cap for foreigners exists, and the chairman of such businesses must be a Taiwanese citizen (though a requirement that half the board of directors and supervisors be Taiwanese has been dropped).

Because the USITC US-Taiwan FTA study does not model these barriers or the effects of removing them, its results probably understate the gains to the US telecom industry (and Taiwanese consumers) should they be dismantled. The US-Singapore FTA, which addresses interconnection, resale of services, regulatory procedures, and nondiscriminatory access to the market, would probably provide a benchmark on procompetitive telecom policy for talks with Taiwan.

Crosscutting Issues

Intellectual Property Rights

The USTR identifies the treatment of intellectual property rights in Taiwan as a “serious and contentious issue” for the United States (USTR 2003a, 361). Despite considerable changes in Taiwanese law and in enforcement action in the run-up to WTO accession, Taiwan is on the Special 301 Priority Watchlist for IPR. In 2003, the USTR acknowledges actions by Taiwanese authorities, but reports no results. Only 10 other economies are on the Priority Watchlist. As mentioned at the start of this chapter, the USTR has ruled out FTA negotiations with Taiwan until existing WTO and bilateral commitments are fulfilled, those regarding IPR in particular.¹⁸

The *National Trade Estimate Report* calls attention to IPR-infringing facilities, pharmaceutical counterfeiting, trade-dress (the distinctive packaging and representation of a product) infringements, and inadequate judiciary and bureaucratic processes for redress of IPR problems. It also cites (USTR 2003a, 361) an International Intellectual Property Alliance (IIPA) estimate that weak Taiwanese IPR regimes cost US businesses more than \$750 million in 2002 (mostly in entertainment software)—a sum almost four times greater than the US welfare gains estimated by the USITC study (\$200 million) and the largest loss claimed by IIPA save that for China (this is illustrative only—revenue and welfare are not comparable). Even if this estimate is overstated, as US industry claims regarding IPR have been in the past, the problem is significant. The USTR asserts that the US-Singapore FTA made significant progress on IPR in the areas of trademarks, copy-

18. The United States has had a trade and investment facilitation agreement (TIFA) with Taiwan since the late 1990s. Official US policy has been not to elevate TIFA talks to the higher level required to facilitate FTA negotiations until existing Taiwanese commitments are implemented. Of course, if strategic considerations should trump standing modalities, then these limitations could be surmounted.

rights, patents and trade secrets, and prevention of the export of infringing goods, including transshipped goods, to the United States. This success has raised the bar for FTA talks; but the USTR is insisting on major improvement in IPR by Taiwan *before* FTA negotiations can be considered.

Rules of Origin

Taiwan enjoys bipartisan support in Washington, and the effects of freer trade with Taiwan *per se* are not so great that they should generate concerted opposition from protectionist Americans. Objection on narrow grounds is likely only in a few industries, such as fasteners, where losses would be concentrated. However, the argument that “free trade with Taiwan is *de facto* free trade with China,” though lacking merit, may be echoed by the numerous groups suspicious of China: interests opposed to free trade, security hawks, anti-Communist pundits, and members of Congress nostalgic for bygone annual MFN battles. The “China issue” will arise in debate over free trade with Taiwan, and will inevitably heighten the attention paid to rules of origin language in any FTA. As noted above, the irony is that Taiwan, despite its massive exports to China, prohibits the import of more goods of Chinese origin than does any other economy.

Rules of origin in a US-Taiwan FTA could be expected to follow the model set out in the recently concluded US-Singapore and US-Chile FTAs. These are by no means simple. In the US-Singapore agreement the rules of origin annex runs 284 pages, with textiles and apparel as well as agriculture getting very detailed treatment (USTR 2003b). Many of the rules are clearly crafted to manage the effects of “free trade” to ensure that something other than a truly level playing field is created between the parties. In the case of Taiwan, no less than Singapore, those sectors expected to see the greatest adjustment (hence benefits) between the two parties would probably see the most battles by lawyers over rules of origin.

Another consideration is that if the Washington proponents of a US-Taiwan FTA are those who take a hawkish position on China, then they might insist on inserting a special rule of origin designed to limit any gains to China. As noted throughout this chapter, the more an FTA distracts Taiwan from better integration with the economy of the region, which includes China, the less well it will serve Taiwan’s interests in the long run. Therefore any special rules of origin designed to reduce Chinese content in US imports from Taiwan should be examined closely.

Conclusions

This analysis has demonstrated that the overall welfare effects of a US-Taiwan FTA are modest, especially for the United States. In absolute terms,

however, the gains to the United States are larger than for all but two of the other prospective FTAs examined by Gilbert.¹⁹ An FTA between the United States and Taiwan would appear to be mostly trade diverting, not trade creating. The biggest reason by far for this outcome is the gains Taiwan would enjoy in textile and apparel exports. To achieve those gains, sunrise industries in Taiwan would likely have to compete with sunset industries more vigorously for resources. Gains in textiles and apparel could be transitory and would even have adverse consequences for Taiwan's long-term economic growth and welfare, because they are concentrated in industries Taiwan cannot sustain in the medium term.

Setting aside for the moment the danger of misallocating resources within Taiwan, a US FTA would partially offset diversion away from Taiwan that would occur if the United States concluded FTAs with many other Asian newly industrialized economies and if politics with China prevented Taiwan from joining in competitive liberalization. Gains from a US-Taiwan FTA alone will not bolster Taiwan's long-term economic welfare and cannot fully offset losses from failure to join in Asian integration. But as noted at the outset, other nations in the Asia-Pacific region have said that negotiating economic arrangements with Taiwan would be easier if the United States broke the diplomatic impasse and did so first. Thus, a US-Taiwan FTA could lead the way to the deeper Asian economic integration that is most likely to support long-term Taiwanese welfare. (Of course, if Beijing withdrew its diplomatic pressure on other Asian nations not to negotiate economic arrangements with Taiwan, then the importance of a US-Taiwan FTA in this regard would be moot.) Failing the ability of a US-Taiwan FTA to facilitate regional economic opportunities for Taiwan, at the bare minimum a US-Taiwan FTA could deliver a modicum of economic gains (diversionary or otherwise) to offset a fraction of the losses from sitting out regional integration.

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19. The two economies are South Korea and Thailand, which Gilbert (2003, table 2) credits with \$2.7 billion and \$820 million in equivalent variation (EV) gains to the United States, compared with \$760 million for Taiwan.

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