

# CRS Report for Congress

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## Taiwan's Accession to the WTO and Its Economic Relations with the United States and China

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### Summary

After several years of negotiations, Taiwan joined the World Trade Organization (WTO), the international organization that sets rules for most international trade, on January 1, 2002. China fought to allow Taiwan to join the WTO only as a “separate customs territory” and only after China obtained membership (which it did in December 2001). Trade and investment relations between China and Taiwan have boomed in recent years; China has replaced the United States as Taiwan’s export market. However, political tensions between China and Taiwan remain high. In an effort to further boost U.S.-Taiwan economic ties (and to lessen Taiwan’s growing economic dependency on the mainland), some Members of Congress have indicated support for a U.S.-Taiwan free trade agreement (FTA). This report will be updated as events warrant.

### Taiwan-U.S. Commercial Relations

Taiwan is a major economic and trade power and a significant U.S. trading partner. Taiwan’s 2004 GDP was \$306 billion (making Taiwan the world’s 20<sup>th</sup> largest economy). Taiwan’s total trade (exports plus imports) in 2004 was \$342 billion (with exports at \$174 billion and imports at \$168 billion).<sup>1</sup> In 2004, Taiwan was the 8<sup>th</sup> largest U.S. trading partner (\$56 billion), 9<sup>th</sup> largest export market (\$21.7 billion) and 8<sup>th</sup> largest import source (\$34.6 billion).<sup>2</sup> The United States is Taiwan’s third largest trading partner (after Japan and China), its third largest export market (after China and Hong Kong) and its second largest source of imports (after Japan). Major U.S. exports to Taiwan include semiconductors and other electronic components, basic chemicals, and industrial equipment. Major U.S. imports from Taiwan include semiconductors and other electronic

<sup>1</sup> According to the WTO, Taiwan is the world’s 16<sup>th</sup> largest exporter and importer (2003 data).

<sup>2</sup> In 2004, U.S. exports to Taiwan rose by 24.3%, while imports were up by 9.5%, over 2003 levels. However, 2004 U.S. exports to, and imports from, Taiwan, were 10.9% and 14.6%, respectively, below 2000 levels.

components, computer equipment, and communications equipment. Total U.S. foreign direct investment (FDI) in Taiwan (on a historical cost basis) in 2003 was \$11.0 billion, while Taiwan FDI in the United States was \$2.7 billion.

**Table 1. U.S.-Taiwan Commercial Relations: 2000-2004 Years**  
(\$ millions)

	2000	2001	2002	2003	2004	2004-2004 % Change
<b>Total U.S. Exports to Taiwan</b>	22.4	18.2	18.4	17.5	21.7	24.3
<b>Top 3 U.S. Exports to Taiwan</b>						
Semiconductors and other electronic components	5.5	4.2	4.9	4.5	4.1	-9.4
Basic chemicals	1.5	1.1	1.2	1.4	2.1	51.2
Industrial machinery	2.7	1.0	1.0	0.7	1.6	141.4
<b>Total U.S. Imports from Taiwan</b>	<b>40.5</b>	<b>33.4</b>	<b>32.2</b>	<b>31.6</b>	<b>34.6</b>	<b>9.5</b>
<b>Top 3 U.S. Imports from Taiwan</b>						
Semiconductors and other electronic components	10.4	7.2	6.3	6.2	7.3	17.7
Computer equipment	8.3	7.0	7.1	5.4	4.1	-22.8
Communications equipment	1.4	1.1	0.9	1.0	1.4	43.8
<b>U.S. Trade Balance</b>	<b>-16.1</b>	<b>-15.2</b>	<b>-13.8</b>	<b>-14.1</b>	<b>-12.9</b>	<b>—</b>

Source: U.S. International Trade Commission DataWeb.

## Taiwan and the WTO

Taiwan's attempt to join the General Agreement on Tariffs and Trade (GATT) and its successor organization, the World Trade Organization (WTO), dates back to 1990. In September 1992, a GATT Working Party was established to handle Taiwan's application to the GATT as "the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu," or "Chinese Taipei" (a designation similar to that of Hong Kong and Macau, both of which, while not independent countries, are WTO members). At that time, several GATT signatories indicated support for allowing Taiwan to join the GATT only after China did, a position supported by many members when the WTO was established in 1995.

Taiwan's WTO membership was formally approved on November 11, 2001, the day after China's WTO membership was approved.<sup>3</sup> On December 2, 2001, the Taiwanese government notified the WTO that it had ratified its WTO accession agreement, and on January 1, 2002, it joined the WTO. Under the terms of its WTO accession, Taiwan agreed to cut tariffs and remove non-tariff barriers over specified time periods:

- **Tariffs.** Simple average tariffs on agricultural products dropped from their pre-WTO level of 20% to 14% in 2002, and will fall to 12.9% by

<sup>3</sup> Later that month, Taiwan's Legislative Yuan passed a comprehensive revision to its tariff schedules to reflect its WTO commitments.

2007 when tariff cuts are fully implemented.<sup>4</sup> Similarly, simple average tariffs on industrial goods dropped from 6.0% to 5.8% (in 2002) and scheduled to fall to 4.2% in 2004. Taiwan agreed to join all Uruguay Round zero-for-zero initiatives by eliminating all tariffs on paper, pharmaceuticals, medical equipment, construction equipment, steel, toys, furniture, agriculture equipment, civil aircraft, distilled spirits, and information technology products. Taiwan also agreed to participate in the WTO Chemical Harmonization Initiative.

- **Automotive Products.** Taiwan agreed to cut tariffs on imported autos from 30% to 10%, decrease the commodity tax on vehicle imports, eliminate an existing 9% subsidy on automobile components designed in Taiwan, and remove a 50% local content requirement for auto parts.
- **Government Procurement.** Taiwan agreed to join the WTO Government Procurement Agreement (GPA), which will open its procurement markets to a wide range of U.S. products, including power-generating, transport and power transmission services.<sup>5</sup> Taiwan also agreed to implement a new, more fair and transparent, contract and dispute resolution system regarding government contracts.
- **Services.** Upon WTO accession, Taiwan agreed to open completely a number of service sectors, including professional services (architects, accountants, engineers, lawyers), audiovisual services, express delivery services, advertising, computer services, construction, wholesale and retail distribution, franchising, and environmental services. Taiwan also agreed to allow foreign companies to hold a controlling interest in Taiwan communications companies, and to remove various barriers for telecommunication services in Taiwan. Finally, Taiwan agreed to provide substantially full market access and national treatment in the full range of financial services, such as banking, insurance, and securities.
- **Agriculture.** Taiwan agreed to immediately liberalize previously closed markets for rice; expand market access for pork, poultry, and variety meats; and to make significant immediate tariff reductions on hundreds of agricultural products (such as potato products, pears, grapes, grapefruit, sunflower oil, and soup). Taiwan also agreed to eliminate restrictive sanitary and phytosanitary (SPS) regulations.
- **Intellectual Property Rights (IPR).** Taiwan agreed to make its IPR protection regime conform to the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) upon accession.

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<sup>4</sup> Taiwan agreed to implement 68% of its tariff reductions upon accession. The remaining 32% (covering 2,217 tariff lines) will be implemented over time. For example, tariff reductions for most chemicals, iron and steel, auto parts, and plywood will be completed by 2004, and those for most motor vehicles by 2008.

<sup>5</sup> *The Taiwan Economic News* reported in December 2002 that Taiwan was close to completing negotiations to join the GPA. However, a final agreement has yet to be worked out.

U.S. government and business officials have given Taiwan relatively good marks for its WTO implementation efforts to date. However, complaints have arisen over a number of issues, including inadequate enforcement of IPR laws, failure to privatize state-owned enterprises, lack of transparency for trade rules and regulations, restrictive SPS measures, uneven administration of tariff-rate quotas (especially for rice), and regulatory barriers on pharmaceuticals and telecommunications.

## WTO and Taiwan-China Commercial Ties

Bilateral trade flows have grown substantially since Taiwan and China joined the WTO, despite the current lack of direct economic and political links (most trade goes through Hong Kong). According to Taiwan trade data, its exports to China have risen from \$9.9 billion in 2002 to \$34 billion in 2004 (up 243%), while imports have risen from \$7.9 billion to \$16.7 billion (up 111%), making China one of Taiwan's fastest growing trading partners (see **Table 2**). In 2004 alone, Taiwan exports to, and imports from, China rose by 58.9% and 51.8%, respectively in 2004 (over 2003 levels).<sup>6</sup>

Taiwan places significant restrictions on imports from China (especially products that might compete directly with Taiwanese-made goods). Many trade restrictions have been lifted in recent years, which has boosted imports from China. Taiwan's trade policies have helped it maintain large trade surpluses with China. Taiwan's trade data indicates that it had a \$17.3 billion trade surplus in 2004 (while Chinese data estimate that surplus at \$51.3 billion).

**Table 2. Taiwan's Major Trading Partners: 2004**  
(\$ billions)

	Total Trade	Exports	Imports	Trade Balance
Japan	56.8	13.2	43.6	-30.4
United States	49.8	28.1	21.6	6.5
China	50.7	34.0	16.7	17.3
Hong Kong	31.9	29.8	2.1	27.7
South Korea	17.0	5.3	11.6	-6.3
<b>Taiwan World Trade</b>	<b>341.9</b>	<b>174.0</b>	<b>167.9</b>	<b>6.1</b>

Sources: Taiwan Bureau of Foreign Trade.

Taiwan has shifted many of its labor-intensive, export oriented, industries to the mainland. The actual level of Taiwanese FDI in the mainland is greatly debated. Taiwan maintains restrictions on the amount and types of investment that are allowed to be made in China by Taiwanese investors, although many seek to circumvent these restrictions by

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<sup>6</sup> Chinese trade data show the level of bilateral trade to be significantly higher than Taiwanese data. Chinese data estimate total trade with Taiwan at \$78.3 billion in 2004; imports from, and exports to, Taiwan were \$64.8 billion and \$13.5 billion, respectively. The disparity between China's and Taiwan's trade data is likely the result of how the two sides count trade that passes through Hong Kong. The Chinese data would indicate that a significant share of Taiwan exports to Hong Kong (as reported in official Taiwanese trade data) is actually re-exported to China.

investing in the mainland through off-shore companies. Taiwanese data show the cumulative level of Taiwanese FDI in China (through October 2004) at about \$39.7 billion, or 48.8% of its cumulative FDI. Some Taiwanese business groups contend that the actual level of Taiwanese FDI in China is far higher than Taiwanese and Chinese official data, with estimates ranging from \$60 billion to over \$100 billion. According to Taiwan's Ministry of Finance (MOF), Taiwanese FDI flows to the mainland over the past five years have "increased by leaps and bounds." According to the MOF, the share of Taiwan's total FDI going to the mainland (on an annual basis) rose from 33.3% in 2000 to 67.2% in 2004, an indication that mainland China has become the dominant destination for Taiwanese investors.<sup>7</sup> Electronics and electrical industries are the largest recipients of Taiwanese FDI in the mainland.

Since 1996, the Taiwanese government has maintained a "no haste, be patient" policy, seeking to limit the level of Taiwanese investment with the mainland for security reasons, but this policy has come under review in recent years, mainly because of growing economic problems in Taiwan. The economic slowdown in the United States and other major world economies in 2001 caused Taiwanese exports (especially information technology products) to decline sharply, raising unemployment to record levels (5.3% in November 2001), and pushing the economy into recession (real GDP declined by 2.1%). These conditions led several Taiwanese government and business officials to call for an abandonment of the "no haste, be patient" policy as a means to help revive the economy. In August 2001, Taiwanese President Chen Shui-bian endorsed the replacement of the "no haste, be patient" policy with an "active opening, effective, management" policy, which would relax current restrictions on investment in the mainland, establish commercial links with China, and gradually allow mainland investment in Taiwan.

Supporters of closer economic integration with the mainland argue that Taiwanese firms must take advantage of China's growing demand for goods and services, as well as its abundant low-cost labor, in order to stay competitive in world markets. Several Taiwanese business representatives have called on the Taiwanese government to remove restrictions on direct commercial links with the mainland, as such restrictions add significant costs to doing business with China.<sup>8</sup> Some supporters of normalized trade relations with the mainland have called on the Taiwanese government to negotiate an FTA with China. Many Taiwanese policymakers believe that closer economic ties with the mainland will help to stabilize the relationship and reduce the likelihood of a Chinese invasion. Opponents of closer ties with China contend that such policies will accelerate the transfer of Taiwanese firms to the mainland, leading to a hollowing out of core industries, and raising the level of unemployment in Taiwan. Another major concern is over becoming too economically dependent on the mainland and thus becoming more vulnerable to political pressure from China.

Chinese officials have indicated support for direct trade links with Taiwan, but have often predicated that support on Taiwan's acceptance of Beijing's "One China Principle,"

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<sup>7</sup> Taiwan Ministry of Finance Press Release, March 20, 2005.

<sup>8</sup> One study found that establishing direct trade links between China and Taiwan would boost GDP on both sides by 3% and increase trade by a total of \$10 billion. See Peter Chow, Francis Tuan and Zhi Wang, "WTO Accession and Economic Integration Among Taiwan, Hong Kong and China," *Pacific Economic Review* (October 2001).

which states that Taiwan is part of China, a position rejected by Taiwan's government. More recently, it appears that Chinese officials have tended to avoid tying political issues to closer economic ties, perhaps in part in the belief that closer economic cooperation will advance China's goal of "reunification." However, cross-strait relations remain volatile. For example, on March 14, 2005, the Chinese government enacted into law its long-standing stated policy that it would use military force if Taiwan declared independence. The Taiwan government responded by announcing that it would slow down the pace at which certain industries are allowed to invest in China and the pace at which bans on certain imports from China are relaxed.<sup>9</sup>

Some U.S. policymakers have expressed concern that China may attempt to use its expanding economic power, and Taiwan's growing dependence on its economic ties to the mainland, to undermine Taiwan's autonomy. Some Members of Congress have indicated support for a U.S.-Taiwan free trade agreement (FTA) that would reduce trade barriers by both sides, thus boosting U.S.-Taiwanese economic ties.<sup>10</sup> Bush Administration officials have indicated support for such an FTA, but only after Taiwan first agrees to resolve various trade disputes with the United States, in particular Taiwan's inadequate enforcement of IPR, and trade barriers on telecommunications services, pharmaceuticals, and various agricultural products<sup>11</sup> On November 29, 2004, the United States and Taiwan resumed discussions (after a six year hiatus) under the Trade and Investment Framework Agreement (TIFA), a forum designed to resolve major trade and investment disputes. Progress towards resolving current trade disputes being addressed under the TIFA could lead to an agreement to begin discussions for a bilateral FTA. China may oppose a U.S.-Taiwan FTA if it views Taiwan's motivation for such an agreement as political, rather than economic. It is not clear whether Chinese opposition (should it occur) would discourage the United States from pursuing an FTA with Taiwan.<sup>12</sup>

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<sup>9</sup> Taiwan, Ministry of Finance press release, March 14, 2005.

<sup>10</sup> Legislation was introduced in the 108<sup>th</sup> Congress, H.Con.Res. 98 (Rep. Ramstad), expressing congressional support for a U.S.-Taiwan FTA. The bill had 69 cosponsors.

<sup>11</sup> Some progress has been made on these issues, especially on IPR. The International Intellectual Property Alliance (IIPA) estimates that IPR piracy in Taiwan cost U.S. firms \$314 million in lost sales in 2004 (down from losses of \$465 million in 2003). In a November 2004 press release, the IIPA stated that Taiwan had "made significant law reform and enforcement progress in 2003-2004," but stated that piracy "remains high" and that much work remains to be done." (See [<http://www.iipa.com>]). In January 2005, the USTR upgraded Taiwan's IPR status from "Priority Watch List" to "Watch List" due to the progress it had achieved in IPR enforcement and copyright protection.

<sup>12</sup> Press reports indicate that China has sought to discourage Japan and Singapore from pursuing FTAs with Taiwan.