

# CRS Report for Congress

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## Taiwan and the World Trade Organization

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### Summary

After several years of negotiations, Taiwan joined the World Trade Organization (WTO) on January 1, 2002. Taiwan's WTO membership is expected to accelerate its trade and economic reforms, boost economic growth, and expand trade and investment links with other WTO members, including the United States. WTO accession by both Taiwan and China (which joined in December 2001) could expand their bilateral commercial ties as well. 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. This report will be updated as events warrant.

### Taiwan's Economy and WTO Application

Taiwan is a major economic and trade power and a significant U.S. trading partner. Taiwan's 2002 GDP was \$289 billion, and its total trade (exports plus imports) was \$243.2 billion. Total U.S.-Taiwan trade in 2002 was \$50.6 billion, making Taiwan the 8<sup>th</sup> largest U.S. trading partner (the U.S. was Taiwan's largest trading partner). U.S. exports to Taiwan in 2002 were \$18.4 billion (making Taiwan the 9<sup>th</sup> largest U.S. export market), while U.S. imports from Taiwan were \$32.2 billion (the 8<sup>th</sup> largest source for U.S. imports). U.S.-Taiwan trade has stagnated in recent years. U.S. exports to Taiwan fell by 25.7% in 2001 (over 2000 levels), and grew by only 1.5% in 2002. U.S. imports from Taiwan fell by 17.6% in 2001 and by 3.5% in 2002.

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 January 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 it appears that several GATT signatories indicated support for allowing Taiwan to join the

GATT only after China did, and this position was supported by a majority of WTO members.<sup>1</sup>

The Taiwanese government made accession to the WTO a top priority and took a number of steps prior to accession to remove a wide variety of tariff and non-tariff barriers. In addition, Taiwan agreed to be treated as a *developed* economy in the WTO upon its accession, a designation that required it to adopt stricter standards on trade than is required of *developing* economies. Taiwan negotiated bilateral trade agreements with 26 WTO members, including the United States (February 1998), providing immediate market access and phased-in commitments for goods, services, and agricultural products.

## **U.S. Policy on Taiwan's WTO Entry and Congressional Concerns**

The issue of Taiwan's WTO accession became a major issue during debate in the 106<sup>th</sup> Congress. Several Members expressed concern that China might try to exert political influence over some WTO members (or take other unspecified steps) to block Taiwan's accession or would try to insert language into China's WTO accession agreement that expressly stated that Taiwan was part of China. Many Members urged the Clinton Administration to restate its position on Taiwan's WTO membership, and others made legislative proposals.

Congressional support for Taiwan's WTO bid was included in H.R. 4444, a bill to extend permanent normal trade relations status to China upon its accession to the WTO. Section 601 of the bill (which was enacted into law on October 10, 2000, P.L. 106-286) states that, immediately upon approval by the WTO General Council of China's accession to the WTO, the U.S. representative to the WTO should request that Taiwan's WTO accession be the next order of business, and that the United States should be prepared to aggressively counter any effort to block Taiwan's accession.

## **Completion of Taiwan's WTO Application**

As noted, Taiwan's accession to the WTO was tied to the completion of China's accession process. On September 13, 2001, China concluded a WTO bilateral trade agreement with Mexico) the last of the original 37 WTO members that had requested such an accord), and on September 17, 2001, the WTO Working Party handling China's WTO application announced that it had resolved all outstanding issues regarding China's WTO accession. Subsequently, on September 18, 2001, the WTO Working Party handling Taiwan's membership announced that it had completed its work. China's WTO membership was formally approved at the WTO Ministerial Conference in Doha, Qatar on November 10, 2001.<sup>2</sup> The next day, the WTO formally approved Taiwan's membership. On December 2, 2001, the Taiwanese government notified the WTO that it had formally ratified its WTO accession agreement and, as a result, Taiwan joined the WTO on January 1, 2002.

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<sup>1</sup> This informal agreement appears to have been taken due to political concerns over offending China, which views Taiwan as part of China.

<sup>2</sup> In November 2001, Taiwan Legislative Yuan passed a comprehensive revision to its tariff schedules to reflect its WTO commitments.

## Taiwan's WTO Accession Agreement

Under the terms of its WTO accession, Taiwan agreed to cut tariffs and remove non-tariff barriers on a wide range of goods 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 2007 when tariff cuts are fully implemented.<sup>3</sup> Similarly, simple average tariffs on industrial goods dropped from 6.0% to 5.8% (in 2002) and eventually will fall to 4.2% by 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>4</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, and to expand market access for pork, poultry, and variety meats. The agreement also requires Taiwan to make significant

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<sup>3</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>4</sup> *The Taiwan Economic News* reported on December 11, 2002, that Taiwan was close to completing negotiations with other WTO members that would enable it to soon join the GPA.

immediate tariff reductions on hundreds of agricultural products, such as potato products, pears, grapes, grapefruit, sunflower oil, and soup. Finally, Taiwan 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.

U.S. government and business officials have given Taiwan relatively high 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 TRQs (especially for rice), and regulatory barriers on pharmaceuticals and telecommunications.

## **Economic Implications of Taiwan's WTO Accession**

Most economists contend that Taiwan's WTO accession will greatly benefit its economy in the long run. For example, a 1999 study by Dr. Greg Mastel (at the International Trade Studies at the Center for National Policy) examined the effects WTO accession would have on Taiwanese imports of six major agricultural and industrial sectors (fruits and vegetables, meat products, automobiles, auto parts, semiconductors, and textile and apparel), and concluded that combined imports of these products would likely rise by an additional \$5.5 billion (a significant level of which would come in the auto sector) over the course of nine years (the time period in which tariff and non-tariff reductions are phased in). The study concluded that, taking in consideration the full range of import categories, this figure would probably increase by nearly ten fold (\$55 billion).<sup>5</sup> The United States is Taiwan's second largest source of imports (after Japan), accounting for 14.9% of Taiwan's imports (2002), and thus U.S. exporters are expected to be a major beneficiary of Taiwan's WTO accession.<sup>6</sup> Taiwan's economy should also be enhanced by its WTO membership through efficiency gains resulting from further economic and trade reforms and by increased foreign trade and investment.

## **WTO and China-Taiwan Commercial Ties**

Accession to the WTO by both Taiwan and China could have a significant effect on their bilateral commercial ties. Despite the current lack of direct economic and political links, China-Taiwan trade and investment have surged over the past several years. From 1991 to 2002, total bilateral trade rose from \$8.1 billion to \$39.6 billion.<sup>7</sup> In 2002, Taiwan's exports to China (\$32.0 billion) grew by 35.4% over the previous year, while its imports from China (\$7.6 billion) grew by 30.7%. Most trade between China and

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<sup>5</sup> Mastel, Greg. *Taiwan in the WTO: An Economic and Policy Analysis*, October 6, 1999, available at [<http://www.taipei.org/un/wto0223.htm>].

<sup>6</sup> The U.S. Department of Agriculture predicts that Taiwan's WTO accession, once fully implemented, could boost U.S. agricultural exports there by an additional \$500 million per year.

<sup>7</sup> Taiwan trade data. Full year data estimated by CRS based on actual data for Jan.-Oct. 2002.

Taiwan takes place indirectly via Hong Kong (due to the lack of direct trade links). While China is a major market for Taiwan's exports, it is a relatively small source of its imports mainly because Taiwan places significant restrictions on imports from China (especially products that might compete directly with Taiwanese-made goods).<sup>8</sup>

Taiwan has shifted many of its labor-intensive, export oriented, industries to the mainland. The actual level of Taiwanese foreign direct investment (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 investing in the mainland through off-shore companies. Taiwanese data show the cumulative level of Taiwanese FDI in China at about \$25.1 billion, while Chinese data estimate this figure at \$32.1 billion. 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.

WTO membership for Taiwan and China could eventually lead to direct trade links, the extension of mutual most-favored-nation (MFN), or non-discriminatory, treatment, a reduction in trade and investment restrictions by both parties (especially by Taiwan), and possibly the use by both parties of the WTO dispute resolution process to resolve trade disputes.<sup>9</sup> Alternatively, Taiwan or China could decide at any point to invoke Article 21 in the WTO, a provision that enables WTO members to suspend MFN treatment to another member for national security reasons.

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 high-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%). Taiwan's economy improved somewhat in 2002, due largely to increased trade with China, but unemployment remained relatively high at about 5.2% in 2002.

Taiwan's current economic problems have led several Taiwanese government 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 direct trade, transportation, and postal links with China, and gradually allow mainland investment in Taiwan.

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<sup>8</sup> The percentage share of Taiwanese exports going to China has risen dramatically over the past few years, rising from 9.1% of total exports in 1991 to 24.9% in 2002. In 2002, China replaced the United States as Taiwan's most important export market. Imports from China as a share of total Taiwanese imports rose from 1.8% in 1991 to 6.8% in 2002, due to a gradual relaxation of import restrictions on Chinese goods by the Taiwanese government.

<sup>9</sup> In December 2002, Taiwan and China held their first ever bilateral consultation in the WTO. Additionally, Taiwan has removed a number of discriminatory trade barriers on Chinese goods.

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.<sup>10</sup> 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>11</sup> Some supporters of normalized trade relations with the mainland have called on the Taiwanese government to negotiate a free trade agreement with China. Many Taiwanese policymakers believe that great 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.<sup>12</sup> 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," 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."

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. Bush Administration officials have indicated support for such a FTA, but only after Taiwan first agrees to resolve various trade disputes with the United States, in particular Taiwan's inadequate enforcement of IPR.<sup>13</sup>

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<sup>10</sup> They say that China's WTO accession will make it a major economic powerhouse and that Taiwan needs to be in a position to take advantage of the growing opportunities in China for trade and investment. But in order for the WTO agreements to apply between China and Taiwan, both sides will need to extend non-discriminatory trade treatment to one another.

<sup>11</sup> One study found that the ban on direct trade links between China and Taiwan adds 60% to freight costs, and that removal of such barriers would boost GDP on both sides by 3% and increase trade by a total of \$10 billion. See Wang, Zhi. *WTO Accession and Economic Integration Among Taiwan, Hong Kong and China*, 2001.

<sup>12</sup> Debate is currently taking place in Taiwan over whether to let Taiwanese microchip makers establish production facilities in the mainland (many already do so illegally without government permission). Taiwanese microchip producers argue that such a move is needed for the sector to remain competitive, especially in the wake of slumping worldwide sales and increased investment in microchip production by foreign competitors, while opponents fear that the "crown jewels" of Taiwan's economy, its high-tech industries, will eventually be lost.

<sup>13</sup> The International Intellectual Property Alliance (IIPA) estimates that lack of IPR protection in Taiwan cost U.S. firms \$757 million in lost sales in 2002, more than double estimated losses in 2001.