
Qualitative Analysis

While the total welfare effects of a US-Taiwan FTA may be small, specific sectors could enjoy or suffer concentrated gains or losses. This chapter offers a qualitative check on the forecasts made by economic models, particularly regarding (1) the sector expected to deliver 90 percent of Taiwan's global export gains (textiles and apparel); (2) two sectors forecast to most significantly benefit US exports (agriculture and autos); (3) one characteristic US loser (industrial fasteners); and (4) one ought-to-be-winner (services) for the United States that underperforms in the USITC forecast, probably because of shortcomings in the model. Finally, the chapter examines the cross-cutting issue of intellectual property protection.

Textiles and Apparel

Textiles and apparel loom large in all estimates of the effects of a US-Taiwan FTA. Table 3.1 summarizes the increase in Taiwan's textile and apparel production and exports as estimated by the USITC and the Chung-Hua Institution for Economic Research.¹ For exports, the table shows

1. 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 of “other manufactures” in the Chung-Hua study.

Table 3.1 Estimated increases in Taiwan's textile and apparel production and exports

Model	Apparel		Textiles		Total	
	Billions of dollars	Percent	Billions of dollars	Percent	Billions of dollars	Percent
Production						
USITC	—	—	—	—	—	8
Chung-Hua	3.3	63	1.7	8.6	4.9	—
Global exports						
USITC	—	—	—	—	2.5	11
Chung-Hua	3.2	152	.7	2	3.6	—
Exports to the United States						
USITC	—	—	—	—	3.1	126
Chung-Hua	3.3	—	.6	—	3.9	—

Estimated increase in total Taiwanese exports (billions of dollars)		
	Global	To the United States
USITC	2.8	6.6
Chung-Hua	3.4	6.4

— = not given in the original source.

Sources: USITC (2002a), Chung-Hua Institution for Economic Research (2002).

the estimated increase in exports both bilaterally to the US market and globally.

The increase in Taiwanese textile and apparel exports to the United States under an FTA is forecast at \$3.1 billion by the USITC and \$3.9 billion by the Chung-Hua study. The studies agree that textiles and apparel would 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 both the global and bilateral increases would be made up overwhelmingly of increased exports of apparel rather than textiles. The estimated expansion of production of textiles 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 Chung-Hua studies respectively estimate that the global expansion

Table 3.2 Estimated effects of the Multi-Fiber Arrangement phase-out on textile and apparel trade of Taiwan and China (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

Source: Ianchovichina and Martin (2001). Dr. Martin generously supplied the data for Taiwan, which, while generated in the model used, were not reported in the published article.

of textile and apparel exports would account for almost 90 percent and more than 100 percent of the projected expansion of Taiwan's global exports under a US-Taiwan FTA.²

Global trade in textiles and apparel is grossly distorted by the quantitative restrictions imposed under the Multi-Fiber Arrangement (MFA), which is due to be eliminated in 2005 pursuant to the Agreement on Textiles and Clothing negotiated in the Uruguay Round. As shown in table 3.2, Taiwan's share of the global market in apparel is expected to fall by about three-quarters, from an initial 1.5 to 0.4 percent, while China's share is expected to increase dramatically, from an initial 18.9 to 45.9 percent. The decline in Taiwan's share of the US apparel market is even sharper, from an initial 3.8 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 gain a substantial additional share of the global market for textiles. If a US-Taiwan FTA is combined with the phase-out of MFA quotas, Taiwan's estimated increase in apparel exports appears to be entirely 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 through relatively high tariffs that typically run 16 to 17 percent, as opposed to the average US manufacturing tariff of only 2.8 percent. Under a bilateral FTA with the United

2. The Chung-Hua study estimates that global exports of textiles and apparel will increase by \$3.6 billion, which is 104 percent of the estimated increase of the \$3.4 billion in Taiwan's total exports.

States, Taiwan's apparel producers would escape this import tariff, while China, India, and most other lower-cost producers would 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. 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 such as 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 higher value-added work at home. A similar transfer now taking place in high-tech industries would likely be augmented by a mini boom in textile production. But it is not clear that Taiwanese leaders want to encourage further migration of manufacturing to China with its lower wages.³

Finally, Taiwan's gains in the textile and apparel sector could be fleeting. Further multilateral trade liberalization or the establishment of FTAs between the United States and lower-cost garment producers would undermine Taiwan's gains. So one is 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 from the increased production and export of a product in which it is not globally competitive?

Agriculture

Agriculture should yield mutual gains under a US-Taiwan FTA, especially if areas where there are tariff peaks and technical barriers 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 the sector 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

3. See Lin (1996) for an analysis of Taiwan and the "Dutch disease."

hobby-farmers, who maintain farms more to qualify for entitlements than as a primary vocation.

Major US export winners would be 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 the USITC would enjoy net trade gains (oil seeds and processed rice decline trivially); globally, seven of the 13 categories would enjoy net trade gains, while the others would decline slightly.

Taiwan's WTO accession commitments included an absolute rice import quota of 145,000 metric tons and tariffs of up to 30 percent for various types of processed rice products—this in the face of apparent annual consumption of 1.4 million metric tons (USITC 2002a, 4-2, 6-5, and 6-6). Under its accession commitments, Taiwan did not permit imports of rice and rice products outside the quota.⁴ Under a bilateral FTA with the United States, Taiwan could further liberalize its rice market beyond the modest liberalization embodied in its WTO commitments. Although this certainly would enhance the economic welfare of Taiwanese consumers, Taiwan might press to “carve out” rice from otherwise comprehensive negotiations.

For its part, the United States maintains a high degree of protection of sugar, with absolute quotas on imports. This sector, however, is unlikely to be liberalized under a bilateral FTA with Taiwan. In the 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.⁵ A similar carve-out of sugar would be sought by US sugar interests in a Taiwan negotiation.

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

4. In the fall of 2002, Taiwan notified the WTO that it was adopting a tariff rate quota system for rice, which theoretically would allow overquota rice imports. The United States, Thailand, and Australia filed an objection with the WTO to Taiwan's modification. Negotiations are ongoing.

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

would likely address them and thus facilitate US exports to Taiwan in this sector.

Motor Vehicles and Parts

Motor vehicles and parts would be the big export winner for the United States under an FTA with Taiwan, according to the GTAP models. US exports to Taiwan would rise by \$441 million, and worldwide by \$369 million, according to the USITC study. Though reflecting only 0.1 percent output growth in the sector overall, this increase is significant in the US-Taiwan FTA context. In the Chung-Hua study, US bilateral vehicle exports would increase \$1.4 billion, more than three times as much as the USITC estimate.

These hypothetical gains, however, almost certainly reflect trade diversion. The United States does not appear to enjoy a comparative advantage in producing motor vehicles for the Taiwan market. The US share of the import car market in Taiwan has been shrinking for some years. This is not due to rising Taiwanese protection of the car industry but rather to the increasing comparative advantage of Japanese and South Korean vehicle producers, which have taken market share from US producers. Japanese and South Korean producers compete not only on price, but also appear to have better anticipated the tastes of Taiwanese consumers regarding interior detailing, size, and style. Taiwanese consumers view autos imported from the United States as being of lower reputation and quality. This perception may extend even to Japanese-brand vehicles manufactured in the United States.

The increase in US vehicle exports to Taiwan forecast by the models reflects trade diversion—in other words, the US market share would rise at the expense of lower-cost cars currently imported from South Korea and Japan. The reason for diversion is that under its WTO commitments, Taiwan retains the right to provide significant ongoing protection to vehicle manufacturers based on the island. Indeed, vehicle manufacture is one of the most highly if not the most highly protected sector. For example, although Taiwan has agreed to a gradual increase in the quotas that limit auto imports, it has the right to continue to use quotas to restrict imports until 2011. Moreover, even when import duty reductions are fully phased in, auto imports will remain subject to a tariff of 17.5 percent, more than four times the average tariff for manufactured goods of 4.15 percent.⁶ Under an FTA, US exports would enjoy an exception to

6. Under its WTO commitments, Taiwan has agreed to a tariff rate quota system. Tariffs on vehicles imported within the quota are being gradually reduced from 29 percent in 2002 to 17.5 percent by 2010. Tariffs levied on imports of vehicles outside the quota are much higher: 60 percent from 2002–06 and 30 percent starting in 2007. Beginning in

both the quota restrictions and the import tariff. Thus, even if their production costs were somewhat higher, US producers would be able to undercut Japanese and Korean producers in the Taiwan market under a US-Taiwan FTA. Naturally, if Taiwan subsequently negotiated FTAs with Japan or South Korea, or joined an ASEAN+3 FTA, then the US advantage would be eliminated.⁷

The bottom line is that, as in the case of Taiwan's gains in market share in garments in the United States, forecasts of US gains in the Taiwan vehicle market come at the expense of lower-cost producers elsewhere. This trade diversion produces global welfare losses, since more real resources are used to produce cars as production shifts from a low- to a high-cost producer.

Major US car producers would hope to achieve some export gains thanks to the 26 percent tariff discount that duty-free treatment would immediately convey (2004 level in quota), yet those producers do not appear to be overly optimistic about potential FTA gains. First, US producers anticipate that US-based Japanese producers might successfully export to Taiwan, diminishing their own gains in the market for imported vehicles in Taiwan.⁸ Second, because of the Taiwanese prohibition on the import of vehicles and parts from mainland China, major US car producers find it difficult to see how Taiwan ultimately will fit into their global production and supply chains. Discussions with US auto firms suggest that despite predictions that they would be a major beneficiary of a bilateral FTA with Taiwan, they would not play a major role in supporting such an agreement.

Industrial Fasteners

Representatives of the US fastener industry have filed hearing statements strongly opposing a US-Taiwan FTA—or at least one that does not exclude

2011, import quotas for vehicles are to be eliminated, and all imports will face a uniform 17.5 percent import duty. See "Addendum 1: Summary of Agricultural and Industrial Product Commitments: Tariff Reductions and Measures for Reducing Non-Tariff Barriers," <http://ewto.trade.gov.tw/kmDoit.asp?CAT434> (accessed January 22, 2004).

7. Another possibility is that joint venture car companies in mainland China might meet Taiwan's demand for imported cars. In the short run, this is not possible for two reasons. First, Taiwan bans the import of all Chinese vehicles as part of a broader policy that covers 25 percent of all products listed in Taiwan's tariff schedule. Second, the absence of any significant export of cars from China and the pricing of vehicles within the mainland market both suggest mainland production costs are substantially above world levels.

8. Rules of origin might preclude this, as some Japanese vehicles assembled in North America have significant content imported from Japan, and these vehicles might not be eligible for preferential tariffs under a bilateral US-Taiwan FTA.

metal fasteners. The industry argues that existing duties on Taiwanese fasteners are not enough to protect US industry, so free trade in the sector would therefore be *prima facie* bad. The industry further posits that protection upstream from them in the US steel industry increases their input costs, making them less competitive—failing to note, of course, that a similar regime for fasteners would simply put the same input cost disadvantage on US manufacturing downstream from them. Most provocatively, industry representatives suggest that for the fastener industry, free trade with Taiwan would *de facto* mean free trade with mainland China. The validity of this claim, of course, depends entirely on the rules of origin, which would be a key part of a US-Taiwan FTA. Responding to this US hearing filing, the Taiwan Industrial Fasteners Institute stated 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).

Services

As noted in chapter 2, most GTAP-based FTA forecasts do not model the effects of liberalization of trade in services. Yet under an FTA with Taiwan, services industries ought to provide the US private sector with some of its best opportunities. Fortunately, the Chung-Hua study includes a second scenario that models a one-quarter reduction in barriers to trade in services, which are disaggregated in the study into six subsectors: public utilities, construction and engineering, trade, transportation and communication, commercial and financial, and other.

Under the Chung-Hua study’s second scenario, total welfare gains to the United States are \$1.5 billion—about 40 percent larger than the \$1.1 billion in the baseline scenario. The output of services in the United States expands by \$2 billion versus \$1.5 billion in the baseline scenario, with the largest share and proportionately largest output gains in commercial and financial services. The largest absolute increase in US services exports would be in transportation and communications services. Financial and telecommunications services are reviewed separately below because the model suggests potential significant gains, and these subsectors appear to be areas of US comparative advantage.

In the negotiations leading to its entry into the WTO, Taiwan made substantial commitments to open its services industries. US interests applauded that liberalization. Rather than worrying about negotiating new arrangements under an FTA, most US services industries now are more concerned about Taiwan’s implementation of its existing WTO commitments.

Financial and Insurance Sectors

The US financial and insurance services industry has 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 Office of the US Trade Representative (USTR 2003a, 362) reports that Taiwan has reformed its financial sector significantly in recent years, in some respects more quickly than required. Most remaining issues have to do with financial and regulatory 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 made considerable progress on market access for insurance in its 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 also 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 telecommunications commitments with the WTO have been fully implemented, and both the US telecommunications industry and the USTR office have identified barriers to market access. These are largely problems of regulations and competition policy. The American Chamber of Commerce (2003) in Taipei points to foreign ownership caps, dominant carrier regulations, and the independence of the regulator as priority issues. For basic telecom services, Taiwan imposes a 60 percent direct plus indirect ownership cap for foreign firms and also requires that the chairperson of such businesses be a Taiwanese citizen. A requirement that half the board of directors and supervisors be Taiwanese has been dropped.

Because the USITC study on a US-Taiwan FTA 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) if those barriers were to be dismantled. The US-Singapore FTA, which addresses interconnection, resale of services, regulatory procedures, and nondis-

crimutory access to the market, would probably provide a benchmark on procompetitive telecom policy for talks with Taiwan.

Crosscutting Issues

Intellectual Property Rights

The USTR has long identified the treatment of intellectual property rights in Taiwan as a “serious and contentious issue” for the United States. Its *2003 National Trade Estimate Report* called attention to facilities that infringe on intellectual property rights as well as pharmaceutical counterfeiting, trade-dress (the distinctive packaging and representation of a product) infringements, and inadequate judicial and bureaucratic processes for redress of intellectual property rights problems. The report also cited an International Intellectual Property Alliance (IIPA) estimate that weak Taiwanese intellectual property rights regimes cost US businesses more than \$750 million in 2002, mostly in entertainment software (USTR 2003a, 361). That sum is not only the largest loss claimed by IIPA save that for China, but also almost four times greater than the US welfare gains (\$200 million) from a potential US-Taiwan FTA estimated by the USITC study.⁹

More recently Taiwan has made significant progress toward improving protection of intellectual property. IIPA’s (2004, 1) estimate of US trade losses due to copyright piracy in Taiwan fell by two-fifths in 2003, presumably reflecting tougher enforcement measures by the Taiwanese authorities. Estimated losses of US firms of \$453 million were far surpassed not only by China but also by Brazil and Russia. Taiwan remained, however, as one of only 15 economies on the USTR’s Special 301 Priority Watch List in 2004. However, amendments to the Copyright Act passed by Taiwan’s legislature in August 2004 and stepped-up enforcement of intellectual property laws generally make it possible that the USTR will conduct a special mid-term review of Taiwan’s protection of intellectual property. A review could lead to the removal of Taiwan from the Special 301 Priority Watch List.

If the USTR does institute FTA talks with Taiwan, it will almost certainly seek more than just the full resolution of existing IPR issues. At a minimum, USTR would seek IPR provisions comparable to those in the US bilateral FTA with Singapore. These provisions, especially in the areas of trademarks, copyrights, patents, and trade secrets, go beyond existing WTO standards. The priority for a potential FTA with Taiwan would be enhanced if there were the prospect of achieving even higher stan-

9. This is of course only illustrative—revenue and welfare are not comparable.

dards in the protection of intellectual property than were achieved in the Singapore agreement.

Rules of Origin

The rules of origin in any US-Taiwan FTA will be closely scrutinized, particularly by those with interests such as those of the fasteners industry, which has already charged that free trade with Taiwan is de facto free trade with China. This argument, of course, lacks merit even if Taiwan were to drop its ban on the import of fasteners from the mainland.

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. Under the US-Singapore agreement, for example, the rules of origin are laid out in a 13-page chapter and supplemented in an annex that runs 284 pages (USTR 2003b). The USTR office believes that these “strong but simple rules of origin will insure that only U.S. and Singaporean goods benefit from the Agreement” (USTR 2003c).