

# CRS Report for Congress

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## Taiwan and the World Trade Organization

Wayne M. Morrison  
Specialist in International Trade and Finance  
Foreign Affairs, Defense, and Trade Division

### Summary

After several years of negotiations, Taiwan joined the World Trade Organization (WTO) on January 1, 2002. Taiwan's WTO membership will likely 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), legislation (S. 1636) has been introduced in Congress to authorize the President negotiate a free trade agreement with Taiwan. This report will be updated as events warrant.

### Taiwan's WTO Application

Taiwan is a major economic and trade power and a significant U.S. trading partner. Taiwan's 2001 GDP was \$280 billion, and its total trade (exports plus imports) was \$230.2 billion. Total U.S.-Taiwan trade in 2001 was \$51.5 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 2001 were \$18.1 billion (making Taiwan the 10<sup>th</sup> largest U.S. export market), while U.S. imports from Taiwan were \$33.4 billion (the 8<sup>th</sup> largest source for U.S. imports).<sup>1</sup>

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.<sup>2</sup> 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

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<sup>1</sup> Total U.S.-Taiwan trade was 25.7% lower than 2000 levels, due in part to economic slowdowns in both Taiwan and the United States. U.S. data for January-July 2002 indicate U.S. trade with Taiwan is down by 6.7% over the comparable period in 2001.

<sup>2</sup> The GATT was created in 1947 and has provided the legal framework for international trade and the forum for successive rounds of multilateral negotiations to reduce trade barriers. The GATT was incorporated into the World Trade Organization (WTO) in 1995.

and Matsu,” or “Chinese Taipei” (a designation similar to that of Hong Kong and Macau, both of which 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>3</sup>

The Taiwanese government made accession to the WTO a top priority and took a number of steps in recent years to remove a wide variety of tariff and non-tariff barriers to prepare for WTO membership. 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. Taiwan and the United States reached a bilateral WTO agreement in February 1998 that would provide immediate market access and phased-in commitments for U.S. priority exports of goods, services, and agricultural products to Taiwan.<sup>4</sup>

## **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.

The Bush Administration indicated its strong support for Taiwan’s WTO accession. In testimony before the House Ways & Means Committee on China’s normal trade relations (NTR) status in July 2001, Assistant USTR Jeffrey A. Bader stated:

We fully expect the WTO to approve Taiwan’s accession in the same time frame as China’s. As a major player in international trade and a new and thriving democracy, Taiwan deserves membership and a larger role in the international community. We

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<sup>3</sup> This informal agreement appears to have been taken due to political concerns over offending China, which views Taiwan as part of China.

<sup>4</sup> As a “down payment” for eventual WTO membership, Taiwan agreed to lower many tariffs, and remove various non-tariff barriers, on a number of industrial goods, agricultural products, and services prior to its entry into the WTO. According to the USTR, many of these reductions were made according to government administrative orders and must be renewed annually until Taiwan enacts permanent reductions upon joining the WTO.

have discussed our expectations on Taiwan's accession thoroughly with all the concerned parties and are confident there is a consensus on this.

## 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. 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.

## 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 and services:

- ! **Tariffs.** Simple average tariffs on agricultural products will drop from their pre-WTO level of 20% to 14% in 2002, and to 12.9% when tariff cuts are fully implemented. Similarly, simple average tariffs on industrial goods will drop from 6.0% to 5.8% (in 2002) and eventually fall to 4.2%.<sup>5</sup> 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 will 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; remove a 50% local content requirement for auto parts, and make regulatory changes that will allow foreign companies to both lease vehicles and operate used car businesses.
- ! **Government Procurement.** Taiwan agreed to join the WTO Government Procurement Agreement, which will open its procurement markets to a wide range of U.S. products, including power-generating, transport and power transmission services. Taiwan will implement a new, more fair and transparent, contract and dispute resolution system regarding government contracts.

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<sup>5</sup> Tariff reductions cover 3,470 industrial products and 1,021 agricultural products.

- ! **Services.** Upon WTO accession, Taiwan will 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 pork, poultry, and variety meats and to make additional liberalization of such products after WTO accession. Taiwan also committed to begin the process of opening its rice market and to open fully markets for pork, variety meats and poultry to all WTO members upon accession by phasing out its tariff rate quota system. The agreement also called for significant immediate tariff reductions on a broad range of U.S. agricultural products, including potato products, pears, grapes, grapefruit, sunflower oil, and soup.<sup>6</sup>

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>7</sup> The United States is Taiwan's second largest source of imports (after Japan), accounting for 17.2% of Taiwan's imports (2001), and thus U.S. exporters will likely be a major beneficiary of Taiwan's WTO accession.<sup>8</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 11 years. From 1991

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<sup>6</sup> USTR Press Release, February 20, 1998.

<sup>7</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>8</sup> The U.S. Department of Agriculture predicts that Taiwan's WTO accession could boost U.S. agricultural exports there by an additional \$500 million per year.

to 2001, total bilateral trade rose from \$8.1 billion to \$30.0 billion.<sup>9</sup> The cumulative value of Taiwanese investment in the mainland at the end of 2001 was \$29.2 billion (making Taiwan the 4<sup>th</sup> largest foreign investor in China). Taiwan has shifted many of its labor-intensive, export oriented, industries to the mainland. Most trade between China and 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 (\$24.1 billion in 2001), it is a relatively small source of its imports (\$5.9 billion), mainly because Taiwan places significant restrictions on imports from China (especially products that might compete directly with Taiwanese-made goods).<sup>10</sup> Taiwan also maintains restrictions on the amount and types of investment that are allowed to be made in China (although many investors seek to circumvent these restrictions by investing through off-shore companies).

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. 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.

Both Chinese and Taiwanese government officials appear to have mixed views on closer economic integration. Each seems to think that closer economic ties gives them greater political leverage over the other to influence the relationship (e.g., Taiwan hopes such ties help to stabilize the relationship with the mainland and reduce the likelihood of a Chinese invasion, while China hopes such ties improve the chances for reunification with Taiwan and diminish the likelihood of Taiwan declaring independence). At the same time, however, each side seems concerned with becoming too dependent on cross-strait economic ties, since a disruption in that relationship could have serious economic consequences for both.

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.<sup>11</sup> However, economic conditions have deteriorated sharply in Taiwan during 2001. Due largely to the economic slowdown in the United States and other major world economies, Taiwanese exports (especially high-technology products) have declined sharply. In 2001, unemployment hit record levels (5.3% in November), and the economy fell into recession (real GDP declined by 2.1%).<sup>12</sup>

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<sup>9</sup> All Taiwanese and Chinese trade data for 2001 cited in this report are estimated, based on actual data for January-November 2001.

<sup>10</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 19.6% in 2001. Taiwanese data for January-June 2002 indicate that this share has risen to 23.8%, making China the most important export market for Taiwan during this period.

<sup>11</sup> The policy has been aimed at restricting investment of over \$50 million as well as certain high-tech industries and infrastructure projects.

<sup>12</sup> Taiwan's economy has showed improvement in 2002, due largely to a pick up in Taiwanese (continued...)

Taiwan's growing economic crisis has 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 communication 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.<sup>13</sup> Some supporters of normalized trade relations with the mainland have called on the Taiwanese government to negotiate a free trade agreement with China. 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. Chinese officials have indicated support for direct trade links with Taiwan, but have 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.

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. In November 2001, Senator Max Baucus introduced S. 1636 (the United States-Taiwan Free Trade Agreement Act of 2001), a bill that would give the President fast track authority (i.e., without amendment and limited debate time to consider the measure in Congress) to negotiate a free trade agreement (FTA) with Taiwan. The proposed FTA would seek to achieve lower Taiwanese trade barriers on U.S. exports of goods and services and thereby boost U.S.-Taiwanese economic ties.

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<sup>12</sup> (...continued)

exports (especially to China), but unemployment remains relatively high (the unemployment rate was 5.35% in August 2002).

<sup>13</sup> They note 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.