



CENTER ON DEMOCRACY, DEVELOPMENT, AND THE RULE OF LAW

# **THE TRANS-PACIFIC PARTNERSHIP AND TAIWAN'S FUTURE DEVELOPMENT STRATEGY**

## **FULL CONFERENCE REPORT**

October 11-12, 2013

Taiwan Democracy Program

Center on Democracy, Development, and the Rule of Law

Freeman Spogli Institute

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## Introduction

On Oct. 11-12, 2013, the Taiwan Democracy Project convened a conference on “The Trans-Pacific Partnership and Taiwan’s Future Development Strategy” at Stanford. The meeting was sponsored by the Center on Democracy, Development, and the Rule of Law (CDDRL) and the Shorenstein Asia-Pacific Research Center (APARC) at Stanford University, and supported with generous funding from the Taipei Economic and Cultural Office in San Francisco.

The conference brought together an impressive collection of academics, government officials, and policy-makers from Taiwan, the U.S., and many other countries in the Asia-Pacific region for a frank, wide-ranging set of discussions of the Trans-Pacific Partnership and its potential impact on Taiwan. The discussions covered six distinct areas:

1. How is the trading environment of the Asia-Pacific region changing, and how is Taiwan’s place in that environment likely to be affected?
2. What is the Trans-Pacific Partnership, what were the motivations behind its creation, and if it is successfully concluded, what is its prospective role in re-organizing trade patterns in the region?
3. How do trade issues play out in Taiwan’s domestic politics? That is, who are the domestic constituencies most and least likely to support freer trade in the region, and what are their potential avenues of influence on Taiwan’s trade policy?
4. What are the likely impacts of changes in the external trading environment on Taiwan’s economic development, considering that the island’s economy is both highly trade-dependent and increasingly tied to that of the People’s Republic of China?
5. Where is the TPP headed? That is, what are the prospects for a successful conclusion of the TPP negotiations, what are the potential domestic obstacles to ratification of the

- agreement in various partner countries, and how is the TPP likely to affect trade among its members if and when it comes into effect?
6. Finally, from the perspective of the current participants in the TPP negotiations, what does Taiwan need to do to join the next round?

The following is a report of the discussion of each of these questions, covering areas of substantive agreement, uncertainties, and disagreement, as well as the overall consensus of participants.

### **The Evolution of The Economic and Trading Environment of East Asia**

*Vinod Aggarwal*

The first presentation of the conference was given by Dr. Vinod Aggarwal, Professor of Political Science and Director of the APEC Study Center at UC Berkeley. He provided an overview of the history of regional economic partnerships in the Asia-Pacific.

Dr. Aggarwal began by reviewing some basic facts about trade in the region. By several measures, regional trade in Asia has expanded rapidly over the last three decades. From 1980 to 2010, Asia's proportion of world trade increased from 15 to 30 percent. Intra-regional trade rose from 30 percent of all trade by countries in the region in 1980 to 48 percent in 1997, dropping down to 35 percent in recent years as China's exports to the US and the EU have soared. Trade with the US as a share of total trade in the region remained at about 20 percent from 1980 to 2000, but has fallen in relative terms to 11 percent in 2010. The emergence of China as the center of regional production networks is arguably the most important part of these shifts; China's share in intra-Asian trade has grown from 18 percent in 1980 to 47 percent in 2010. The US remains important as a final destination of exports from the region, but intermediate production and assembly now occurs in China for many products.

For much of the post-war period, Asian trade has been, in Aggarwal's words, "under-institutionalized," with informal networks of Japanese and U.S. multinational firms and ethnic Chinese businesses playing the central role in fostering intra-regional trade. But since the early 1990s, there has been an explosion of institutions and forums that, wholly or in part, address trade issues in the Asia-Pacific region. In addition to the World Trade Organization, Aggarwal includes the following:

- The ASEAN Free Trade Agreement
- ASEAN plus 3 (Japan, China, and South Korea)
- The Regional Comprehensive Economic Partnership (RCEP), which consists of ASEAN members plus Japan, China, South Korea, India, Australia, and New Zealand;
- The Shanghai Cooperation (SCO), which includes China, Kazakhstan, Kyrgyzstan, Russia, Tajikistan, and Uzbekistan;
- The Asia-Pacific Economic Cooperation (APEC)
- The South Asian Association for Regional Cooperation (SAARC)
- The Trans-Pacific Partnership (TPP), which now includes 12 countries: New Zealand, Chile, Brunei, Singapore, the United States, Canada, Mexico, Australia, Malaysia, Peru, Vietnam, and Japan.

The lack of agreement in the latest WTO negotiations, the Doha Round, has also spurred many countries in the region to pursue bilateral trade accords, both with other Asia-Pacific countries and with those elsewhere. The resulting set of agreements has raised concerns about an increasingly complex "noodle bowl" of trade rules and regulations: since each accord is unique, firms have to adjust to a different set of rules for each bilateral trading relationship. In short, Aggarwal suggests, the Asia-Pacific region now has a problem of "over-institutionalization" of

inter-state trade: there are many agreements with overlapping membership and different requirements.

The objective of both the TPP and the RCEP, the two most prominent sets of ongoing negotiations, has been to reduce the complexity of these intra-regional trading rules. But they diverge significantly in both their ambitions and their potential membership. RCEP is about “harmonizing around the edges” of intra-regional trade—that is, seeking to standardize the rules and regulations specified in the many bilateral agreements in the region. The TPP, by contrast, is a much more ambitious attempt to adopt a fundamentally new, “high-quality” agreement, one that standardizes domestic regulation of wide swaths of each member’s economy. In a sense, then, the TPP and RCEP as currently constituted are “competing alternatives.” This impression of competition is reinforced by the different membership of both groups: China is conspicuously absent from the TPP negotiations, while the US is not part of RCEP, although both countries have informally discussed joining both accords. Nevertheless, in Aggarwal’s view it is possible they could eventually develop into complementary agreements, with the RCEP serving as the first, easier stage, and membership in the TPP requiring a second, more comprehensive and rigorous stage of trade liberalization.

*Tain-jy Chen*

Dr. Aggarwal was followed by Professor Tain-jy Chen, Professor of Economics at National Taiwan University and president of the Chung-Hua Institute for Economic Research. Dr. Chen’s presentation addressed the potential effects of changing regional trading patterns for Taiwan. He began by cautioning against assuming that China could be excluded from any meaningful regional trade agreement. In Dr. Chen’s words, “forgetting China is unrealistic.” He also highlighted the growing economic clout of the ASEAN countries, forecasting that ASEAN would be the greatest source of growth in the world over the decade.

China has been central to the growth in intra-regional trade in East and Southeast Asia over the last 10 years. Two major events have fueled that growth. First, in 2001, China joined the WTO, which led to a boom in FDI in China, as well as rising imports and exports. Second, China began negotiations to join the ASEAN free-trade area in 2002; these negotiations concluded in a preferential trade agreement in 2010 with the six original members of ASEAN, and by 2015 the agreement will expand to include the other four (Vietnam, Laos, Cambodia, and Myanmar). The average tariff on Chinese products across sectors among the six original members was cut from 12.8 percent to 0.6 percent as a result of the FTA. As a consequence, China's manufacturing supply chains have become increasingly integrated with ASEAN countries, and it has exported an increasing volume of goods, both intermediate and final, to ASEAN, increasing 8.2 times from 2001 to 2012. China has now replaced Japan as the largest source of imports to ASEAN countries. Notably, intra-ASEAN trade has actually *declined* as a share of total ASEAN imports, from 24.6 percent in 2006 to 22.8 percent in 2012, at the same time that China-ASEAN trade has been increasing rapidly.

The reason for these trends, Dr. Chen argued, is that the China-ASEAN linkage through the free trade agreement has helped transform ASEAN industrial production, leading to greater integration and specialization. Before China's rapid economic expansion, the production network of East Asia was structured in a "flying geese pattern," with Japan at the head supplying the capital and technologies, Taiwan and Korea in the second rank, and ASEAN in the third. The most sophisticated materials and components were made in Japan, while the less sophisticated ones were made in Taiwan and Korea, and ASEAN countries were limited to assembly of pre-made parts. China's rise has disrupted this pattern. Because of China's size and its openness to foreign direct investment, all kinds of materials and components became available in China. Both multi-national corporations and indigenous Chinese companies engaged in similar production in China, and these products flooded the ASEAN markets.

This increase in low-cost Chinese-made materials and components has in fact transformed ASEAN production, enabling local firms to compete more effectively with multinational corporations (MNCs). Previously, MNCs operated production behind tariff barriers in each country to produce import-substituting goods, using materials sourced from their parent companies, and MNC industrial production was relatively expensive and unconnected to local industries. But the increase in competition from Chinese-made products spurred MNCs to revamp their supply chains and reorganize production in ASEAN countries. ASEAN has become a substitute for China as rising Chinese wages have driven labor-intensive industries to look to relocate. As a result, foreign direct investment in ASEAN has risen rapidly over the last decade, increasing 3.5 times compared to China's 3.0 times.

Thus, China now operates as a “mid-way house” for ASEAN industrial production. No ASEAN country has a market large enough to support mega-scale specialized production, but with the growing links to China, ASEAN has developed industrial production clusters that are integrated across national borders—for example, there are now many mega-projects in ASEAN countries in the petrochemical and steel industries that would not be viable without links to China. With its high savings ratios and tendency to over-invest, China is now a natural complement to the economies of Southeast Asia, which in general have a higher appetite for consumption. The links between ASEAN and the Chinese economy offer at least in part a solution to the so-called “global imbalance problem” of excess savings. This more specialized production structure also makes further liberalization of trade more likely in ASEAN.

Taiwan has largely been on the sidelines of these developments, according to Dr. Chen. Taiwanese firms were major investors in ASEAN countries between the mid-1980s and 1990s, but since then, most Taiwanese FDI has been concentrated in China. With only a few exceptions, the Chinese operations of most Taiwanese firms are completely separate from their ASEAN operations, and many companies abandoned their presence in SE Asia completely after establishing production in China. In recent years, many firms have attempted to reestablish a

presence in ASEAN markets, but they have generally struggled to break in. Moreover, the China-ASEAN FTA has also put Taiwanese firms at a disadvantage. Thus, Taiwan is effectively an “outsider” in ASEAN markets now.

Dr. Chen described three strategies that Taiwanese firms might pursue to expand into ASEAN markets. The first is to attempt to establish and build value in Taiwanese brands themselves. This process has proved difficult for most firms. Sustaining a brand appears to be more difficult than establishing one—it requires pooling together regional resources in technology development, production, marketing, and services. And Taiwanese firms are generally weak in marketing and services. Second, Taiwanese firms can be integrated into local production chains. But in order to secure those kinds of partnerships with local firms, Taiwanese companies have to provide resources that are lacking in local industries. In Chen’s view, these are most likely to be technology-related. The third strategy is for Taiwanese firms to become a sub-system of multi-national production chains. American, Japanese, and European MNCs want into the ASEAN markets, and Taiwanese firms might be able to offer the ability to integrate the regional supply chains to serve MNCs. Taiwanese firms might have an advantage in this area because of a shorter geographical distance and greater cultural ties and understanding.

Finally, Dr. Chen discussed the challenge that regional free trade agreements pose for Taiwanese firms operating in Asia. Bilateral trade agreements of the kind that have proliferated in the region in recent years have been barriers to Taiwanese firms’ access to local markets in the region, but they have not done much damage to offshore-sourcing operations because most countries provide duty-reimbursement privileges to these operations. However, with multi-country FTAs, even these operations will be affected. In most multi-lateral FTAs, the regional value of content (RVC) is the most commonly applied standard for rules of origin tariffs. In order to clear this value-of-content hurdle, non-member countries are likely to be excluded from future value chains. This is the greatest threat to Taiwanese firms from a regional FTA that excludes Taiwan.



In summary, in Dr. Chen's view, Taiwan faces a "double challenge." First, the export-oriented business model that sustained decades of economic growth there needs to be transformed. And second, Taiwan's ambiguous political status is a potentially formidable obstacle to its participation in regional trading institutions.

*Comments by Miles Kahler and Hung-mao Tien*

Formal comments were provided on the Aggarwal presentation by Miles Kahler, and on the Chen presentation by Hung-mao Tien.

Dr. Kahler emphasized three main points in his comments. The first was that not all of the regional trading agreements are created equal. Many of those listed by Aggarwal do not actually reflect much additional institutionalization, because they are in effect "talking shops." The second was to reiterate how central China's economic growth has been to the drive for greater institutionalization of regional trading arrangements. The number of real, meaningful trade agreements—not "talking shops"—has risen rapidly since 2000, while in the rest of the world most of the action occurred during the 1990s. The later movement in East Asia, Kahler argued, was because of the China factor. The third was that the institutional design of multi-lateral trading arrangements is likely to be driven mostly by the most dominant state in the group. Thus, to understand the arrangements the TPP is likely to adopt, one needs to understand the relative power and the interests of each major state in the negotiations. The United States, in Kahler's view, is likely to push for a "WTO-plus" style arrangement, with precise, binding agreements, while Japan is going to seek to protect services and investment. China, conversely, is wary of any agreements that move beyond trade and investment to tackle other issues, such as regulatory policy. From this perspective, ASEAN is an interesting case: the four members who have joined the TPP negotiations—Malaysia, Brunei, Vietnam, and Singapore—have in effect indicated their willingness to accept US preferences about institutional design. But several

powerful ASEAN members, notably Thailand and Indonesia, are currently outside the TPP, so ASEAN will be split by the agreement. Thus, rather than the emergence of two competing regional blocs, the TPP and RCEP are likely to feature overlapping membership, with very different implications for how trade relations in the region evolve.

Dr. Tien began his comments by making several points about factors that might influence regional economic integration and Taiwan's place in it. First, Taiwanese businesses, he noted, may have a strong cultural advantage through their ability to connect with ethnic Chinese networks throughout Southeast Asia. There are also other factors driving the relocation of production to Southeast Asia and China, among them the expansion of transportation networks in China and elsewhere in Asia, which make it easier to maintain complex regional supply chains. Dr. Tien also raised the concern that referring to ASEAN as a whole obscured important variation among countries, with production concentrated in only a couple of them. There was also a question of whether Japanese and Chinese products are in direct competition with one another in the region, or whether instead they are sufficiently differentiated as to meet different consumer demands. Finally, Dr. Tien noted the flexibility of Taiwanese firms in using an off-shoring strategy: even though Taiwan has no FTA with ASEAN as a whole, Taiwanese investment and products can still enter ASEAN via China or Singapore.

Dr. Tien then elaborated on several points. First, he noted that Dr. Chen had focused almost entirely on manufacturing challenges, and not on finance or the services industry more broadly. Yet services are critical to Taiwan's economy, responsible for 70 percent of Taiwan's GDP and 58 percent of its workers. Despite these figures, the services industries have contributed only 45 percent of GDP growth in recent years, while manufacturing has contributed 55 percent of growth with only 30 percent of GDP. Thus, any talk of domestic reform or the benefits of new free trade agreements needs to consider the impact these will have on services as well as manufacturing. Second, Dr. Tien noted that Chinese policy-makers are now interested in the TPP as a potential opportunity for China, which bodes well for Taiwan's eventual

participation as well. For instance, on a recent trip to Zhejiang, Dr. Tien noted that the TPP came up in conversations with Chinese officials, and that a lot of Chinese experts are now writing policy papers and articles on this topic. Third, he suggested that a deeper problem for the Taiwanese economy is the steady outflow of foreign direct investment over the last decade, which has accelerated in recent years despite the Ma administration's rapport with the PRC. In short, the improvements in cross-Strait relations have not led to new FDI in Taiwan—an outcome that suggests a pessimistic view of Taiwan's development outlook.

### *Discussion*

The conversation then moved to an open discussion among panel members, other conference participants, and audience members. There was a general consensus among participants on a couple of points.

First, despite the focus of the conference on formal free trade agreements—the TPP, RCEP, and various other bilateral and multi-lateral arrangements—these are only one part of the changing trading environment of the region. Equally as important have been infrastructure improvements led by China, including the construction of road and rail links through the countries of peninsular southeast Asia. The investment decisions of MNCs in the region are also clearly affected by a number of other factors besides tariffs and trade regulations—labor costs and availability of production materials, for instance. Thus, the gains and losses accruing to the Taiwanese economy as the result of changing trade regulations are going to be on the margins in the short run, if they are at all meaningful. It is only in the medium to long term that a new trading regime could have a significant impact on Taiwan.

Second, several participants reiterated that Taiwan's domestic investment environment was not favorable for attracting FDI—a fact borne out by the large net outflow of investment in recent years. The ECFA with China was expected to improve this trend, but it has had a surprisingly small impact. Participants noted several possible explanations. The primary one is

that the Taiwanese market is too small to attract much interest from Chinese firms; the investment that has come in as a result of ECFA has been motivated by political as much as economic interests. Another explanation is that there are still stringent restrictions in Taiwan on the ability of foreign investors to withdraw funds once they have been committed.

Participants also debated but did not reach a consensus on a couple other issues. First was whether the RCEP and TPP could potentially evolve into two separate stages of a grand free trade agreement for the entire Asia Pacific region (FTAAP). Many participants liked this idea and thought the two were natural complements: less developed or less open countries that find it impossible to meet the stringent conditions of the TPP could instead join the RCEP as a “first stage” or “antechamber,” and enjoy many benefits from trade liberalization despite being at a very different stage of development. There was less certainty about whether this was actually likely to occur, however, or what it might mean for Taiwan. One concern is that RCEP is an ASEAN-centered trading arrangement: countries must already have an FTA with ASEAN as a whole in order to be eligible to join. Thus, Taiwan would have to overcome this hurdle somehow in order to participate in RCEP.

A related question was about China’s position on the TPP. China has been suspicious of the motivations behind the TPP until recently, viewing it as a potential vehicle to contain and isolate China in the region. Seen in this light, Taiwan’s participation in the TPP could become a politically sensitive issue in U.S.-China relations and lead to a delay in or rejection of accession. Moreover, there was a general consensus among participants that China would have no realistic chance of gaining TPP membership in the near term, even if it sought it. The TPP includes requirements about opening up government procurement contracts to foreign bidders, and places restrictions on the kind of forceful industrial policy that is common among local governments in China. However, a couple participants noted that Chinese attitudes seem to have shifted in recent months. The addition of Japan, in particular, has made clearer to Chinese policy-makers that the TPP will not be an American-dominated initiative. Some Chinese have expressed an interest in

using the TPP as a means to advance difficult domestic reforms. If this view does become the predominant one among policy-makers, then Taiwan's addition to TPP negotiations is less likely to be opposed by China.

### **The Evolving Structure and Geopolitics of the Trans-Pacific Partnership**

The second panel of the conference focused on the Trans-Pacific Partnership itself, covering the motivations for the TPP, its evolving structure, and the geopolitical considerations shaping its future.

#### *Don Emmerson*

Don Emmerson, a senior fellow at Stanford's Shorenstein Asia-Pacific Research Center (APARC), gave the first presentation. He began by noting that President Ma Ying-jeou had already referred to both the TPP and RECP as agreements that he would like Taiwan to join, which Ma did in comments delivered via videoconference at Stanford in April. Should President Ma commit Taiwan to seeking membership in both organizations, Dr. Emmerson asked, would there be any external barriers to that objective? To answer that question—that is, to understand the prospects for Taiwan's membership in either body—one must first examine the positions of both the United States and the People's Republic of China. Unless the PRC approves of Taiwan's membership, Taiwan is unlikely to win entry—both in RCEP, of which the PRC is a member, but also potentially in the TPP, for which the United States might be reluctant to anger China by pushing forcefully for Taiwan's admission.

On the United States side of the equation, Dr. Emmerson identified a couple major hurdles for Taiwan's membership in the TPP. First is the concern that the new Secretary of State John Kerry does not have the commitment to Asia that his predecessor Hillary Clinton did. The

U.S. “pivot” toward Asia was a real shift in policy, in Dr. Emmerson’s view, and it was appropriate to call it a pivot—with the added caution that a pivot can swing both ways! Under Secretary Clinton, the U.S. commitment to building stronger ties with its Asian allies was consistently demonstrated; for instance, she visited all 10 ASEAN member states (plus East Timor) during Obama’s first term, and she was the first U.S. secretary of state ever to appear at ASEAN’s annual meeting. Kerry’s chief priority, by contrast, is the Middle East, and his focus on issues there is likely to pull attention and resources from the administration’s diplomatic initiatives in the Asia-Pacific region. Obama’s absence from the latest APEC meeting, ostensibly due to the government shutdown in Washington, D.C., reinforced the impression of a U.S. administration whose attention is once again diverted by distractions elsewhere, and was thus a particularly damaging signal to the region.

Second, it is not clear what the United States’ position is on inviting China to join the TPP, or how it would handle Chinese objections to a Taiwanese application for membership. In Dr. Emmerson’s words, “from an American perspective, there is no such thing as an American perspective” on the TPP. One major point of tension is the differing concerns of the U.S. State Department, which as a government agency is “all about policy,” and the U.S. Trade Representative office, which is “all about economics.” The United States’ position on admitting either Taiwan or, more controversially, China to the TPP negotiations would depend in part on how this potential intra-government battle plays out, with consequences for Taiwan that are all-but-impossible to foresee.

Finally, even if the Obama administration is able to reinvigorate its diplomatic initiatives in Asia and wholeheartedly support the TPP, it is easy to imagine the TPP failing to pass the United States Congress, given the partisan animosity there toward the Obama administration. Thus, Taiwan’s interest in joining the TPP may be moot if the initial trade agreement does not even win approval in the United States.

On the Chinese side of the equation, there is similar ambiguity about the ultimate approach the PRC will take toward the TPP. It is not clear if China would be interested in joining the TPP itself, if it would tolerate Taiwan's separate membership in the TPP, or if it would actively oppose the whole arrangement as a direct competitor to the RCEP. China's official position, according to a scholar at CASS that Dr. Emmerson spoke with, is in essence:

“China has not been invited to join the TPP negotiations, and the negotiations are being conducted in secrecy. Because China does not know what the text of the agreement is, China cannot decide whether or not to join.”

It is even possible that Chinese leaders might see the TPP as a valuable opportunity to “lock in” a commitment to difficult domestic reforms, in much the same way that Zhu Rongji in the 1990s advocated membership in the WTO as a way to advance his own reform agenda. Thus, it is difficult to anticipate what position China will ultimately take on the TPP agreement.

Dr. Emmerson also laid out a conceptual distinction useful for understanding the differences between the TPP and RCEP. Trade arrangements, he argued, can helpfully be classified as varying along a spectrum between two extremes: “sovereigntist” and “interventionist.” The first intrudes minimally on the sovereignty of participating countries, tends to affect goods much more than services, and focuses on tariff rather than non-tariff trade barriers. RCEP is a sovereigntist trade agreement, reflecting the “ASEAN way” of mutual non-interference in member countries' internal affairs. The second intervenes more in domestic regulation and has active, legally binding enforcement mechanisms. The TPP is toward this end of the spectrum, and illustrates the Euro-American approach to trade liberalization. A key difference between the two is that “interventionist” arrangements require domestic economic reform, some quite substantial, while the “sovereigntist” arrangements generally require little fundamental change in the domestic economy.

Dr. Emmerson noted that there is, at least in theory, a key precondition for a country to join RCEP: it must have a free trade agreement with ASEAN. In that sense, RCEP can be thought of as “ASEAN-plus.” In his words, the model is that “you build a roof on the room, and you don’t alter the room”—in other words, a sovereigntist arrangement. RCEP enables the participation of any ASEAN FTA partner that did not participate in the original negotiations and is willing to join after the negotiations are concluded.

Dr. Emmerson summed up his remarks by emphasizing that trade relations in the region are in a “fast-moving, liquid situation,” and arguing that all sides should seek to avoid creating two ideologically and geographically opposed blocs of countries in mutually exclusive trade agreements.

#### *Bai Gao*

Bai Gao, Professor of Sociology at Duke University, gave a presentation on China’s potential responses to the TPP. He began by describing what he termed “two imaginations” of the TPP in China, reflecting two views of how to interpret the TPP initiative in the context of U.S.-China relations. The first is that the TPP represents a “securitization of trade policy”—that is, the use of economic means to achieve political ends. In this view, the TPP is part of a U.S. grand strategy to build an “anybody-but-China club” intended to counter-balance China’s influence in the region, in a manner similar to the Cold War blocs led by the United States and the Soviet Union. The second is that the TPP represents a “multilateralization of regionalism.” That is, the TPP is a sincere attempt to build a high-quality free trade agreement whose major objective is the promotion of U.S. economic interests in the 21<sup>st</sup> century, especially exports of U.S. goods and services. In this view, the TPP is most likely to be used as a vehicle to pressure China to open up its services industry, tighten its intellectual property rights protection, and reform its SOEs, rather than as part of a regional security framework.



The key signal of US intentions vis-à-vis the TPP is how insistent it is on a comprehensive, high-quality agreement for all members. If the United States is willing to lower the requirements for some countries to win their accession to the TPP—for instance, allowing continued protection in Japan’s agricultural and health care sectors, or not demanding reform of Vietnam’s state-owned enterprises—then that provides support for the securitization view of the TPP. If, on the other hand, the TPP is successfully adopted and turns out to be a “high-quality next-generation free trade agreement” with consistent standards for all members, then that provides support for the multilateralization view.

In Dr. Gao’s view, the U.S. “pivot” toward Asia has increased the perceived strategic pressure on China. In addition to the threats from India, Russia, Japan, and the claimants in the South China Sea, China also now has to be concerned about a possible U.S. attempt to build an exclusive club of American allies to “contain” China. If it is successful, the TPP may “change the rules of the game profoundly” in the Asia Pacific region, shifting production and trade away from China and toward TPP members. This concern has sparked what Gao terms a “dogfight in Asia” approach to trade issues by China. The RCEP as well as the China-Japan-Korea FTA, the China-Korea FTA, and the Economic Cooperation Framework Agreement with Taiwan are all part of this strategic response to the perceived threat of a U.S.-led trading arrangement that excludes China.

Dr. Gao asserted that the RCEP should be particularly attractive to other Asian countries as an alternative to the TPP for a couple of reasons. First, it acknowledges the different circumstances of individual countries and makes it easier for all to be included in a coherent regional trading system. Second, RCEP is centered on the ASEAN countries and makes them the major players in this process of trade liberalization. Third, RCEP negotiations do not operate under the principle of full participation by all 16 member countries, so no country can hold the negotiations hostage with demands on a particular issue.

The other, complementary Chinese response to the U.S. “pivot” to Asia is to pursue greater connections westward toward continental Asia in order to hedge its potential risks in the Asia Pacific region. Included in this response is the promotion of the BRICS as an alternative bloc of countries with similar interests. The proposed BRICS Development Bank, with a starting capitalization of US \$100 billion, is one possible way that China can build institutional alternatives to the World Bank and International Monetary Fund and promote the use of its own currency as a replacement for the dollar in international finance. Dr. Gao included China’s efforts to strengthen cooperation with Russia and central Asian countries via the Shanghai Cooperation Organization as other parts of the Chinese response to the TPP. He also noted the importance of Chinese-led infrastructure projects throughout continental Asia, in which the Asian Infrastructure Bank will play a major role. Included among these is the China-Pakistan Economic Corridor, which would consist of roads, railroads, oil and gas pipelines, and fiber-optic lines for communication. In his visits to central and southeast Asian countries in recent months, Xi Jinping has also recently begun using language about creating a “New Silk Road Economic Belt” that would significantly increase Eurasian continental economic integration. All these initiatives, in Dr. Gao’s view, represent a “Chinese hedging strategy” against the TPP and the broader threat posed by the American strategic pivot toward Asia.

Nevertheless, there is also a view in China that the TPP could be valuable for China to join, if in fact it does not represent a U.S.-led effort to build an “anybody-but-China” club in the Asia-Pacific region. Much like China’s ascension to the WTO helped Chinese leaders push forward difficult domestic economic reforms, the TPP could serve as a way to drive the next wave of economic change. The opening of the Shanghai Pilot Free Trade Zone, an initiative trumpeted by the new Chinese premier Li Keqiang, should be viewed in this light. The economic reforms announced in November 2013 at the Third Plenum of the 18<sup>th</sup> Central Committee also are an indication of this approach. These include land, taxation, financial, and fiscal reforms.

In Dr. Gao's view, Chinese exclusion from the TPP in the long run would have two major negative impacts. First, it would start a realignment of Asian manufacturing networks. Since TPP members would not face tariffs in their bilateral trade, it would be more economical for MNCs to shift production from China to countries such as Vietnam or Malaysia to reduce production costs. This shift might lead to chaos in the short term, and potentially to rising consumer prices in North America and Western Europe. Second, the exclusion of China may harm the long-run interests of the United States by denying it preferential access to China's rapidly growing domestic market. The consulting firm McKinsey has estimated that between 2010 and 2020, the number of urban households with an income of more than US \$34,000 will jump from 4.2 million to 20.9 million, and those with an income between \$16,000 and \$34,000 will jump from 13.7 million to 166.6 million. As a consequence, the Chinese position in trade negotiations will be strengthened greatly in another decade. In fact, the countries poised to gain the most are those that have membership in both the RCEP and the TPP, such as Japan, Australia, and other ASEAN TPP members. In this view, the United States may turn out to have the most to lose from excluding China from the TPP.

Dr. Gao concluded his presentation with three points. The Chinese consumer market, he emphasized, is a huge draw for foreign producers, and will become only more so in the future. Second, China is in no hurry to join the TPP because its economic position, and therefore its negotiating power, will be even greater in another decade. And third, the economic might of the world is rapidly shifting away from Europe and toward the BRICS: in 2050, the top seven economies in the world will be, in order, China, the US, India, Brazil, Mexico, Russia, and Indonesia.

*Comments by Mignonne Chan*

Formal comments were provided by Mignonne Chan, Adjunct Associate Professor at Tamkang University in Taipei. Dr. Chan highlighted several points of convergence between the

two presentations. She emphasized that trade liberalization in the region has a “competitive” aspect to it—economic liberalization and the signing of free trade agreements are ways to develop an economic and even geopolitical advantage over similarly placed rivals. Thus, China’s response to the TPP should be interpreted in this light: it is attempting to enhance its long-term influence in the region through the expansion of bilateral trade agreements and through RCEP. Dr. Chan also noted that she thought ASEAN countries were in general not enthusiastic about the “sovereigntist” approach promoted by the United States, and that RCEP was likely to be more appealing to most of these countries in the short- to medium-term. A good indication of the directions and impact of each would be the actions of the six countries that are currently in both the TPP and RCEP: Australia, Brunei, Malaysia, New Zealand, Singapore, and Vietnam. Finally, she emphasized that Taiwan faces considerable domestic constraints in any effort to join the TPP—the interests of the domestic business community and international partners diverge significantly, in her view.

### *Discussion*

The discussion then moved to an open conversation with other conference participants and members of the audience. There was a consensus that the region would be much better served by having the TPP and RCEP evolve into complementary arrangements, but that there is a real danger of the TPP, in particular, being interpreted as a U.S.-led anti-China organization. There was some disagreement about how likely China was to take this view of the TPP, or whether the TPP would survive if constituted in this form. It is helpful that the two initiatives have overlapping membership: Australia, New Zealand, Malaysia, Singapore, Brunei, and Vietnam are parties to both. It is also noteworthy that both the Obama administration and the new Chinese leadership have expressed interest in China’s participation in the TPP at some point in the future. Thus, most participants agreed that China was ultimately unlikely to oppose the creation of the TPP, and might even seek to join it at some point.

A related point of consensus was that China's participation in the TPP was clearly in Taiwan's best interests. If Chinese leaders view the TPP as an "anti-China club," then supporting TPP membership for Taiwan becomes quite politically costly for the United States. If, on the other hand, China seeks and is able to join the TPP relatively soon, then Taiwan's path to TPP membership becomes considerably smoother.

One open question that emerged from discussions was whether the Obama administration would even be able to win approval for the TPP. Participants noted a couple of serious domestic obstacles that could derail the agreement in the U.S. For one, President Obama does not currently have FastTrack negotiating authority (FTA), which is required in order to get an up-or-down vote on the agreement in Congress. The hostility of many Republicans to Obama and their control of the House could make it impossible for him to get FTA passed, and he faces significant opposition from the left wing of his own party as well. One participant suggested that the so-called "Tea Party" Republicans might not actually oppose FastTrack authority, because they have little interest in trade issues one way or another. But there remains a real possibility that the TPP might never take effect because it fails in Congress.

### **The Challenges of Freer Trade for Taiwan**

The third and final panel of the day turned the conference focus from a general picture of the TPP to the challenges and opportunities it poses for Taiwan. Both presenters covered aspects of Taiwan's domestic political economic and the potential challenges they raise for achieving membership in the TPP.

*Szu-yin Ho*

The first speaker was Szu-yin Ho, a professor at the Graduate Institute of International Affairs and Strategic Studies at Tamkang University, and the former deputy secretary-general of the National Security Council in the Presidential Office in Taiwan. He offered a pessimistic overall view of trade politics in Taiwan.

Dr. Ho began by noting that the trend in international trade since 2005 has been for countries to seek bi-lateral or regional trade agreements. The most important regional FTA talks are the TPP, RCEP, and the Transatlantic Trade and Investment Partnership (TTIP). In light of this trend, Taiwan is a major outlier: it has signed only one major FTA in East Asia, the Economic Cooperation Framework Agreement (ECFA) with China. If Taiwan remains outside major regional FTAs, both its manufacturing and services industries will be at a competitive disadvantage relative to countries that are members of the TPP or RCEP.

With this challenge in mind, President Ma Ying-jeou announced publicly on September 12, 2012, that Taiwan would like to join the TPP negotiations. The opposition Democratic Progressive Party (DPP) also announced that it would support TPP talks, making this one of the few policy areas that both the DPP and the ruling Kuomintang (KMT) are in agreement. Nevertheless, this interest from Taiwan has not elicited much of a response from the current TPP members. In particular, the United States has been conspicuously cold toward Taiwan's request for TPP membership. The U.S. view, as related by Dr. Ho from a former US Trade Representative member, is that "the United States does not feel Taiwan can be a constructive partner at the TPP negotiation table; and it is not just the US—other countries feel that way as well."

The reason for this attitude is Taiwan's previous handling of the issue of U.S. beef imports. In 2009, Taiwan signed a protocol with the USTR expanding beef imports to include bone-in beef, offal, and ground beef. This expanded list of beef products stirred concern among some consumer advocacy groups, as the newly-included items may be linked to mad cow disease.

The U.S. argued that any beef import ban should be based on scientific evidence—a very important position in American trade negotiations over agricultural products. While Taiwan’s legislature did not directly oppose the beef protocol, it did subsequently change the Law of Food and Health to effectively revoke the agreement to expand beef products. This action violated American trade negotiation norms of scientific standards for decisions about food safety, up-or-down votes on trade agreements, and implementation of domestic laws and regulations in accordance with international agreements.

In 2012, the beef issue again became a source of tension when U.S. beef imports were found to contain ractopamine, a drug used to promote leanness in animals raised for their meat. The DPP responded by occupying the podium in the legislature to prevent any discussion or deliberation on the floor about approving these imports. A ruling by the Codex Alimentarius Commission, the body tasked by the WTO to serve as a reference in disputes about food safety and consumer protection, affirmed the US position that a certain level of ractopamine can be safely consumed. The Taiwan government then permitted imports of beef containing ractopamine, but stipulated that pork imports with the substance would be forbidden—a scientifically inconsistent position that did not sit well with American trade negotiators. Thus, since that time, the U.S. position has been that any future trade pact depends on Taiwan demonstrating a determination to liberalize its economy.

Dr. Ho argued that Taiwan’s national government will face three “headwinds” in its international trade negotiations, regardless of whether it is controlled by the KMT or the DPP. The first is rising levels of cynicism and risk-aversion in Taiwanese society. During the beef dispute, for instance, the government’s statements about food safety, particularly that the risk of contracting mad cow disease was virtually zero, were completely ineffective in persuading the general public to support government policy. Within the public domain in Taiwan, single-issue interest groups now have a strong presence, and these usually adopt an absolutist position on food-safety, environmental, and labor issues—all relevant to trade. There has also been a surge in

“yellow journalism” in Taiwan’s media environment, and a tendency to give platforms to “experts” based on their policy recommendations. As a consequence, the loudest voices in the public sphere typically have no interest in discussing policy trade-offs.

Second, the structure of Taiwan’s government itself is problematic for negotiating trade agreements. The United States Trade Representative Office functions as a broker between the executive branch and Congress, between the government and the private sector, and between the United States and other countries. Taiwan does not have any similar kind of organization to fill all of these roles. Instead, in Taiwan trade negotiations are handled either by the Office of Trade Negotiations or by the Board of International Trade, both in the Ministry of Economic Affairs. As a consequence, trade policy has to compete with many other priorities for the minister’s attention. Moreover, MOEA is supposed to coordinate the trade interests of other ministries, but it often is ignored by other departments of the executive branch.

In the legislature, too, the cards are stacked against effective trade policy-making. The legislature includes a Party-Caucus Negotiation Committee (PCNC) that is chaired by the LY speaker and includes two members from each party caucus. All parties with at least three seats are entitled to form a caucus—so, for instance, the Taiwan Solidary Union with three seats in the current legislature has two seats on the PCNC, while the majority KMT also has only two seats. If a decision is reached in this committee, it is binding on all caucuses; but if a decision cannot be reached, the DPP and TSU can effectively filibuster the legislature by taking over the chairman’s podium to prevent a floor vote on a bill. The current Speaker Wang Jin-pyng has consistently refused to use the Sergeant-at-Arms power to maintain order in the legislature and prevent these takeovers. Thus, bills that are actively opposed by the DPP result in fist-fighting or stalemate, or are referred back to the PCNC. The consequence for trade legislation is that the executive branch’s legislative priorities are subject to the whims of the PCNC, and particularly the policy preferences of the minority parties—no matter how effective the minister’s lobbying effort is with the rest of the legislators, and despite the KMT’s majority in the legislature. In Dr. Ho’s view,



this creates a serious “institutional deficit” for Taiwan’s trade policy, which is undermining Taiwan’s international credibility on trade issues. The difficulties in addressing four major trade issues in recent years—the beef import debates in 2009 and 2012, the ECFA in 2010, and the pending Trade in Services Agreement with China—illustrate the consequences of this institutional deficit.

The third kind of “headwind” is from the international setting of trade negotiations. For one, the TPP places an emphasis on rule-based, high-standard trade liberalization. In Dr. Ho’s view, there is little stomach in Taiwan to accede to this kind of trade agreement right now. In addition, the U.S. has adopted a method of “sequencing” its trade negotiations with Taiwan. Only after Taiwan liberalizes its beef and pork trade will the U.S. be willing to hold trade talks on another product or service. Even if Taiwan successfully negotiates a series of agreements with the United States, there is no guarantee that it will eventually lead to TPP negotiations. Unless Taiwan receives a commitment from the U.S. that a resolution of the beef and pork issues will not merely lead to talks over another U.S. priority, such as the use of generic drugs in Taiwan’s national health system, Taiwan is unlikely to continue with this “sequencing” approach as a path to eventual TPP membership. And if the accession protocol for the TPP is similar to that of the WTO, the scope of trade liberalization required of Taiwan will be even broader than if Taiwan engages in TPP talks now.

Dr. Ho concluded by considering whether the RCEP is a realistic alternative to the TPP for Taiwan. Here, in his view, the barrier is China. The Chinese position is, in effect, that for Taiwan to join the RCEP, it must “build political mutual confidence” with China—code words for holding unification talks. Thus, the prospects for Taiwan’s membership in either the TPP or the RCEP do not look especially promising at this point in time.

*Yun-han Chu*

The second speaker of the panel was Dr. Yun-han Chu, Professor of Political Science at National Taiwan University and Fellow at Academic Sinica. Dr. Chu's comments focused on the domestic politics of trade in Taiwan, with special attention to changes in Taiwan's political system and to public opinion and attitudes in Taiwan over the last decade.

Dr. Chu began by emphasizing the one positive he sees for Taiwan's prospects of joining the TPP: everyone significant in Taiwan is in favor. The KMT and DPP have both gone on record supporting Taiwan's participation in TPP negotiations, and the major contenders for the 2016 presidential election have also voiced their support. Nevertheless, once one moves past the rhetoric, the reality is much less promising. As one indication of how politically explosive trade issues can be in the region, national security advisors in both Taiwan and South Korea have been forced to resign over beef import policy in the last five years.

The upshot is that Taiwan is trailing significantly behind other countries in the region, particularly South Korea, in expanding its network of free-trade agreements. For instance, South Korea has now wrapped up free trade agreements with the United States and the EU and is engaged in active talks with China. More than 35 percent of Korean exports now face no tariffs at all under FTAs, while in Taiwan the corresponding number is five percent. At the same time, President Ma's agenda for speeding up and expanding the FTA negotiations with China and neighboring countries has encountered many obstacles and moved at a frustratingly slow pace. Thus, given this recent past, it will be a tall order for Taiwan to conclude high-quality FTAs such as the TPP in the near future.

Dr. Chu identified several domestic factors impeding progress on free trade negotiations. First, there is a great deal of domestic opposition to new FTAs. A majority of Taiwanese have experienced income stagnation and a real decline in purchasing power, as wages have remained largely the same for the past decade while the cost of living has increased substantially and the social safety net remains inadequate. New college graduates receive roughly the same starting salary now as they would have 15 years ago in nominal terms, even though there has been

significant price inflation over that time period. Taiwanese society is becoming more unequal: the wealthiest 5-10 percent of all Taiwanese have enjoyed most of the gains from growth over the past 10 years.

Second, the government has been unable to foster a cohesive pro-trade political coalition. It has also been unable to persuade potential losers from new agreements to go along, either by providing material side-payments or through moral persuasion. Instead, single-issue interest groups have mushroomed in Taiwanese politics, and these groups tend to take fiercely uncompromising stands in public debates about policy.

Third, in the absence of strong executive leadership in the government and in the ruling KMT, the locus of decision-making has shifted from the executive branch to the legislature. Since the legislature's size has been cut in half, to 113 members, it functions more like the U.S. Senate—every legislator wants to have an impact and an independent voice. The legislative reforms have helped to create a breeding ground for lobbyists and “fat-cat donors” who seek to influence the policy-making process. As a consequence, decision-making in Taiwan has become very fragmented, with a large number of effective veto players able to block new initiatives. Overall, there is not currently a conducive environment for the government to propel free trade legislation through the legislature.

Dr. Chu provided some data on public opinion in Taiwan drawn from the latest round of the Asian Barometer survey. In comparison to respondents from other countries in East Asia, Taiwanese were more protectionist overall on most measures. The strongest supporters of free trade in Taiwan tended to be concentrated in urban areas and had higher education levels. Strikingly, pan-Green (DPP and TSU partisans) supporters were significantly more protectionist on average than pan-Blue (KMT and PFP partisans) supporters: more than 60 percent of pan-Green respondents gave protectionist answers to one particular measure. Lower income and a poor assessment of the state of the economy were also associated with protectionism—for

instance, of the roughly 65 percent of respondents who thought the economy was doing badly, protectionist positions were favored by a 2-1 margin.

In conclusion, Dr. Chu described several interrelated processes that in his view are undermining support for free trade in Taiwan. A key contributor is the ascendance of the legislature at the expense of the executive branch, which has increased the pervasiveness of rent-seeking behavior by legislators and created more access points for lobbyists and single-issue interest groups. These include business tycoons and trade industry groups, which have been keen to “adopt” their own legislators who safeguard their narrow interests, rather than attempting to influence the broader direction of policy. In recent years, the Taiwanese business elite have in effect been “free-riders,” staunchly supporting free trade and advocating the acceleration of FTA negotiations, but at the same time refusing to shoulder any of the burden of public outreach in support of free trade. Business interests have also opposed efforts to improve the social safety net, instead lobbying for tax cuts and generous deductions for depreciation and R&D spending. Taiwan’s total government tax revenue today is only 13 percent of GDP, the lowest among all newly industrialized countries in the world.

The ascendance of the legislature has also contributed to the fragmentation of the policy-making process. The opposition parties in the legislature actually have a number of disruptive tactics they can employ to slow down consideration of bills they oppose, despite their minority status. The DPP, for instance, was able to prevent consideration of ECFA for quite some time, and the recent decision by the legislature not to hold an up-or-down vote on the services agreement with China but instead to subject it to line-by-line scrutiny and roll-call votes illustrates how difficult it is for the government to advance its priorities even when it holds a majority.

As a consequence, the executive branch has become highly susceptible to all manner of competing demands from various interest groups, and it has led the government toward a lowest-common-denominator approach to trade negotiations: whenever a group says no to something, it

is off the table. The agreements that Taiwan has been able to conclude so far have been “low-hanging fruit”—in the Chinese case, because they were willing to make unilateral concessions to reach a deal, and in the New Zealand and Singapore cases because those countries’ primary exporters pose little threat to Taiwanese producers. But this approach will certainly not get Taiwan through the much tougher negotiations of the TPP, or with more demanding trade partners such as India, Indonesia, Australia, or Malaysia.

*Comments by Rupert Hammond-Chambers*

In his comments, Mr. Hammond-Chambers made an impassioned case that Taiwanese membership in the TPP was in U.S. interests. He asserted that while the U.S. should support cross-strait economic ties, it also needed to continue to signal that it was strongly vested in Taiwan’s security.

That said, he noted some worries about the current TIPA negotiations, and more broadly the current U.S. administration’s commitment to and understanding of Taiwan. The replacement of Secretary of State Hillary Clinton and her deputy for East Asian and Pacific affairs, Kurt Campbell, was “a blow” to the U.S.-Taiwan relationship. He expressed concern that Clinton’s replacement, John Kerry, did not have the background in Asian affairs nor the power to put people in place “who understand Taiwan.” The Obama administration currently lacks people who have strong relations with Taiwan, and as a consequence there is drift in the U.S.-Taiwan relationship right now.

Mr. Hammond-Chambers also remarked that President Ma’s unpopularity is “historic” at the moment, which is “a shame.” Ma is committed to free trade, but because of his political weakness and the lack of leadership on free trade issues, it has been very difficult for policy-makers in Taiwan to get behind free trade policies. His best effort, Mr. Hammond-Chambers asserted, was in his second inaugural speech, when Ma stated that trade with China was but one component of a global trade strategy. The sequencing of trade agreements, starting with ECFA,

was a sensible approach, but because of the president's unpopularity the process of expanding Taiwan's trading relations has stalled. A good illustration is the cross-Strait services agreement: although it was signed in June, President Ma has been unable to win approval in the legislature despite a large KMT majority there.

The priorities of the new Chinese leadership on Taiwan policy also do not bode well for cross-Strait relations. Over the next couple of years, Xi Jinping is likely to push for movement on political and military issues which do not have popular support in Taiwan. Mr. Hammond-Chambers noted that President Ma is "the best the Chinese are going to get" as well as "the best the U.S. is going to get"—realistically, he is as pragmatic on cross-Strait issues as any Taiwanese leader is likely to be, and as favorably predisposed to expanding free trade agreements. If he cannot get new agreements approved, then that bodes poorly for the future. At the same time, Ma's difficulties also take pressure off the DPP to moderate their own China policy. In practice, Taiwan's legislature has now taken the lead in policy-making, including trade policy, abrogating power for itself at the expense of the executive. In Mr. Hammond-Chambers's view, this is not a good development because it is likely to produce inconsistent and fragmented policy outcomes.

To sum up, Mr. Hammond-Chambers urged the United States to declare publicly that it supports Taiwan's membership in the TPP, as much for political reasons as for economic ones. Otherwise, Taiwan is likely to remain on the outside of the agreement and will be extremely vulnerable to Chinese coercion.

### *Discussion*

Several key points of agreement emerged from discussion. First, several participants noted that trade issues in Taiwan cut across party lines. The DPP has generally opposed free trade agreements with China, and public opinion data show much stronger protectionist attitudes among core DPP supporters than among KMT ones. Yet these attitudes may have less to do with opposition to free trade per se and more to do with the fact that the FTAs are with China. From a

national interest standpoint, the TPP's strongest support should come from the DPP because it advances a balancing strategy of reducing Taiwan's economic dependence on the mainland market. There is an opportunity for the DPP's candidate in the 2016 election to frame TPP membership in a positive light as a way to secure Taiwan's independent economic future.

Second, most participants agreed that Taiwan's past struggles with the United States over trade issues were much less prohibitive than they seemed. U.S. State Department officials have recently made positive statements about Taiwan's participation in the TPP, and it is ultimately in the U.S. interest to have Taiwan as a member. In addition, the domestic reforms needed to demonstrate a commitment to the "high-quality" standards of the TPP are not unique to Taiwan. Several other aspirants, notably Japan and Korea, have similar domestic troubles and yet are considered viable candidates for membership.

Third, there was nevertheless a strong consensus among conference participants that Taiwan's political system presented structural obstacles to the objective of TPP membership. These include the disproportionate influence of narrow interest groups through the legislature, bureaucratic conservatism and opposition to reform, and even a lack of manpower and coordination among Taiwan's trade negotiating teams. In order to move toward TPP membership, Taiwan's leaders will probably need to find ways to mitigate opposition and overcome these structural roadblocks.

### **Views on Taiwan's Development Strategy for the Next Phase**

The second day of the conference kicked off with presentations on the opportunities and challenges for Taiwan's future economic development.

*Sheng-cheng Hu*

The first speaker was Dr. Sheng-Cheng Hu, a research fellow at Academia Sinica and the former chairman of the Council for Planning and Economic Development. He began by briefly reviewing the main sources of the past several decades of economic growth in Taiwan. From 1952-2012, Taiwan's economy grew at an average rate of 7.3 percent per year. Starting with an overwhelmingly agrarian economy, Taiwan has been transformed into a newly industrialized country with a large and globally competitive information and communications technology (ICT) sector. State-led industrial policy played a key role in this growth. Although there were many individual successes and failures in the government's management of the economy, including picking winners and losers, the major thrust toward liberalization and globalization of the economy has contributed significantly to Taiwan's development.

However, Taiwan's economic performance in recent years has been sub-optimal, for several reasons. The services sector in Taiwan has remained far less liberalized and globalized than the manufacturing sector, and its productivity growth has been far lower as a result. Moreover, because manufacturing is only 24 percent of Taiwan's economy, while the services sector is 73 percent, productivity growth in services would have a much larger impact on Taiwan's development. On the same note, the value-added in the ICT sector has declined in recent years, from 33.3 percent in 2003 to 29.2 percent in 2011; the job-creation effect from the ICT sector is quite limited as well, with the percentage of export orders outsourced overseas now as high as 85 percent of total orders. Hon Hai, also known as Foxconn Technology Group, is a good example of this trend: it employs over one million workers worldwide, but less than 10,000 are in Taiwan.

In addition, Taiwan's growth has been especially volatile in recent years, for at least two reasons. First, Taiwan's manufacturing is concentrated in ICT-related fields: in 2011, these accounted for about 51 percent of manufacturing output, 40 percent of total exports, and about 50 percent of the market value of the Taiwan Stock Exchange. These fields are highly capital- and technology-intensive, and they are also highly cyclical. Thus, a slowdown or boom in the ICT



sector has an outsized impact on Taiwan's overall growth rate. Second, Taiwan's exports are concentrated in just a few markets: in 2012, China and Hong Kong together were the destination of nearly 40 percent of all the island's exports, while the ASEAN-6 countries together absorbed another 18.5 percent. By contrast, Taiwan's reliance on the U.S. market has declined significantly over the last decade, from 23.4 percent in 2000 to 10.9 percent in 2012.

Taiwan faces several challenges ahead to improve the competitiveness of the island's economy. Taiwan generally scores quite well in international competitiveness reports, ranking anywhere from 13<sup>th</sup> to 3<sup>rd</sup> in recent ratings, but those are only an indication of potential. Taiwan still fails to attract much foreign direct investment (FDI) at all, and domestic private investment has actually declined slightly in recent years as a share of GDP. Nor has the Economic Cooperation Framework Agreement (ECFA) with the PRC helped change these patterns; the agreement has turned out to be investment-neutral, rather than bringing a wave of new investment from overseas. In Dr. Hu's view, this result is because Taiwan does not offer overseas investors many attractive investment options. The investment that has come to Taiwan as a result of ECFA has been driven as much by political as economic motives.

Cross-strait relations are an especially difficult challenge for Taiwan's future development strategy. For one, economic relations are turning from cooperation to competition, with Chinese firms increasingly producing their own high-end parts and components in fields that Taiwanese firms used to dominate. For another, rising wages in China make it less attractive as a manufacturing base in the future, such that Taiwanese firms may need to move production out of China. At the same time, China's consumer markets are growing rapidly, and Taiwanese firms will have to deal with the uncertainty of competing in that market in the future.

Taiwan also will have to deal with the special challenges posed by a rapidly aging population. The burden of social insurance is going to be very large as the ratio of retirees to workers rises—Taiwan is heading toward this demographic transition faster than any other country at the moment.

Dr. Hu emphasized that the best prospects for future growth come from a strategy of greater domestic liberalization and integration with the world economy. Taiwan's services sector is ripe for change. For instance, state-owned banks still control at least 50 percent of the market share in the banking industry, and there are still a number of large state-owned enterprises, including power and sugar companies, that could be privatized. In addition, Taiwan currently lags behind Korea and China in the number and impact of large, globally-scaled and oriented companies. The Taiwanese economy has traditionally featured a large number of small and medium-sized enterprises (SMEs), in contrast to the *chaebols* of Korea, and Dr. Hu sees this as an increasing disadvantage. Supporting the growth and international expansion of some of these SMEs should be a priority of the government, and the TPP can potentially provide additional impetus. The strengths of the ITC industry might also be leveraged to develop new strengths, such as in green technology, green energy, biotech, health care, and medical devices. But the role of government in developing these industries will have to be less than it has been in the past: the expertise is in the private sector, and micro-managing industrial policy is unlikely to succeed. Instead, the best contribution government can make is to remove obstacles to business activities, including restrictions on land acquisition and prolonged environmental impact analyses.

#### *Gee San*

The second speaker was Dr. Gee San, Vice Chairman of the Taiwan External Trade Development Council (TAITRA) and a former deputy chairman of the Council for Economic Planning and Development.

Dr. San painted a more sanguine picture of the long-term effects of cross-Strait relations on Taiwan's development. He began by noting that Taiwan is impressively competitive in world business rankings. For instance, Taiwan was rated 11<sup>th</sup> globally, and 3<sup>rd</sup> in the Asia-Pacific region, in the IMD's "World Competitiveness" category for 2013. The World Economic Forum's "Global Competitiveness Index" ranks Taiwan similarly at 12<sup>th</sup> and 4<sup>th</sup>, respectively. In addition,

the Knowledge Economy Index compiled by the World Bank placed Taiwan 13<sup>th</sup>, and 3<sup>rd</sup> in the Asia-Pacific region, above Singapore. Taiwan's ranking on the World Bank's "Ease of Doing Business" index has improved significantly under the Ma administration, jumping from 61<sup>st</sup> globally in 2008 to 16<sup>th</sup> in 2012. Another indicator that demonstrates Taiwan's economic prowess is the rankings of patents awarded: for the period between 1998 and 2012, Taiwan placed 4<sup>th</sup> overall, behind only the U.S., Germany, and Japan. On a per-capita basis, Taiwan has led the world in patent density since at least 2006. On less tangible indicators, Taiwan also scores well: this year Taiwan's Director-General of Budget, Accounting, and Statistics created a "Happiness Index" that placed Taiwan 19<sup>th</sup> among developed and newly-industrialized countries, notably above South Korea, Japan, Italy, Israel, and Brazil. The overall picture, then, is that Taiwan is currently in a strong social and economic position relative to much of the rest of the world.

Nevertheless, Dr. San identified several major challenges for Taiwan's future development. One is that Taiwan's political isolation is starting to have a negative impact on its international economic relations as well. To date Taiwan has only been able to sign free trade agreements with smaller nations in Central and South America such as Panama and Chile; its main markets of the EU, the United States, and Japan remain outside any FTA. Taiwan's major trade agreement in recent years was the ECFA with the PRC, signed in 2010. But this success pales in comparison to South Korea's flurry of agreements, including the Korea-US FTA, which came into effect in 2012, and the Korea-EU FTA which took effect in 2011. Another challenge is the increasing pace of technological advance in the world's leading economies. Future innovation is likely to require large amounts of capital and manpower, and Taiwan's economic scale makes it challenging to muster sufficient resources to produce significant advances. A related issue is that small and medium-sized enterprises (SMEs) produce a large share of Taiwan's economic output. In markets with large economy-of-scale effects, this preponderance of SMEs is a distinct disadvantage. Taiwanese firms have struggled to expand their market shares and develop their brands abroad—tasks which become more important as Taiwan's

economy becomes more integrated regionally and globally. Other challenges include an increasingly conservative, risk-averse bureaucracy that is subject to immense media scrutiny and pressure from the legislature, and an aging population that will be followed in the near future by a decline in the size of the work force.

Taiwan's most delicate economic challenge is managing its relationship with mainland China. Taiwanese investment in and trade with China rose rapidly during the DPP years of 2000-2008, when cross-Strait political relations were strained. By 2007, Taiwan's exports to mainland China topped 40 percent of its total exports, the highest number ever. The Ma administration's view has been that trade relations with China have become too important to Taiwan's economy to continue to avoid or neglect discussing them with the PRC. Hence, one rationale for signing ECFA was to foster greater stability in cross-Strait economic relations. The Ma administration has viewed closer economic relations with the PRC as a stepping-stone to greater economic integration with the rest of the world. In Dr. San's view, this approach has been quite beneficial: a better political rapport with China has improved the opportunities for Taiwanese businesses elsewhere as well. Taiwan's best economic strategy is to cultivate its advantages in the mainland Chinese market, rather than to view closer economic ties as a threat.

Dr. San concluded by suggesting that Taiwan's position is similar to those of small countries on the European periphery such as the Netherlands, Sweden, or Finland. Taiwan could benefit from being a gateway for access to mainland China's economy, in much the same way that, for instance, the Netherlands contains important ports that handle cargo from all over Europe. Taiwan is well-positioned to act as a key hub for logistics, capital flows, and talent flows in the region, but only if it continues to pursue greater openness to the Chinese economy. Lifting restrictions on the movement of people, commodities, and capital is the best way to promote economic development in Taiwan.

TPP membership for Taiwan dovetails with this strategy. The TPP is likely to become a prominent force driving regional economic integration, and Taiwan would realize enduring benefits from joining the partnership.

*Comments by Mignonne Chan*

Dr. Mignonne Chan provided formal comments on the presentations. She first noted that small- and medium-sized enterprises make up the bulk of Taiwanese firms and produce the majority of Taiwan's GDP. The challenge for these firms, and for Taiwan, is that fierce competition between them keeps profit margins low and limits their ability to grow. Taiwan's economy would benefit if more of these enterprises were able to scale up and develop a stronger presence abroad. In the past, this process has been aided in certain industries by the government, through a national industrial policy. The most successful manifestation of this strategy is the Taiwan Semiconductor Manufacturing Company. But it is difficult if not impossible for the government to successfully pick winners like this now: the expertise in emerging technologies lies in the private sector, not in government. Nevertheless, the government could develop programs that promote investment in "next-generation" manufacturing technology, such as 3-D printing, and then aid firms that move into these markets.

Dr. Chan highlighted several potential stumbling blocks in any future negotiations to enter the TPP. First, depending on the details, the intellectual property rights requirements might be extremely disadvantageous to Taiwanese interests. If IPR protection is extended to as long as 70 years, in the most extreme proposal, then Taiwanese technology firms may face lawsuits from foreign IPR "roaches". Second, the TPP may require Taiwan to privatize many of its remaining state-owned enterprises (SOEs), which in Dr. Chan's view may not be in Taiwan's interest. Third, if China is not also in the TPP, the rules of origin requirements may require Taiwanese firms to do a lot of restructuring, relocating production to TPP member countries from China. And fourth,

there is some concern that the TPP's new legal enforcement mechanisms will conflict with the independence of the judiciary and legal system in Taiwan.

Dr. Chan concluded by offering a series of "reality checks" to the prospects for joining the TPP: that issues ranging from IPR rules to pork could be too disadvantageous for Taiwan to overcome; that any Asia-Pacific FTA cannot supersede ECFA or other economic treaties with the mainland, and that by undertaking reform before attempting to join the TPP negotiations, Taiwan would be unilaterally giving away concessions that could be useful in bargaining.

### *Discussion*

The conversation then turned to an open discussion of the economic issues facing Taiwan. Several participants noted that Taiwan's economic and political challenges did not sound particularly unusual. Japan, for instance, faces the same problems of an aging population and poor returns on investment at home. Japanese companies have done quite well in the rest of Asia and then used the profits for research and development at home. By contrast, cross-Strait integration seems to be driving a net decline in research and development in Taiwan, as firms attempt to reduce costs rather than add value. There was no clear consensus about why this pattern was different in Taiwan. Another difference with Japan is that foreign workers may offer Taiwan a partial solution to an aging workforce—Taiwan may be culturally better positioned than Japan to absorb an influx of foreign workers.

Participants also emphasized both the difficulty and the importance of addressing the distributional consequences of trade liberalization. Growing income and wealth inequality is a major source of public opposition to free trade. Unemployment is not particularly high, compared to rates in the U.S. or especially Europe, but the key difference in Taiwan is that the country has not in recent history experienced unemployment at high rates. With many college graduates unable to find jobs today, young people are particularly apprehensive. Moreover,

wages are low relative to the cost of living, and wage growth has stagnated, generating widespread unhappiness with economic conditions in Taiwan.

None of these trends are unique to Taiwan—in fact, they are common among democracies in the world today. But the success of a trade liberalization agenda may depend on whether effective schemes can be devised that address some of these concerns, and compensate the losers from reform. Taiwan’s current government tax take is only 13 percent of GDP—quite low by comparative standards—which limits its ability to fund the social safety net and improve the lot of lower-income families who might be harmed by trade reforms. An increase in corporate and income taxes would better ensure that the gains from liberalization are widely shared across Taiwanese society. Instead, Taiwan’s fiscal policy has if anything moved in the opposite direction: the cut in the inheritance tax, for instance, has not only disproportionately benefited wealthy families but also contributed to skyrocketing housing prices, which are especially acutely felt by young and middle income people. Unless Taiwan is able to devise policies that address this widening wealth gap, trade liberalization will continue to be a polarizing issue.

One interesting contrast mentioned in this discussion was the Taiwanese government’s approach to WTO accession. There, the administration admitted that some farmers would lose their jobs as a result of the agreement, and promised compensation. Although there were protests, the agreement was approved by the legislature. By contrast, the impression of participants was that the Ma administration took a different approach to the services trade agreement with the PRC, emphasizing the benefits to the overall economy without talking about who would be negatively affected or discussing the proposal with the legislature. This may be one reason the services trade agreement has faced so much opposition even within the KMT caucus in the legislature.

### **The Future of the TPP: Views from Participating Countries**

This panel included presentations covering the perspectives of four different countries participating in the TPP negotiations (New Zealand, Japan, and Singapore) or seeking membership in the next round (Korea). Each presenter had considerable experience working on trade issues in his or her respective country.

*Charles Finny*

The first presentation was by Charles Finny, the lead negotiator on the Taiwan-New Zealand FTA and the early stages of the China-New Zealand free trade agreement. Mr. Finny began by noting that, in his view, an agreement on the TPP is possible by the end of the year, or at the latest before the summer of 2014. He also suggested that China may eventually want to join the TPP, and that the “APEC solution” of having Taiwan, Hong Kong, and China all join at the same time was the most likely way for Taiwan to gain membership.

Finny emphasized several steps that Taiwan could do to help make TPP membership a reality. The first is ratifying and putting into force the free trade agreement that Taiwan and New Zealand just signed, and doing the same for the agreement that Taiwan and Singapore are negotiating now. The Taiwan-New Zealand FTA is, in Finny’s view, one of the highest-quality FTAs in the region, in many ways even exceeding the likely standards of the TPP, and the Singapore agreement is likely to be of similar caliber when it is signed. Thus, Taiwan can make a major statement about its readiness for TPP membership by showing it can get these agreements ratified and put into force.

A similar logic applies to ratification of the ECFA services agreement: it is both critical in China’s eyes and improves the prospects for Taiwan’s eventual membership in the TPP. Finny noted that there was a strong correlation between progress on the ECFA negotiations and Singapore starting its own negotiations with Taiwan on an FTA. He also suggested that Taiwan



is likely to find sympathetic allies in Chile, Australia, and Japan, and that those three countries are likely to be the strongest proponents of Taiwan joining the TPP among current members.

Mr. Finny also sounded cautionary notes about both the support Taiwan is likely to find from the United States and the likely pace of negotiations when Taiwan does formally seek membership. Membership in the TPP, in his words, “is not just a US gift”—all the existing members will have a right to veto, so Taiwan’s diplomatic efforts will need to focus on more than just the United States if it hopes to have a realistic shot at gaining membership. Nor does Taiwan’s current trade policy have much to do with its absence from the TPP negotiations in the future. The United States is likely to welcome Taiwan into the TPP with open arms whenever the conditions are right, because it is in the economic and strategic interests of the United States and all the other TPP members. That said, the process of negotiating membership in the TPP is likely to take a long time: it is notable that the Taiwan-New Zealand FTA took 12 ½ years in total to negotiate before it was signed.

Finny ended by pointing out the considerable difficulties ahead in getting the TPP ratified and put into force in the various member countries. Civil society organizations are gearing up to oppose the agreement in many of the member countries, and even in New Zealand it will be controversial despite the general consensus there on the benefits of free trade. Thus, it will be some time even in the best-case scenario before the TPP actually takes effect, which gives Taiwan and its allies in the partnership some time to decide on next steps.

### *Shujiro Urata*

Shujiro Urata, Professor in the Graduate School of Asia-Pacific Studies at Waseda University, gave the next presentation. Dr. Urata began his talk by emphasizing that the economic situations in Japan and Taiwan share a number of characteristics, including an ageing population, the need to adjust to a growing Chinese economy, and the challenges of liberalizing important sectors of the domestic economy. In light of these similarities, Urata’s comments

focused on the challenges facing Japan's economic recovery since the Abe government took office in December 2012.

Prime minister Abe announced his government's intention to join the TPP in March 2013, and Japan was formally accepted into the negotiations 90 days later. Abe appears to consider the TPP to be one of the most important, if not the most important, foreign economic policy objectives facing his government. He has assembled a team of about 120 government staff and assigned a senior LDP member, Akira Amari, to lead the TPP negotiations. Nevertheless, there remains a heated debate in Japan, and even within the ruling LDP, between pro- and anti-TPP groups.

To understand the high priority the Abe government places on the TPP, Dr. Urata emphasized the poor future prospects of the Japanese economy if current trends continue. Japan has now suffered through two decades of low economic growth, starting with the collapse of the bubble economy in the early 1990s. Japan's labor force has been shrinking since 1995, and its absolute population peaked in 2006 and has been declining steadily since. The National Institute of Population and Social Security Research projects that under current trends, Japan's population will drop below 100 million by 2046 and be below 90 million by 2055. Thus, without a reversal in population decline, Japan's labor input will continue to fall as well unless there is a large increase of women and the elderly in the workforce, or an influx of foreign workers. At the same time, the domestic savings rate has also been declining due to the aging of the population, from 33.7 percent in 1990 to 21.4 percent in 2010. Due to a shrinking population and a low growth rate, private consumption in Japan is not growing, and a future expansion of government spending is limited by a huge public debt that now is more than twice annual GDP.

To make matters worse, Japan's economy has remained quite closed in comparative terms. Its ratio of imports and exports to GDP—16.5 and 17.4 percent, respectively, in 2011—are lower than any other country in the region, while inward foreign direct investment was only 3.9 percent of GDP. The corresponding numbers for APEC as a whole were 25.0, 25.9, and 23.2

percent. Thus, an increase in trade, especially with the rest of Asia, offers Japan one of the few realistic avenues for growth over the next couple of decades.

Two features of Japan's current trade agreements are noteworthy. First, the country's FTA coverage ratio—the proportion of all trade covered by FTAs—is small. Japan has enacted 13 FTAs with 15 different countries, covering 18.6 percent of all trade as of 2010. This ratio is substantially lower than the United States (38.8%), South Korea (34.0%), and ASEAN (60.0%), while slightly higher than China (16.2%) and India (17.9%). This low coverage is due to the absence of FTAs with Japan's major trading partners such as the United States, China, and the EU. Second, Japan's level of trade liberalization is quite low relative to other developed countries including the US, EU, Australia, and New Zealand. The country has consistently excluded potentially sensitive agricultural products from trade liberalization; on average, less than 90 percent of product areas have no tariffs, whereas in the US the corresponding number is over 95 percent.

Dr. Urata suggested that the greatest benefit for Japan of TPP membership is likely to be its role in fostering a free-trade arrangement for the entire Asia-Pacific region. The export opportunities for Japanese corporations would expand significantly, leading to growth in this sector of the economy. At the same time an expansion of imports would reduce the production of products that compete with imports, potentially negatively affecting employment. If workers and funds shift from the production of import-competing goods for which demand is shrinking to the production of export goods for which demand is rising, then growth can be expected for the economy as a whole. The Cabinet Office estimated using a computable general equilibrium model that the TPP would result in an 0.66 percent increase in Japan's annual GDP growth. Moreover, this estimate is a static effect; the estimates of the dynamic effects are much higher, on the order of a 2.0 percent increase in GDP growth over the long run for TPP membership, a 1.8 percent increase for RCEP membership, and a 4.3 percent increase for membership in both. Thus, an expansion of Japan's free trade agreements is one of the main components of the third

arrow, the growth strategy, of the Abe government's "three arrows," the first and second arrows being aggressive monetary easing and an increase in "flexible fiscal spending" on public works projects.

Nevertheless, there remain significant obstacles to Japan's participation in new FTAs. The sectors likely to suffer the most adverse effects from the TPP, and thus to provide the strongest political opposition, are the agricultural sector, medical services, and state-owned enterprises. The agricultural sector as a whole features relatively low tariffs. But this average masks generous protection schemes for key agricultural products such as rice, wheat, and sugar, which include quotas as well as high tariffs. The LDP government has already made it clear in the TPP negotiations that it will attempt to exclude rice, wheat, beef and pork, dairy products, and sugar and starch products from liberalization, which together account for 94 percent of overall tariff lines in Japan. Dr. Urata was skeptical that Japan would be able to reach an agreement to join the TPP because other member countries are trying to achieve a much higher level of trade liberalization.

The medical sector is also a strong opponent of the TPP, arguing that it would damage Japan's national health insurance system. The argument here is that the introduction of market mechanisms to determine pharmaceutical prices and the presence of profit-driven private companies in the medical services sector would undermine the health care system. Japan Post, the national postal system but also a major provider of banking services, also opposes the TPP.

In Dr. Urata's view, there are realistic ways to overcome this opposition. Trade liberalization could proceed more gradually, with the provision of trade adjustment assistance for negatively affected workers. The Abe government is also especially well-positioned to undertake reforms in the near future: it controls large majorities in both houses, and it will not face another election for two and a half years. Abe may also have earned some goodwill, with the positive short-term effects of "Abenomics" contributing to a sense of economic recovery in Japan.

To conclude, Dr. Urata argued for viewing the RCEP and TPP as complements, not competitors. For Japan, at least, the two agreements offer different kinds of benefits, and membership in both would be for the best. They also may develop into stepping-stones toward a full Asia-Pacific free trade zone, which would provide large benefits to Japan and the rest of the region in the long run. An Asia-Pacific FTA might even in turn become the basis for a new global FTA.

*Jin Kyo Suh*

Jin Kyo Suh, Senior Fellow at the Korea Institute for Economic Policy, provided an overview of the Korean perspective on the TPP. Korea is not a member of the current round of negotiations but is potentially one of the first to seek to join once the original agreement is finalized and goes into effect.

Dr. Suh began by noting that Korea's economic is highly trade-dependent, with a total of exports and imports combined greater than annual GDP. In contrast, the corresponding ratio in the United States and Japan is about 30 percent of GDP. In recent years, Korea has aggressively pursued FTAs with countries around the world. Those already in effect include FTAs with the EU, Turkey, India, Singapore, ASEAN, the United States, Peru, and Chile; several more are under negotiation, including with Australia, New Zealand, Canada, and Colombia. Korea is also a party to the RCEP negotiations, and in July 2013 it concluded an agreement with China and Japan for a trilateral FTA.

The current Korean government view of the TPP is mixed. There is interest in the TPP insofar as it turns into a template for future global trading rules among WTO members. The issues being negotiated in the TPP that are not part of previous FTAs or the WTO are of particular relevance here. Nevertheless, Dr. Suh asserted, there is a strong suspicion in Korea and other developing countries that the major trading powers of the region are trying to create new rules that work primarily to their own advantage, in effect creating a new discriminative club.

The entrance costs of joining the TPP appear quite high: for instance, Canada has had to make major concessions on its supply management system for dairy and poultry, and also on copyright laws. Korea already has pending FTAs with several TPP members in which certain sectors have presented major difficulties: agricultural products in Canada, Australia, and New Zealand; automobiles in Japan; and protection for swaths of domestic manufacturing in Mexico. The worry is that Korea will be forced to pay a high price in these areas to win TPP membership.

In addition, the TPP is seen in Korea as a de facto attempt to isolate China: the TPP will contain many provisions that China would be unable or unwilling to meet for the foreseeable future. Thus, were Korea to join the TPP negotiations, the fear is that it would be seen in Beijing as another step in the “encirclement” of China. This “China factor” looms large in Korean calculations about the TPP. China is a leading trade partner of South Korea: it is the destination of 25 percent of all Korean exports. China is also the primary partner and ally of North Korea, with important influence over North Korean decision-making and thus a potentially crucial player in South Korea’s security environment.

For these reasons, there is considerable support in South Korea for pursuit of RCEP membership in addition to, or in place of, TPP membership. Dr. Suh suggested a several-step process leading to Korean membership in both the TPP and RCEP. First, a successful conclusion of the China-Korea bilateral FTA is a precondition for RCEP membership and the China-Japan-Korea FTA negotiations. If the China-Korea agreement is concluded quickly, it could also serve as a kind of insurance if Korea does not gain membership in the TPP; with agreements with both China and the U.S., Korea would not be especially disadvantaged. Second, Korea would benefit from expressing interest in joining the TPP as soon as possible, so as to pay lower entry costs. Third, Korea could accelerate the China-Japan-Korea FTA, which would be a useful stepping-stone to the conclusion of the RCEP. Finally, Korea could use the best features of its existing FTAs to craft a reduced form of RCEP as an interim solution to a final agreement, and at the same time play a major role in linking the development of RCEP with the US-led TPP.

*Deborah Elms*

The next speaker was Deborah Elms, Senior Fellow and Head of Temasek Foundation Centre for Trade and Negotiations at Nanyang Technological University in Singapore. Dr. Elms provided in her comments both the Singaporean view of the TPP and also an overview of the potentially major features and innovations of the TPP agreement itself.

She began by commenting that there was a great deal of confusion about what the agreement is likely to contain. If and when the TPP goes into effect—the optimistic forecast is in 2015 or early 2016—tariffs will drop to zero on 90 percent of all goods traded between the twelve member countries. Most of the remaining tariffs will also fall to zero, but more gradually over the next seven to ten years. There will also be significant reductions in non-tariff barriers, particularly some regulatory and product standards issues, including provisions to minimized differences in food and product safety standards and inspection requirements. And the TPP will have measures to improve trade facilitation and movement of goods and services across borders—for example, there will be new rules for logistics and express delivery services. Notably, the TPP is not only about trade in goods; services trade will be opened up in a number of sectors, there will be better protection of investment for firms in TPP member countries, and government procurement will be opened to outside competition. There will also be new rules for e-commerce and new intellectual property rights protections, and the agreement will include a robust dispute settlement procedure to be used by all TPP members.

The overall effect is to create the potential for significant trade diversion from non-TPP to TPP countries. One way this could occur, Elms emphasized, is through the cumulative effect on supply chains. To produce a technologically advanced product, for instance, parts may cross borders five or six times, so that a seven percent tariff could have a cumulative effect of 35-40 percent of the product's price. Firms will have a big incentive, in Elms's view, to relocate parts of their production chains to TPP countries from non-TPP countries. These effects will be felt

more strongly in countries that are not in the TPP but have significant links through production chains to TPP members—the biggest losers are likely to be Taiwan and Thailand, who do not have large domestic markets and are not tied into regional trade through other FTAs. And within these non-member countries, the most globally-integrated sectors are poised to lose the most—for instance, the ITC sector in Taiwan. In sum, then, Taiwan stands to lose a great deal from not being part of the TPP: its most globally-competitive industries will have the strongest incentive to move production out of Taiwan and into other TPP member countries.

### *Discussion*

The ensuing discussion of the presentations highlighted the high level of uncertainty surrounding the TPP, including the actual language, the practical consequences of the agreement, and the potential concessions that each member country is offering. Because the negotiations are taking place in strict secrecy, even the best-informed participants at the conference could not say with confidence what the final agreement would contain. For instance, despite the promotion of the TPP as a new kind of “high-standard, 21<sup>st</sup> century” trade agreement, the language and regulations governing non-tariff barriers were considered likely to be disappointing to advocates of trade liberalization. Nevertheless, it was thought possible that the treaty’s “living agreement” clause could develop into a powerful instrument for removing non-tariff barriers.

On the question of who was offering what, participants noted that Japan initially attempted to exempt a large number of agricultural products from tariff eliminations and to seek to retain protection for services, and that it was pressured by other members to offer much more. There was some consensus that the Abe government was willing to commit political capital, including offering reforms in medical services and insurance sectors, in order to secure membership for Japan.

Despite the uncertainty surrounding the TPP’s text, it was suggested that the KORUS FTA was a good model for what Taiwan should expect in TPP negotiations. If Taiwan pursues



TPP membership in the next round, it is likely to be joined by at least a couple other countries: notably Korea and Thailand. There is also a distinct possibility that China might officially seek membership at the next opportunity. Discussions on the next round of negotiations are likely to begin once the TPP takes effect, likely in 2015 or 2016.

### **Taiwan's Strategy and the TPP**

The final panel of the conference featured three presenters, each presenting their view on what Taiwan would need to do domestically to prepare itself for TPP membership.

#### *Don Shapiro*

The first presenter, Don Shapiro of the American Chamber of Commerce in Taipei (AmCham), began by stating that in AmCham's view the TPP would bring substantial benefit to Taiwan's economy. For one, it would give Taiwan the ability to rebalance and diversify its trade beyond China. Conversely, exclusion from TPP in the long run would be devastating for Taiwan's trade and investment: the ability to attract FDI to Taiwan, already problematic, would become even more acute, and even Taiwanese companies might feel the need to relocate production to a place within the TPP. Given this assessment, Mr. Shapiro expressed some concern that the Ma administration does not have a sense of urgency to lay the groundwork for eventual TPP accession.

Mr. Shapiro noted that the 2013 edition of AmCham's annual Taiwan White Paper urged Ma to make achieving TPP membership a national priority. The White Paper suggests that the Ma administration set up a national campaign in an attempt to influence public discourse and to indicate to the bureaucracy that Taiwan's interests are best served by working toward this goal. In a public statement about seeking TPP membership, Ma at first indicated a 10-year time frame

for accession, later reduced to eight years; for many in the international business community in Taiwan, Mr. Shapiro said, this time frame is still too long. More recently, former premier Sean Chen proposed in remarks on the TPP that Taiwan attempt to join by 2015, a statement that was reiterated by the head of TECRO in Washington, D.C., King Pu-tsung. Shapiro was unsure if this represented a change in official thinking, or even if it did, whether president Ma possessed the political capital to move so quickly.

Nevertheless, in recent months there have been several developments that bode well for Taiwan's eventually accession to the TPP, if the Ma administration is able to take advantage. For one, Taiwan's negotiations with Singapore and New Zealand have been successfully concluded, and agreements signed, without interference from China. For another, problems with US access to the Taiwanese market for beef have been mostly resolved. For a long time, beef was the overriding issue in U.S.-Taiwan trade negotiations; because of Taiwan's restrictions on the import of beef, the US side for 5 ½ years was unwilling to hold the Trade and Investment Framework Agreement (TIFA) talks, which normally are convened annually on a routine basis. However, last year Taiwan took action and set a tolerance limit of 10 parts per billion on the feed additive ractopamine, which is used by nearly all U.S. ranchers. As a consequence, TIFA talks were resumed this past March. These talks have gone well, with two working groups set up, one on investment issues and the other on technical barriers to trade. In Mr. Shapiro's assessment, the TIFA process and Taiwan's readiness to be considered for membership in the TPP are directly related. The U.S. sees satisfactory progress on TIFA issues as the best way for Taiwan to demonstrate a commitment to the high-standard, 21<sup>st</sup> century provisions that the TPP is supposed to represent. The U.S. is but one of the 12 TPP members, and newcomers to the group will have to win the agreement of all existing parties—so the United States view on Taiwan's participation will not necessarily be decisive. Nonetheless, the US influence on the TPP and its leverage in the partnership are undeniable.

A compelling reason for Taiwan to accelerate its schedule for TPP accession is that the negotiations are going more smoothly and the group is expanding faster than expected. It now looks possible that the agreement could be wrapped up and signed before the end of 2013. During Mr. Shapiro's "Door-knock" visit to Washington D.C. in September 2013, his group found a consensus that the USTR of the Obama administration would work aggressively to conclude the negotiations. The addition of Japan to the TPP also was viewed in Washington as a "game-changer," leading to a major increase in the heft and significance of the organization when it is created. The Abe administration's enthusiasm for joining the TPP has in turn changed the former "wait-and-see" posture of South Korea, and its representatives are now talking openly about seeking membership as well. Thus, Taiwan would do well to prepare to join the second round of TPP candidates, which may begin negotiations as soon as next year. If Taiwan is not among those included in the next round, then it will have to satisfy even more members than it would at present.

Given this apparent need for urgency, Mr. Shapiro raised and dismissed three possible reasons for Taiwanese reluctance to prepare for TPP negotiations. One is the worry that the TPP will not be successfully concluded for some time, leaving Taiwanese officials facing down interest groups in the legislature and expending a lot of political capital to win approval, then having nothing immediate to show for it. However, since the negotiations have proceeded more quickly than expected, Mr. Shapiro thought this possibility to be increasingly remote. Another possible objection to moving quickly is the argument that one should not make concessions before bargaining—that to talk about reforms before attempting to win a seat at the table is to negotiate with oneself. But action on some reforms may be necessary even to earn a place at the negotiating table, in Mr. Shapiro's view. Finally, there is the possibility of an embarrassing public rejection of Taiwan's candidacy—of Taiwan going through the trouble of preparing for TPP accession, only to be refused at the negotiating stage. Mr. Shapiro thought this was a risk that should be absorbed, given the potential costs of not even trying.

Mr. Shapiro also listed a number of issues that have caused problems in US-Taiwan trade relations, and thus are potential stumbling blocks in any application by Taiwan to join the TPP. Chief among these is pork: although the issue of the feed additive ractopamine in U.S. beef imports has been largely resolved, there remains a complete ban on imports of pork containing the substance, which the U.S. views as a scientifically and logically inconsistent position. The issue remains politically sensitive on both sides: the U.S. pork lobby is well-connected on Capitol Hill, and both hog farmers and consumer advocacy groups in Taiwan have demonstrated a willingness to take to the streets and airwaves to attack the government over pork imports. Other issues include:

- the foreign investment approval process, especially the difficulty foreign private equity firms have encountered when deals involve taking listed companies private;
- the efforts by Taiwan's Financial Supervisory Commission to force the return of all data processing to Taiwan, especially that of foreign banks and life insurers;
- the adoption of unique-to-Taiwan regulations that ignore standard international practice and impose a heavy burden on multi-national companies, such as labeling requirements;
- education rules that make it all but impossible for American universities to open centers for study abroad or local education in Taiwan—centers that are now common in many other countries;
- proposed new National Health Insurance policies on drug reimbursement that threaten to make many original drugs uncompetitive in the local market;
- the inability of chiropractic doctors trained and licensed in the U.S. to be recognized in Taiwan as professional practitioners.

In terms of the external political considerations surrounding Taiwan's entry into the TPP, Shapiro emphasized that China's attitude is a major question mark. The U.S. has a standard

answer about Taiwan's accession: that TPP membership "is open to all APEC members willing to commit to the high standards of the trade agreement," and that this stipulation applies to Taiwan the same as to any other APEC economy. American officials have recited this formula to PRC counterparts many times without any objection in response. In addition, Beijing has recently softened its rhetoric toward the TPP, and has not objected to Taiwan's FTA negotiations with New Zealand and Singapore—both of whom are TPP members. China may not want to be seen as obstructing Taiwan's TPP entry if that would damage the KMT's standing in the next presidential election.

Within Taiwan, too, there are encouraging developments in the Ma administration. One was the replacement of Financial Services Commission chairman Chen Yuh-chang, which was followed by greater flexibility in the financial sphere. Another was the initiative to create Free Economic Pilot Zones, which include virtual zones for qualifying enterprises such as financial services and medical services that could demonstrate the value of deregulation on a limited basis, then be enlarged to cover the country as a whole. These could be a boon to financial services, in particular. Mr. Shapiro summed up by noting that most U.S. companies regard Taiwan as a good place to do business. The encouragement to join the TPP is to help Taiwan reach its full economic potential, and to prevent its economic marginalization in the long term.

Shapiro emphasized four concluding points. First, the biggest obstacle to Taiwan's entrance into the TPP is its own existing regulatory practices. Second, Taiwan should start now to revise laws and regulations that are contrary to the spirit of the TPP, which will help lay the groundwork with other TPP members for eventual accession. Third, once the first round of negotiations is finalized and the text made public, Taiwan should scrutinize it to determine where it needs to make changes, and then make a concerted push to promote its candidacy. Finally, Taiwan deserves consideration for the TPP because of its substantial role in world trade, and its participation would be in the best interests of the United States.

*Roy Chun Lee*

The second presenter was Dr. Roy Lee, Deputy Executive Director of the Taiwan WTO and RTA Center at the Chung-Hua Institution for Economic Research. He addressed in more detail the issue of domestic reforms needed in order to prepare Taiwan for TPP accession.

Dr. Lee opened his remarks by stating bluntly that “the TPP is of critical importance to Taiwan.” The economic implications had already been discussed extensively at the conference, he noted, but it was worth reiterating how great an impact TPP membership could have for Taiwan. Taiwan’s economy is heavily dependent on trade, with exports of manufacturing goods averaging 65 percent of GDP over the last decade, and exports of services averaging another 11 percent. About 64 percent of Taiwan’s total trade value (and 72 percent of exports) comes from trade with TPP members and China (including Hong Kong). However, Taiwan to date has only a handful of preferential trading agreements that together cover less than six percent of total trade. With major competitors including Korea, Japan, Singapore, Malaysia, Vietnam, and even China all seeking to sign new FTAs, Taiwan is lagging behind in a way that should raise anxiety. For instance, Korean, Taiwanese, and Japanese firms are all in competition with one another in the U.S. market. Because of the KORUS FTA, almost all Korean imports to the U.S. will be tariff-free by 2014, giving these firms a leg up on Taiwanese competitors. TPP membership in combination with the ECFA agreement with China would “catch Taiwan up with Korea” in the opportunities available to its exporters.

In addition, the TPP and many of the other new FTAs in the region have gone beyond traditional tariff liberalization to include so-called “deep integration” arrangements that address non-tariff barriers and harmonization of domestic regulations. The benefits of these arrangements may be even larger than tariff reduction by reducing costs and uncertainty in cross-border transactions and making investments less risky. In Dr. Lee’s view, the greatest long-term cost to Taiwan of not joining the TPP would be the lost opportunities to benefit from these efficiency-inducing reforms.

The TPP also offers political benefits for Taiwan. Despite various government restrictions, Taiwan's trade and investment has become highly concentrated in China: over the last decade, mainland China and Hong Kong have been the destination for nearly 40 percent of Taiwan's exports and around 65 percent of total outbound investment. The TPP could help foster greater diversification Taiwan's trade and investment patterns, reducing Taiwanese economic dependence on the PRC. In addition, TPP membership would probably help reduce public concerns about the long-term political impacts of trading arrangements with China, as manifested in the debates over ECFA and the recently-signed cross-Strait services trade agreement.

Dr. Lee mentioned two points of uncertainty about Taiwan's ability to gain accession to the TPP. First and foremost is the "China factor": what will China's ultimate position be on the TPP, and by implication its attitude toward Taiwan's membership in the partnership? On this point there have been encouraging signs in recent months. Open discussion of China's strategy toward the TPP was not allowed in Chinese policy circles until early this year, but is now permitted, and the debate has included an increasing number of positive comments about China's potential participation. Possible TPP participation is in fact an explicit rationale for the recent creation of the Shanghai Pilot Free Trade Zone. Nevertheless, China's own internal estimates suggest it would need 10 years or more to meet the requirements for TPP membership. If China insists on being admitted before Taiwan, or at the same time, as was the case for the WTO, then Taiwan will also be forced to wait at least a decade for accession. One of the major factors affecting Taiwan's TPP prospects, then, will be whether China adopts a more flexible approach vis-à-vis Taiwan's participation than it did in WTO negotiations.

The second point of uncertainty is the level of determination within the current administration to push for domestic reform that would help Taiwan's TPP prospects. These come in two forms. The first are so-called "confidence-building measures" that Taiwan needs to take before winning support from the U.S. and other TPP members. Dr. Lee cited Japan's commitments to re-opening its markets to U.S. beef imports, expanding automobile import quotas,

and reforming the Japan Post insurance system as examples of the kinds of “down-payments” that Taiwan would have to offer. The second form of commitment is to changing regulatory structures to comply with TPP standards—for instance, rules governing electronic commerce and ICT-related services and the cross-border transfer of data and information. The structure of public utilities and state-owned enterprises such as telecom companies is another critical area for reform, as are restrictions on foreign investment which make it difficult to pull capital out once it has been committed. Dr. Lee noted that his research center put out a WTO Trade Policy Report in 2010 identifying 135 different regulations that need to be eliminated or reformed to conform with international practice.

Dr. Lee indicated that the greatest resistance to these kinds of domestic changes is likely to come from within the bureaucracy. Many of these reforms will require top authorities to take new initiatives and bring fundamental changes to the way government agencies have traditionally operated. But there is little appetite in regulatory agencies for change. In Dr. Lee’s words, after Taiwan gained membership in the WTO, it “took a ten-year break from regulatory reform,” and it has been “hard for regulators to accept that we are lagging behind.” Unilateral liberalization seems difficult under these conditions, so from this perspective, the TPP is important not only for shaping Taiwan’s external trade environment but also for its overall domestic economic health.

*Peter Chow*

The final presentation of the conference was given by Peter Chow, Professor of Economics at the City University of New York. His comments centered on the relative benefits of different trade agreements, including the TPP and RCEP in comparison with other bilateral trade agreements.

Dr. Chow began by asserting a “myth of FTAs”—that the apprehension that Taiwan would be marginalized if it did not begin signing its own bilateral FTAs was misplaced. On balance, he argued, FTA benefits in the region have not been fully realized to this point. A recent



study by the Asian Development Bank Institute found that the percentage of firms taking advantage of preferential trading rules under FTAs was surprisingly low across the region: 29 percent in Japan, 25 percent in Thailand, 21 percent in Korea, 20 percent in the Philippines, and only 17 percent in Singapore. Even in Taiwan, the rate at which preferential trading rules were utilized in 2012 under the EFCA with China was only about 20 percent for textile products and roughly 50-60 percent in petrochemicals, machinery, and transport equipment. The low level of utilization seems to be due to the different rules of origin requirements included in each FTA. The administrative cost of complying with local content requirements is higher than any benefit gained from importing under the preferential rules of an FTA. As a consequence, many firms continue to import products under the WTO's most-favored nation rules rather than under bilateral FTAs. Thus, the rapid increase in FTAs in the region in recent years has had a relatively small impact on regional trade.

Dr. Chow suggested that Taiwan's best strategy for expanding trade links was to seek membership in both the TPP and RCEP—what he termed a “double play.” While RCEP membership offers more benefits to Taiwan in the short run because of the higher existing tariff barriers of many of the RCEP-member countries, the advantages of belonging to the TPP are also considerable. The key question is not which one Taiwan should join, but which membership to pursue first. For the moment, it appears that negotiations to join the RCEP cannot occur until 2015, when the founding members are expected to sign the original agreement. Even at that point, RCEP membership requires that a country first have an FTA with ASEAN, which Taiwan does not. By contrast, Taiwan is already a member of APEC, which is a key precondition for joining the TPP talks. Given the size and importance of Taiwan's economy for trade in the region, the founding TPP members can probably be persuaded to allow Taiwan to join as long as the U.S. backs the bid.

Dr. Chow also commented on the domestic political considerations. The constituencies of the two political camps in Taiwan tend to harbor divergent attitudes toward further economic

integration with China. To date, trade with and investment in the mainland has disproportionately benefitted big businesses, and fewer gains have accrued to the small and medium enterprises that make up the vast majority of Taiwanese firms. The ECFA agreement may also have had undesirable income redistribution effects. Overall, the KMT's constituencies have benefitted to a much greater degree than the DPP's from cross-Strait integration in recent years. As a consequence, most of the DPP is wary of further steps toward integration and is likely to oppose prioritizing RCEP over the TPP. Many in the KMT, by contrast, are not troubled by Taiwan's increasing dependency on the Chinese market but are concerned that China may eventually stop offering economic incentives that benefit Taiwan. Thus, a segment of the blue camp are wary of joining the TPP for fear of antagonizing China and jeopardizing the next round of negotiations for an expanded ECFA.

If neither the RCEP nor the TPP is a viable option for Taiwan in the future, Dr. Chow suggested that there might be a "third way" of some sort that would deliver at least some of the same benefits as these two arrangements. One possibility is pursuing a kind of "Mexican model," whereby Taiwan pursues bilateral trade agreements with both a large economy (the U.S. or China) and also other smaller economies in the region. Taiwan could then become a sort of regional economic "hub" bridging these various economies. Another possibility is joining the Pacific Trade Alliance, an emerging trade bloc which includes Colombia, Costa Rica, Chile, Peru, and Mexico, with observers from Japan, Canada, New Zealand, Panama, Guatemala, and Spain. Together, the five member states account for half of all exports and 36 percent of the GDP of Latin America. The Pacific Alliance also has the political appeal of including the last significant bloc of countries that still maintain formal ties with Taiwan instead of the PRC.

Dr. Chow concluded by emphasizing the importance of economic restructuring in Taiwan regardless of whether it is able to obtain membership in a regional trade agreement. As in many other countries in the region, agriculture remains a major stumbling block: it is economically weak but politically strong and is likely to be a source of fierce opposition to liberalization.

Moreover, the TPP includes three major agricultural exporters—the United States, Australia, and New Zealand—whose presence poses an existential threat to many agricultural sectors. Taiwan’s services sectors also would benefit from greater liberalization, although here the political implications are quite different depending on the trading partner. Liberalization of services with China would generally benefit those at the high end of the sector while adversely impacting the less skilled. But liberalization of services trade with the United States would invite an influx of formidable American high-end services firms in finance, communications, and transport, potentially harming the interests of those high-skills sectors, while low-end services firms would not feel much impact.

*Comments by Jeffrey Schott*

Jeffrey Schott, Senior Fellow at the Peterson Institute for International Economics, offered comments on the presentations. He began by asking three questions: (1) is Taiwan ready to join the TPP?; (2) are TPP members ready to accept Taiwan?; and (3) what are the options for Taiwan?

On the first question, is Taiwan ready, Mr. Schott offered a simple answer: no. Taiwan has “a lot to do on services,” and there is a lack of appreciation within the bureaucracy that reforms in services and regulations are necessary to get more space on other issues. To that end, Taiwan would do well to study the Korea-US FTA (KORUS). Dr. Lee’s paper mentioned an analysis of Taiwan’s currently regulatory structure in light of KORUS; Mr. Schott thought that this was a promising first step toward identifying what needs to be reformed in Taiwan.

On the second question, are members of the TPP ready to accept Taiwan, Mr. Schott noted that Taiwan’s accession is not an issue right now, because the window to join the first round of negotiations is already closed. When the treaty enters into force is still unclear, but he speculated that it would probably be six months after the U.S. Congress ratifies the deal—so likely in 2016 or 2017.

Then the question becomes: when can new members accede to the TPP? The process for new members is likely to be “set out in vague and general terms,” but it is certain that any new applicant will be asked to renegotiate the terms of entry. In other words, for the next round of members, negotiations will be new, and there will undoubtedly be additional demands made on the countries that apply. Notably, if Taiwan seeks membership, it is likely to have a lot of company: Korea, Indonesia, Thailand, and the Philippines are all possible participants in the second round. If China applies, the demands made of it are likely to be much greater than any other applicant, far beyond what would be asked of Taiwan. Any new member’s accession will also have to be approved by the U.S. Congress, which will be another hurdle to overcome.

On the options for Taiwan over the next few years, Schott raised several possibilities. One is to work on helping to get the multilateral trade negotiation system back on track. In his view, “Taiwan can do a lot beyond the region,” by working to build consensus on a “Doha-plus” arrangement, and joining the discussion on trade in services. A second possibility is to continue to pursue small-scale FTAs, not least for building capacity among Taiwan’s trade negotiation teams.

One option that Mr. Schott was quite pessimistic about was the possibility that Taiwan join RCEP. In his words, “RCEP is not a useful path.” For one, joining RCEP requires having an FTA with ASEAN, which Taiwan lacks. More critically, however, RCEP is not likely to foster a rapid expansion of regional trade because of the “foot-dragging” of some of the member countries, particularly India. What benefits there are from RCEP are likely to flow to the poorer ASEAN countries such as Myanmar, which may be the biggest winner from the arrangement.

Like many of the other conference participants, Mr. Schott emphasized the “China factor” as a major unknown. China’s ultimate approach toward the TPP will have a major impact on Taiwan’s options. There is a strong possibility that China’s new leaders will foster a change in attitude there toward the TPP, and will seek ways to use it to improve China’s domestic economy.

This change in attitude is bolstered by Japan's decision to participate, which from China's perspective makes the TPP more than just a U.S.-dominated initiative.

In sum, Mr. Schott predicted that Taiwan would be able to get into the TPP in the next round. But there could also be another opportunity to join some kind of Asia-Pacific hybrid incorporating the best elements from both, if China is interested in bridging the gap between integration across the Pacific and within Asia.

### *Discussion*

The ensuing discussion centered on two issues: the consequences for Taiwan if it does not gain accession to the TPP, and the likelihood of succeeding if it does seek membership.

On the first question, there was considerable debate and some disagreement. Most participants viewed TPP membership as an undoubtedly good thing for Taiwan, but some thought Taiwan would have other realistic options to expand its trade relations if it did not enter the TPP, perhaps through bilateral agreements or closer integration with the PRC. Others viewed Taiwan's options as much more limited. The U.S. position appears to rule out any bilateral agreement with Taiwan, and other arrangements such as the Pacific Alliance are not likely to deliver anywhere near the benefits that the TPP would. In that case, Taiwan's only realistic alternative would be even greater integration with the Chinese economy.

The majority view was that RCEP was not a feasible alternative to the TPP for Taiwan. One obstacle is procedural: Taiwan lacks a free trade agreement with ASEAN, which is a requirement to join RCEP. Another is political: China is not likely to support Taiwanese participation in RCEP until and unless it agrees to reunification talks. A third is pragmatic: RCEP's membership is large and diverse, including countries as different as Japan and India, and it is also a much less ambitious framework than the TPP. As a consequence, RCEP membership would not provide the kinds of benefits to Taiwan that the TPP would in the long run.

Participants also had divergent assessments of Taiwan's likelihood of gaining membership in the TPP. Those focused primarily on domestic concerns were generally pessimistic, emphasizing the sheer number of changes required and the depth of opposition to reform in Taiwan. Those focused primarily on external concerns were more positive, however. It is striking that both Malaysia and Vietnam are current participants in the TPP negotiations—both countries may be forced to adopt much more drastic and far-reaching reforms than Taiwan would. Their presence in the TPP suggests that the constraints on Taiwan are more political than economic in nature.

### **Conclusions from the Conference**

The motivation for the conference was to consider the opportunities and constraints on Taiwan's future economic development, particularly in the context of a changing trading environment in the Asia Pacific region. The two dozen participants provided a variety of perspectives on this topic, engaging in a great deal of lively debate and conversation. Although there remained some disagreement among the panelists as a whole, three key conclusions emerged by the end of the conference. First, that it is in Taiwan's national interest to join the Trans-Pacific Partnership. Second, that the external obstacles to Taiwan's participation are significant but not insurmountable. And third, that domestic obstacles to Taiwan's membership are likely to be more intractable than international ones.

**It is in Taiwan's national interest to join the Trans-Pacific Partnership.** The benefits of TPP membership are initially likely to be modest, and there is still some doubt that the agreement will ultimately win approval in the United States and other member countries and enter into effect. Nevertheless, if it does, the benefits of TPP membership are likely to be substantial over time for

Taiwan, including greater access to its major export markets as well as the enactment of growth-inducing domestic reforms. More importantly, the costs of *not* being a member of the TPP are potentially large. Most other countries in the region have already joined the partnership or are seeking to join in the next round, including Korea, Japan, Malaysia, Singapore, Vietnam, and the United States. These make up the bulk of Taiwan's major trading partners; the only notable omission is the People's Republic of China. Because Taiwan's economy is highly trade-dependent, and because many of its most efficient and highest-value industries depend on links to regional production chains, any alteration in the regional rules of trade could have a major impact on Taiwan's economy. If and when it comes into force, the TPP promises to produce such an impact, creating strong incentives for trade-dependent firms to relocate much of their activity from Taiwan to TPP member countries.

If Taiwan remains outside of this new regional trading bloc, the prospects for domestic-driven economic growth do not look very good. It has a rapidly aging population and a shrinking workforce, and it has attracted little foreign direct investment in recent years. Nor has closer economic integration with the People's Republic of China to this point reversed the net outflow of investment. Taiwan's high rankings in competitiveness and ease-of-business indices are of less consequence if its economy becomes more isolated from the rest of the world.

Furthermore, alternative arrangements to the TPP, to the extent that they exist, are likely inferior to TPP membership. For both political and pragmatic reasons, the RCEP is not a realistic alternative for Taiwan in the short- to medium-term: Taiwan does not have a trade agreement with ASEAN, would have to seek Chinese approval which is likely to come at an impossibly high political cost, and would not reap much benefit beyond tariff reductions for some of its exports. Bilateral FTAs are feasible but do not offer the same kind of unified, comprehensive framework that the TPP does. They also in practice have tended to be under-utilized, with firms preferring to trade under the WTO's MFN rules instead. Thus, their impact is likely to be limited. Finally, Taiwan's economy is already heavily dependent on the Chinese market, and further integration is

fraught with domestic political challenges and security concerns. Thus, Taiwan appears to have much to lose from not gaining membership in the TPP, especially over the long term.

**The external obstacles to Taiwan's accession to the TPP are significant, but not insurmountable.** As it has since at least the 1970s, Taiwan's participation in international affairs of any kind depends crucially on the positions of two countries, the United States and the People's Republic of China. As an agreement among states that will regulate trade around the Asia Pacific region, the Trans-Pacific Partnership is no different. Conference participants repeatedly emphasized that attitudes in the United States and China would together be decisive for Taiwan's prospective membership in the TPP. Neither country's support is guaranteed. But neither country's opposition is a certainty, either. And Taiwan does appear to have some ability to influence the positions that both countries ultimately take.

On the United States side, the recent history of bilateral trade relations is not good. U.S. negotiators have expressed frustration at continuing restrictions on important agricultural products such as beef and pork. As importantly, Taiwan's political process has generated outcomes that violate multiple norms of U.S. trade practice: using scientific standards for decisions about food safety, holding up-or-down votes on trade agreements, and implementing domestic laws and regulations in accordance with international agreements. And Taiwanese policy-makers have demonstrated little inclination over the past 10 years to undertake reforms desired by their U.S. counterparts, from relaxing restrictions on foreign direct investment to adopting international best practices on consumer regulation and inspection of imports. As a result, the United States position in recent years has been that Taiwan is not a reliable trade partner, and that its inclusion in the original TPP negotiations would be counterproductive.

Nevertheless, the conference deliberations indicated more latent support in Washington for Taiwan's participation in regional trade arrangements than can be gleaned from the actions and statements of USTR officials. Multiple conference participants noted that they had heard



encouraging statements from State Department officials in support of Taiwan's participation in the next round of TPP negotiations. The U.S. official position is that any member of APEC is eligible to participate; since Taiwan is part of APEC, Taiwan is therefore eligible as well. U.S. officials have apparently presented this formulation to Chinese authorities many times without objection. In addition, several participants argued, Taiwan's membership is in the interests of both the United States and other founding members of the TPP.

The concerns about Taiwan's trading practices do not appear to be insurmountable, either. For one, several of the founding members of the TPP look substantially less prepared for accession than does Taiwan. Vietnam and Malaysia will undoubtedly have to implement major reforms of their state-owned enterprises and government procurement rules. The next round is likely to include Thailand and Korea, at a minimum, neither of whom appears obviously better positioned than Taiwan to join the agreement. In addition, Taiwan has recently completed negotiations and signed free trade agreements with New Zealand and Singapore, and it can demonstrate its commitment to trade liberalization by winning legislative approval for both. And even some of the major sources of tension in U.S.-Taiwan trade relations have recently eased, as beef imports to Taiwan have jumped 40 percent in the last year. Overall, despite what appear to be unavoidable tensions over specific trade issues, these are unlikely to supersede the larger strategic interest of the United States in seeing Taiwan join the TPP.

On the Chinese side, the initial reaction in the PRC to U.S. participation in the TPP was quite suspicious, which did not bode well for Taiwan. Many Chinese elites thought of the TPP as a manifestation of U.S. efforts to "securitize" trade policy, feeding into fears prevalent among Chinese hawks of a U.S. effort to "contain" China and prevent its rise into a world power. Until recently, that appeared to be the predominant view in China. However, several conference participants noted a change in attitude in recent months among many Chinese officials and academics. Rather than seeing the TPP as an implicit threat to China's development, an increasing number now see it as a sincere attempt to build a more effective regional trade regime.

From that perspective, China might actually benefit from joining the TPP in the next round: by pledging to meet the TPP requirements, the country would commit to a new stage of difficult but necessary economic reforms, in much the way WTO membership was used by Zhu Rongji to advance a reform agenda in the 1990s. Thus, there is now a significant and growing group of Chinese policy-makers who are more inclined to support the TPP. In fact, conference deliberations highlighted that it is in Taiwan's best interest for China also to join the TPP. At the least, Taiwan is much better off if the TPP is viewed primarily as a trade regime rather than as the beginning of an alliance with security implications.

Conference deliberations also highlighted the importance to Taiwan of seeking TPP membership sooner rather than later. The next round of negotiations for new members is likely to begin shortly after the TPP takes effect, in 2015 or 2016. Those negotiations will be completely new, and every original member will have a veto. Taiwan is likely to have to satisfy demands from a wide array of its trading partners to accede to the TPP in that round. Yet waiting will merely increase the number of members; each round is likely to lead to a higher price of admission. Thus, it is in Taiwan's interest to join before many other countries are added to the agreement.

**The domestic obstacles to Taiwan's membership are likely to be more intractable than international ones.** Taiwan's domestic political challenges may present the greatest obstacles to its TPP aspirations. The conference deliberations returned several times to the same set of roadblocks to greater trade liberalization in Taiwan. The most fundamental is a strong protectionist element in Taiwanese public opinion, which persists and has even strengthened despite the fact that Taiwan has long been one of the chief beneficiaries of trade liberalization. Public support for protectionism is concentrated among the less-educated, rural segments of the population. Core pan-Green supporters are also on average significantly more protectionist, although such sentiments can be found in significant numbers among pan-Blue partisans as well.

It is not clear to what degree this partisan difference reflects deeper aversion to liberal trade policies in general, or instead a narrower hostility toward free trade agreements with China.

This opposition stems in part from growing income and wealth inequality, which is a major source of protectionist sentiments throughout the democratic world. Starting from a remarkably low level, inequality in Taiwan has risen significantly over the past two decades. Unemployment, especially among college graduates, is also quite a bit above the historical average, and wage growth has stagnated. The current administration has not directly addressed most of these concerns through policy initiatives. Likewise, it has not taken steps to compensate the losers from trade liberalization, choosing instead in the case of the cross-Strait Economic Cooperation Framework Agreement to focus entirely on the benefits that it would bring. Yet the long-term success of a trade liberalization agenda in Taiwan may depend on whether effective redistributive policies can be devised and implemented. It will probably require increasing the government's tax take—currently only 13 percent of GDP—strengthening the social safety net, and implementing programs targeted especially at lower-income workers who are disproportionately harmed by free trade agreements. Otherwise, trade liberalization will continue to be fiercely opposed by narrow but highly organized constituencies.

One non-obvious suggestion to emerge from the conference deliberations was that the DPP is well-positioned to act as a champion of trade liberalization under the guise of the TPP, despite having a strongly protectionism element among its base. DPP supporters are likely to sympathize with an agreement that helps Taiwan diversify its economy away from the mainland Chinese market and strengthen economic ties with other countries in the region. There is an opening for the principal opposition party in Taiwan to reframe the debate over free trade by casting the TPP as an insurance policy against over-dependence on China. President Ma's current unpopularity makes it unlikely that his administration alone will be able to rally support behind an economic reform agenda. If the significant changes required for TPP membership are

to be attempted, then that effort would be strengthened if there are forceful advocates in both the Green and Blue camps.

Another serious domestic obstacle to trade reform is the ascendance of the legislature at the expense of the executive branch in Taiwan, and the concomitant fragmentation of policy-making. The legislative reforms of the last decade have increased the influence and authority of individual legislators, and as a consequence they have made it easier for sectoral interests to block reforms. Taiwan does not have any institutional procedure corresponding to fast track negotiating authority in the United States, nor does it have a single body like the U.S. Trade Representative to coordinate trade policy among the executive, the legislature, and the various private business lobbies. Unless Taiwan's trade policy-making process is reformed to reduce access points available to individual interests, more trade agreements are likely to be pulled apart and altered by the legislature in a way that renders them invalid. Such may be the fate of the cross-Strait services agreement, currently facing more than a dozen public hearings and line-by-line roll-call votes in the Legislative Yuan.

Finally, the Taiwanese bureaucracy appears to be yet another obstacle to reform. One of the key initiatives of the TPP is to standardize legal frameworks that govern products, such as child safety regulations or food inspections. Even on these issues, which do not inflict obvious harm on a particularly constituency, the various regulatory agencies in Taiwan have not had a promising record over the past decade, instead moving if anything in the direction of crafting more requirements that are unique to Taiwan. If Taiwan is to gain membership in the TPP, it will require overcoming the entrenched conservatism and resistance to reform of the bureaucracy.

To view photos of the Trans-Pacific Partnership Conference, please click on the link to be transferred to the Facebook album: <http://goo.gl/bemaoT>.

**ADDENDUM**



The Taiwan Democracy Program at the  
Center on Democracy, Development, and the Rule of Law

*Conference on*

**The Trans-Pacific Partnership and Taiwan's  
Future Development Strategy**

co-sponsored by  
The Walter H. Shorenstein Asia-Pacific Research Center

October 11-12, 2013  
Bechtel Conference Center, Encina Hall  
Stanford University

Friday, October 11

8:15 -9:00 am Breakfast and Registration at Encina Hall

9:00 - 9:15 am Welcoming remarks

**Larry Diamond**, Director, CDDRL, Stanford University

9:15 - 11:00 am

**How the Economic/Trading Environment of East Asia is Evolving**

**Chair: Larry Diamond**, Director, CDDRL, Stanford University

1 *Broad overview of trends in regional trade and trading partnerships*

**Vinod Aggarwal**, Professor of Political Science and  
Director of the Berkeley APEC Study Center, UC Berkeley

2 *Challenges for Taiwan's future development strategy in a changing global economy*

**Tain-Jy Chen**, President of Chung-Hua Institution for Economic  
Research (CIER); Professor of Economics, National Taiwan University;  
Former Chairman of the Council of Economic Planning and Development

**Discussants:** **Miles Kahler**, Rohr Professor of Pacific International  
Relations, UC San Diego  
**Hung-mao Tien**, President, Institute for National Policy  
Research (INPR), Taiwan; Former Minister of Foreign  
Affairs, Taiwan

11:00 - 11:15 am      Coffee Break

11:15 - 1:00 pm

**The Trans-Pacific Partnership: Its Evolving Structure and Geopolitics**

**Chair: Daniel Sneider**, Associate Director for Research, Shorenstein Asia Pacific Research Center, Stanford University

1      *The geopolitics of the TPP: Implications for the shaping of the balance of power in Asia Pacific*

**Donald Emmerson**, Senior Fellow, Shorenstein Asia Pacific Research Center, Stanford University

2      *China's Role in Asia Pacific trade and its responses to the TPP*

**Bai Gao**, Professor of Sociology, Duke University

**Discussant: Mignonne Chan**, Adjunct Associate Professor, National Cheng Chi University; former advisor to the President, National Security Council, Taiwan

1:00 - 2:15 pm      Lunch Break

2:15 - 4:00 pm      **How is Taiwan Responding to the Challenge of Freer Trade?**

**Chair: Peter Chow**, Professor of Economics, City University of New York

1      US-Taiwan trade relationships and Taiwan's diplomacy to date

**Szu-yin Ho**, Professor of Political Science, National Cheng Chi University

2      Taiwan's domestic politics and the constituencies for free trade

**Yun-han Chu**, Professor of Political Science, National Taiwan University; Fellow, Academia Sinica; President, Chiang Ching-kuo Foundation

**Discussant: Rupert Hammond-Chambers**, President, US-Taiwan Business Council

4:00 pm              Bus to Sheraton Hotel

6:00 pm              Meet in the lobby of the Sheraton to walk to dinner at Scott's Seafood, 855 El Camino Real, Palo Alto

Saturday, October 12

8:15 am Breakfast at Encina Hall

9:00 - 10:45 am

**Taiwan's Development for the Next Phase: Two Views**

**Chair: Hung-mao Tien**, Institute for National Policy Research, Taiwan

- 1 **Sheng-Cheng Hu**, Fellow, Academia Sinica; Former Chairman, Council for Economic Planning and Development
- 2 **San Gee**, Vice Chairman of the Taiwan External Trade Development Council (TAITRA); former Deputy Chairman, Council for Economic Planning and Development

**Discussant: Mignonne Chan**, Adjunct Associate Professor, National Cheng Chi University; former advisor to the President, National Security Council, Taiwan

10:45 - 11:00 am Coffee Break

11:00 am - 1:00 pm **Looking to the Future, Part I: Where is the TPP Headed?**

**Chair: Donald Emmerson**, Senior Fellow, Shorenstein Asia Pacific Research Center, Stanford University

- 1 *New Zealand perspective*  
**Charles Finny**, Partner, Saunders Unsworth; former lead negotiator on the Agreement between New Zealand and the Separate Customs Union of Taiwan, Penghu, Kinmen and Matsu on Economic Cooperation, and on the China-New Zealand FTA
- 2 Japan perspective  
**Shujiro Urata**, Professor, Graduate School of Asia-Pacific Studies, Waseda University
- 3 Korea perspective  
**Jin Kyo Suh**, Senior Fellow, Korea Institute for Economic Policy
- 4 Singapore perspective  
**Deborah Kay Elms**, Senior Fellow and Head of Temasek Foundation Centre for Trade & Negotiations, Singapore

1:00 - 2:00pm Lunch Break



2:00 - 3:45 pm

**Looking to the Future, Part II: Taiwan's Strategy and the Future of the TPP**

**Chair: Yun-han Chu**, Professor of Political Science, National Taiwan University; Fellow, Academia Sinica; President, Chiang Ching-kuo Foundation

1 What does Taiwan need to do to join the TPP, and to improve its credibility on trade issues with the US?

**Don Shapiro**, Senior Director, American Chamber of Commerce in Taipei

2 *Taiwan's View of the TPP*

**Roy Chun Lee**, Deputy Executive Director, Taiwan WTO and RTA Center, Chung-Hua Institution for Economic Research

3 *Global Opportunities, Local and Transnational Politics: Taiwan's Bid for FTAs*

**Peter Chow**, Professor of Economics, City University of New York  
*Co-authored with Tun-Jen Cheng*

**Discussant: Jeffrey Schott**, Senior Fellow, Peterson Institute for International Economics

3:45 - 4:15 pm Concluding Discussion

4:15 pm Bus to Sheraton Hotel

6:00 pm Meet in the lobby of the Sheraton to get a bus to dinner at Ming's Restaurant, 1700 Embarcadero Road, Palo Alto