



A New Dawn?

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THE NEW REALITIES OF U.S.-TAIWAN ECONOMIC AND TRADE RELATIONS

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President Donald Trump's economic policies have impacted economic relations between the United States and Taiwan. In addition to pulling out of the Trans-Pacific Partnership agreement and renegotiating existing trade deals such as NAFTA, the Trump administration has also been targeting poor intellectual property protection in China. Trump has called for investigations into access barriers such as U.S. companies being required to share trade secrets in exchange for access to the Chinese market, and plans to impose tariffs on China according to Section 301 of the Trade Act of 1974. Trump's promotion of trade protectionism and policies encouraging manufacturing to move back to the United States not only poses a great challenge to Taiwan that adopts a model of receiving orders in Taiwan, producing goods in China, and exporting them to the United States, but also exerts pressure on Taiwan to adjust its industrial structure. In fact, U.S. and Taiwanese industries complement one another, are connected by a vertical division of labor, and are closely integrated. Exports of Taiwan's intermediate goods have a positive impact on U.S. manufacturers' final exports of consumer goods. The two sides should continue to strengthen their mutual strategic partnership, promote exchanges in trade, investment, defense and other aspects, and improve economic and trade relations through a Trade and Investment Framework Agreement (TIFA).

The Trump Administration's New Economic and Trade Policy

Similar to supply side economics during the Ronald Reagan era, policies proposed by Trump during his presidential campaign were mainly aimed at stimulating private consumption by tax cuts and boosting aggregate demand by expanding infrastructure spending. Obviously, cutting corporate taxes is aimed at prompting companies to transfer overseas funds back to the United States, attracting foreign direct investment,

leading manufacturing back to the country, and creating more domestic jobs.

But tax cuts and increased public expenditure will also increase the federal government's budget deficit and Treasury bond yields, which may discourage private investment. For instance, the day after Trump was elected, 10-year U.S. Treasury bond yields rose sharply from 1.92 percent to 2.05 percent, an increase of 10.27 percent. The financial market was shocked by Trump economics. The Federal Reserve also suggested that it would shrink the balance sheet and gradually sell bonds purchased through quantitative easing (QE) to recover excess money from the market, which would be one of the uncertainties for the financial market in the future.

Of course, tax cuts, infrastructure spending, projects and other policies need congressional approval before implementation. Although the Republican Party controls both the House and the Senate, uncertainties still remain.

On the other hand, it is slowly becoming clear that Trump's trade reorientation means replacing multilateral agreements with bilateral negotiation. Assuming that free trade cannot revive the U.S. economy and would kill domestic jobs, he has accused China of using discriminatory government subsidies to frequently manipulate its currency, infringe upon patent and intellectual property, and dump products in the U.S. by relying on lower labor cost, thereby causing job losses at home. He proposes to impose punitive import tariffs on Chinese goods to reduce the U.S. trade deficit with China.

Based on his America First policy, Trump continues to adjust trade policy and threatens to start a trade war if the U.S. trade partners refuse to open their markets. Since taking office, the President has withdrawn the United States from the TPP, ended TTIP negotiation, requested renegotiation of NAFTA by threatening to break away from the Agreement, and also asked South Korea to renegotiate KORUS to achieve better treatment of American labor.

Growing fears of a U.S.-led trade war looms, raising fears about a global trade recession and, with its protectionism stance, weakening U.S. global leadership; the unipolar global politics and economy will be redirected towards multi polarization. Russia pits itself against the United States, creating geopolitical contradictions. China is enhancing its international influence by promoting its Belt and Road initiative. A previously divided Eurozone is united after the election of Emmanuel Macron as President of France. Enjoying moderate economic growth, Japan is strengthening its diplomatic ties with countries to wean itself from its dependence on the U.S., enhancing its alignment with India, managing threats from China head-on, and reaching an Economic Partnership Agreement (EPA) with the European Union. Under Trump's international trade and economic policies, it seems the United States is increasingly isolated.

Repositioning U.S.-China Trade Relations

On the campaign trail last year, Trump strongly criticized China for deliberately manipulating and devaluing its currency as well as offering disguised export subsidies and dumping cheap products in the United States. He vowed to label China a currency manipulator and impose punitive import tariffs on Chinese goods.

Yet after Chinese Premier Xi Jinping visited the United States in April 2017, the U.S. government began to place hopes on China to deal with the North Korean issue. China was included in a watch list in *Foreign Exchange Policies of Major Trading Partners of the United States*¹ submitted by the U.S. Department of the Treasury to Congress. Trump tweeted that Washington was working with China on the North Korean issue and that labeling China as a currency manipulator depended on how those diplomatic endeavors shaped up.²

The trade numbers, however, tell a clear picture: the trade deficit for goods with China reached \$347 billion in 2016. Even if the surplus in U.S. services is taken into account, the total trade deficit still stands

at \$309.6 billion, a figure Trump cannot ignore politically.

Separately, Trump also signed an executive order requesting the United States Trade Representative (USTR) office and other federal agencies to present the *Omnibus Report on Significant Trade Deficits*³ to monitor U.S. trade deficits with major trading partners.

After the U.S.-China Mar-A-Lago summit⁴ in April 2017, the United States and China established the Comprehensive Economic Dialogue and agreed on the U.S.-China 100 Day Action Plan aimed at easing their trade disputes. Under that deal, China agreed to purchase U.S. liquefied natural gas, lift the ban on imports of U.S. beef imposed for 14 years, and allow U.S. credit card, e-payment, and credit rating institutions to gain access to Chinese markets⁵. However, the dumping of Chinese steel as well as aluminum, automobile parts, and other products on the U.S. market, remained unresolved.

Meanwhile, the U.S.-China 100-Day Action Plan is now overdue, which for Trump who is accustomed to receiving payments within 90 days of business transactions would consider a serious default. The President repeatedly tweeted his impatience, and said that he is planning to counter Chinese dumping of steel and aluminum by imposing tariffs and import quotas. There are still differences in industrial issues between the two sides as well as unsolved unbalanced trade relations. Whether the United States will use tariffs and quotas or even trigger a trade war remains to be seen.

One significant source of contention is the fact that China requires European and U.S. companies to share their technology in exchange for access to the Chinese market. President Trump requested that USTR launch an investigation into access barriers in China and made plans to impose sanctions on China with comprehensive tariffs according to Section 301 of the 1974 Trade Act. A political game over trade imbalances has thus already begun.

When logos, patents, and other intellectual

properties of U.S. companies are stolen by Chinese companies, the Chinese government will ask U.S. companies to share research and development achievements, while forcing them to transfer technologies or build joint ventures in exchange for access to the Chinese market. From IBM, Intel, and Qualcomm to AMD, U.S. companies have had to make concessions for fear of being rejected by the second largest economy in the world.

Chinese practices of focusing on self-production in essence are a means to develop “red supply chains” and enhance the country’s technological capabilities. The U.S. has strongly condemned such compulsory market access conditions. Trump has repeatedly demanded that USTR investigate market access barriers and impose trade sanctions if necessary. This defiant position has received support domestically, even among Democratic legislators and corporate executives.

China definitely does not want a trade war. China’s Ministry of Commerce declared that the government values intellectual property protection, noting that trade policies adopted by all WTO members should be in accordance with rules of the organization⁶, insinuating that the U.S.’s Section 301 violates the World Trade Organization’s rules. On the one hand, Beijing has stressed the need for economic cooperation with Washington and has tried to appease the United States with agricultural products and other early harvest lists. On the other hand, China has prepared countermeasures such as import restrictions of specific products. It is clear that China will retaliate forcefully should a trade war erupt.

Threatened by the prospect of a trade war with the United States, China had to support a resolution of the UN Security Council proposed by the U.S. to impose economic sanctions on North Korea. That will temporarily cut North Korea’s economic dependence on China. As a political game over trade imbalance between the two largest world economies begins, global political and economic risks increase, and if a trade war is triggered, worldwide economic turmoil will ensue. Given that the U.S.-China trade

deficit cannot be resolved in a short period of time, engaging in institutional dialogue is still the strategy to pursue to avoid a trade war between the two.

Deepening U.S.-Taiwan Economic Relations

“In 2016, Taiwan was the United States’ 10th-largest single-economy trading partner. U.S. trade with Taiwan accounted for 1.8 percent of total U.S. trade with the world. U.S. two-way merchandise trade with Taiwan amounted to \$65.4 billion in 2016, a decrease of 2.1 percent from the \$66.8 billion in 2015. U.S. merchandise trade deficit with Taiwan fell \$1.8 billion, from \$15.0 billion in 2015 to \$13.3 billion in 2016.”⁷

As described below, U.S. trade flows with Taiwan remained heavily dependent upon consumer electronics, most notably computer components. Also in 2016, the U.S. services trade surplus with Taiwan fell by \$763 million relative to the year before, from \$4.3 billion in 2015 to \$3.5 billion in 2016. The decline in the services trade surplus was attributable to a \$739 million decline in U.S. services exports to Taiwan and a \$24 million increase in U.S. services imports from Taiwan in 2016.⁸

Capital and intermediate goods take the lion’s share of U.S.-Taiwan trade. In 2016, capital goods, intermediate goods, and raw materials accounted for 67 percent of Taiwan’s exports to the U.S.

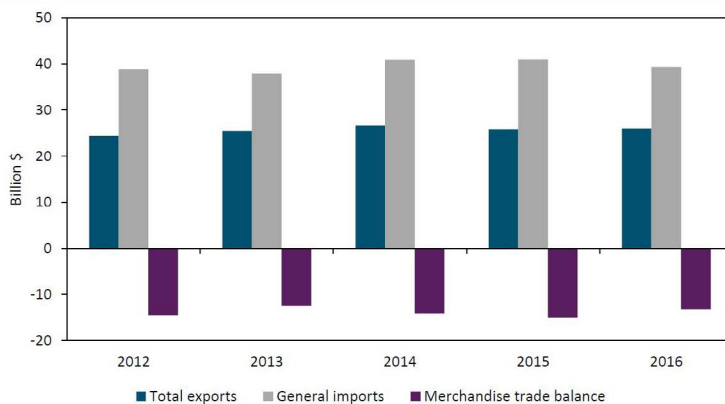
and 86 percent of Taiwan’s imports from the U.S. Consumption goods only accounted for 33 percent of Taiwan’s exports to the U.S. and 14 percent of Taiwan’s imports from the U.S. The bilateral trade pattern reflects the cooperative and complementary nature of U.S.-Taiwan trade.

Taiwan’s exports to the U.S. mainly consist of industrial and manufacturing “parts and components” which are complementary to the U.S. trade, industry, and economy. The index of intra-industry trade (trade within the same industry, or “IIT”) between the U.S. and Taiwan was more than 0.4 out of a maximum of “1” in the past decade, which is one of the highest among the major trading partners of the U.S. in East Asia (Chow, 2016. pp.120-122).⁹

In general, Taiwan’s exports contribute to the U.S. global supply chain. By using the data from WTO-OECD database on the “foreign contribution to exports” in 25 countries, Chow calculated that the percentage of Taiwan’s exports to the U.S. global supply chain is greater than those from Indonesia, the Philippines, and Thailand combined (Chow, 2016. p.133).¹⁰ Therefore, Chow concluded that Taiwan is a “natural trading partner” for the United States, more so than any of other U.S. trading partners in South and East Asia.

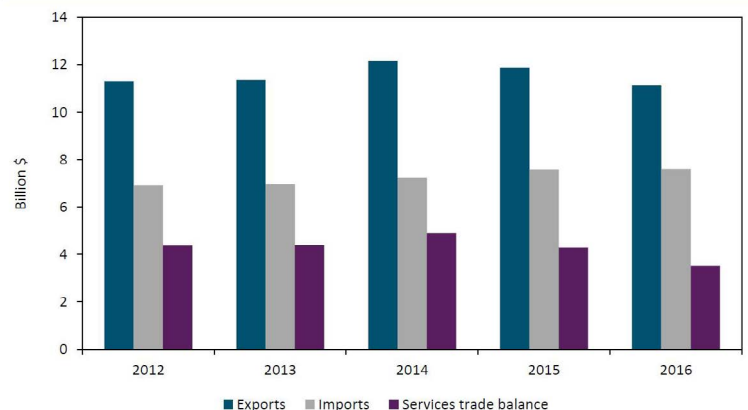
In July 2017, USTR officials led a delegation to Taiwan for a trade dialogue. Although it was merely a

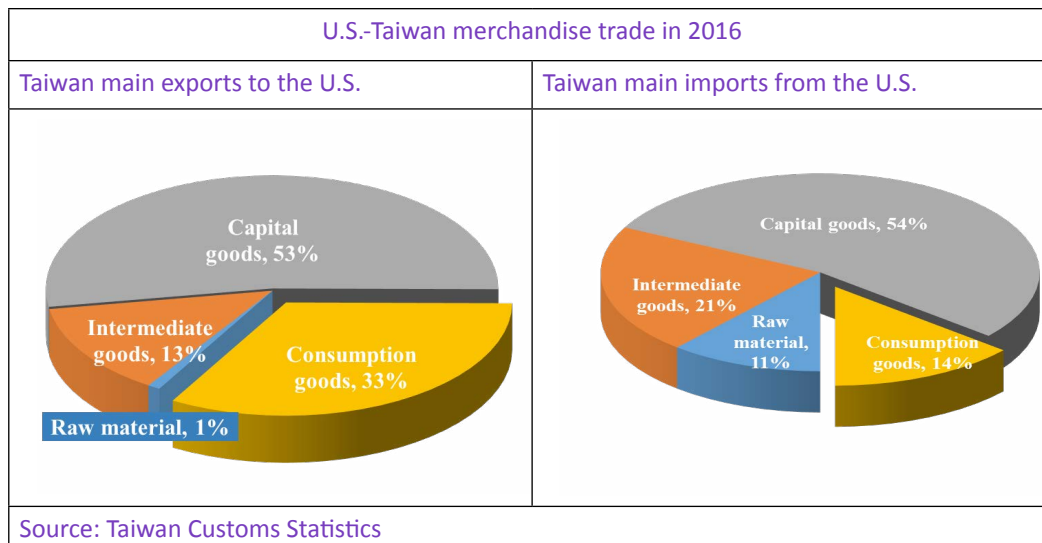
Figure 6.15 U.S. merchandise trade with Taiwan, 2012–16



Source: Official trade statistics of the U.S. Department of Commerce, accessible via the USITC DataWeb (accessed February 23, 2017). Note: Underlying data can be found in appendix table B.5.

Figure 6.16 U.S. private services trade with Taiwan, 2012–16⁹





technical consultation to prepare for this year’s TIFA, there was certain symbolic significance since it was the first U.S.-Taiwan trade dialogue after President Trump took office.

Moreover, the recently-concluded Comprehensive Economic Dialogue between the U.S. and China lacked substantive results. The U.S., China, and Taiwan have close economic ties that affect one another, making U.S.-Taiwan trade dialogue even more important.

Taiwan is among the top ten trading partners of the U.S., The U.S. economic prosperity or slowdown and trade policy have a profound impact on Taiwan. In addition, Taiwanese technological research and development and intermediate goods trade with the U.S. significantly affect U.S. exports of final goods. The iPhone is a good example to make this point. Although Apple has reduced its dependence on suppliers of upstream components, the yield rate and shipment situations of many key components can still affect the launch time of a new generation iPhone.

Taiwan has been relying on the supply chain integration with China in Original Equipment Manufacturing (OEM). Taiwanese companies’ OEM export model with China as the “factory” leads to export demands for intermediate goods

from Taiwan, and a big proportion of the final consumption goods produced in China is exported to the United States. Some believe that Taiwanese manufacturers’ transnational production activities partly attributed to the U.S. goods trade deficit with China of \$347 billion in 2016 or the overall trade disputes between the two countries. Yet the trilateral economic and trade relations among the U.S., China, and Taiwan based on the model of receiving orders in Taiwan, producing goods in China, and exporting them to the U.S. is unlikely to change substantially in the near term.

Foxconn’s Investment in the United States

With changes in the overall economic environment in China, Taiwanese companies have proactively diversified their investments with some of them investing in the United States in recent years. For instance, in June, Taiwan sent a delegation to the Select-USA Investment Summit. It was reported that the delegation presented a “manufacturing in America”¹¹ plan to the Trump administration, with a possible investment amount totaling \$34 billion from Taiwanese companies such as Formosa Plastics Group, CPC Corporation, and Foxconn.

Receiving the greatest attention was a joint announcement made by President Trump and Hon

Hai Precision's Chairman Terry Gou in the White House, unveiling that Foxconn Technology Group would invest \$10 billion in a high-end liquid-crystal display (LCD) production facility in Wisconsin, which would create an initial 3,000 jobs and potentially lead to an additional 13,000 jobs for the state.

It remains to be seen whether Hon Hai, which invests in foreign countries to expand its global reach, could shift its investment in China to the United States on a bigger scale. However, Taiwanese midstream and upstream manufacturers' establishment of production facilities in the United States will not only enhance U.S.-Taiwan ties by integrating supply chains more fully, but also help Taiwanese manufacturers with technological and industrial upgrades. Taiwanese businesses would have a chance to get rid of the pursuit of China's "red supply chain," developed by national resources, which remains a headache for the Taiwanese.

Integrated into the international supply chain, Taiwan's manufacturers adopting a production model of high-level international division of labor have also started to pursue a new industrial model closely connected not only to the North American market, but also production lines. Taiwanese manufacturers are used to international labor division, and their industrial structures are concentrated in midstream and upstream components. Taiwan manufactures textiles, auto components, and electronic components, while the United States produces final consumption goods, controls distribution channels, and manages brands. For instance, Apple designs iPhones and other electronic products. The timing of product launches and sales performances closely affect the bottom line of Taiwanese electronic manufacturers deeply integrated into Apple's supply chain.

Diverging from its usual international division of labor model of receiving orders in Taiwan, producing goods in China, and exporting them to North America, Foxconn decided to invest in a new LCD production facility in the United States. Moving closer to the largest consumer market in

North America will help Hon Hai, which focuses on upstream production, and have a better understanding of the demands of the final market. Looking ahead, Taiwanese companies should be able to further understand customer preferences in the North American market, develop proprietary brands, and manage marketing channels, all of which will be beneficial to increasing their added value. Not only would that bolster Taiwan's own industrial transformation, but it would also meet the Trump administration's priority to create jobs in the U.S.

In response to the Trump administration's mandate of encouraging companies to invest at home, Hon Hai's investment in the United States can help strengthen U.S.-Taiwan economic and trade relations, and may even become a new model of deepening U.S.-Taiwan cooperation. After all, the Trump administration's policy pivots on moving manufacturing back to U.S. shores to create new jobs for Americans, especially for those in the key states in the presidential election where shrinking local industries have worsened the job market. The President's decisions to withdraw the U.S. from TPP, renegotiate NAFTA, and adjust trade policy are all aimed at creating jobs. Building upon the foundation of profound industrial integration and labor division relations between the U.S. and Taiwan, expanding investment and establishing production facilities in the United States would contribute to the improvement of mutual economic and trade ties.

Conclusion: The United States and Taiwan and Strategic Partners

Taiwanese businesses would not want to see trade disputes between the U.S. and China escalate into punitive tariffs, or even a trade war with countermeasures by China.

Taiwan's multinational companies have gradually established a new management model to diversify manufacturing in the reconfigured international supply chain.

Under the leadership of President Tsai Ing-wen, Taiwan is now promoting a "New Southbound Policy"

to reflect the production model based on diversified manufacturing from multinational migration. The government is also promoting a “5+2 industrial innovation program”, that includes investing in green energy technology, promoting the growth of a Silicon Valley in Asia, boosting the national defense industry, investing in smart machinery as well as the biotech and pharmaceutical industries. These programs aim to diversify investments to China that have been replaced by the “red supply chain.”¹² The program attempts to reestablish strategic industrial cooperation mechanisms with Europe, the U.S., Japan, and other advanced economies, further deepening integration of the U.S.-Taiwan supply chain and creating a transnational management model based on multinational production. Governments of the two sides should jointly build an integration platform for cooperation and the development of new industries.

Taiwan’s industrial sector should acknowledge the importance of fair trade proposed by the Trump administration and the White House’s “Made in America” policy. Industries such as petrochemical, steel, textile, and electronics have plans to invest in the United States. The Tsai administration has shown a willingness to address trade issues between the two sides by means such as expanding procurements from the U.S. and encouraging Taiwanese businessmen to invest in the U.S.

The U.S. and Taiwan enjoy mutually complementary economic and trade relationships. A vertical division of labor exists between industries of the two countries, particularly in semiconductor integrated circuits, screws and nuts, auto components, and petrochemical industries. Taiwanese exports of intermediate products facilitate American final exports of consumption goods. For American companies, there are complementary and beneficial business opportunities of mutual cooperation between Taiwan and the U.S.

The governments of Taiwan and the U.S. should establish an integrated platform for the development

and cooperation of new industries. For example, Taiwan’s National Development Council and the U.S. State Department hold an annual Digital Economy Forum to discuss their respective policy initiatives and development strategies in the digital economy. The forum also confirms substantive areas of cooperation between the two, including innovation and entrepreneurship, and the application of smart cities. Such cooperation is not only the development direction for the Asian Silicon Valley program, but also an important government-to-government platform. For the U.S., the Asian Silicon Valley initiative’s research capabilities and innovation and entrepreneurship facilitate further cooperation with U.S. startups.

Under U.S. policies of revitalizing manufacturing and “America First”, Taiwan can support the production of intermediate parts and components, and also further connect with manufacturing base in Southeast and South Asia. The Taiwanese and U.S. governments can play a leadership and planning role, which is consistent with Taiwanese President Tsai Ing-wen’s proposal to establish an “upgraded” strategic partnership between Taiwan and the U.S. The U.S. and Taiwan should continue to strengthen their mutual strategic partnership and promote exchanges in trade, investment, defense, and other areas. With the deepening of the U.S.-Taiwan trade relations, the two sides should further enhance economic and trade ties through TIFA and continue to move forward with the signing of a Bilateral Investment Agreement.

As the Trump administration works to adjust its new trade policy, the natural trading partnership between the United States and Taiwan becomes even more valuable.

Jinji Chen was the 2017 Taiwan Scholar at the Wilson Center and is a professor in the business administration department at CTBC Financial Management College in Taiwan. The author would like to thank the Asia Program of the Wilson Center for providing suggestions and feedback for the conference.

Endnotes

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- 9 Chow, Peter. 2016. “Trade Complementarity and Natural Trading Partners Between the U.S. and the Second Round of TPP Members” in Peter Chow (eds) “The Trans-Pacific Partnership and the Path to Free Trade in the Asia Pacific.” Edward Elgar. pp. 118-160.
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- 11 Taiwan delegation set for Select-USA Investment Summit, <http://taiwantoday.tw/news.php?unit=2,6,10,15,18&post=116949>
- 12 See press release, Office of the President of Taiwan, August 3, 2017, available at <http://english.president.gov.tw/News/5185>.