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# BEYOND GEOPOLITICS – THE CASE FOR A FREE TRADE ACCORD BETWEEN EUROPE AND TAIWAN

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## SUMMARY*

THIS PAPER WEIGHS the case for a free trade agreement (FTA) between the European Union (EU) and Taiwan. It focuses on the role Taiwan has to play in the EU's economic and geopolitical strategy in Asia. Taiwan is one of the key players in the world's Information and Communication Technology (ICT) supply chains. It is also one of the few liberal democracies in East Asia. As such it deserves closer attention from the EU. But Taiwan has been overlooked in the EU's FTA strategy in Asia.

Strengthening EU-Taiwan trade relations, through an FTA or other means, must be seen in the context of Taiwan-mainland China relations. Taiwan is diplomatically isolated, with decades of strained, often hostile, relations with the mainland. That has changed since the election of a KMT government in Taipei in 2008, and a major rapprochement is underway. Both sides have signed an Economic Cooperation and Framework Agreement (ECFA). Will that be a bridgehead to Taiwanese FTAs with key trading partners? Will it open the door to an FTA with the EU?

The instinctive reaction in the EU is to point to geopolitical obstacles. There is a widespread belief that China will oppose any move towards an EU-Taiwan FTA, and that the latter would upset EU-China diplomatic and commercial relations. This has prevented a serious discussion about the pros and cons of an EU-Taiwan FTA from even starting. Our purpose is to start just such a discussion.

Taiwan has a distinctive niche in the global ICT production chain, especially in the import and export of intermediary inputs, i.e. parts and components. Taiwan, with only 23 million inhabitants, has 19 firms in the OECD's list of top 250 global ICT firms, compared with 9 from South Korea and 39 from the EU. Taiwanese ICT production is increasingly research-and-development (R&D) intensive. Taiwanese firms account for roughly 80 per cent of the global production of laptop/notebook computers. These are mainly exported via mainland China, where the bulk of their production takes place.

Taiwan offers real opportunities for European firms to increase market access and raise their profile in Asia. In particular, it could boost the competitiveness of the European ICT sector. Overall, EU-Taiwan trade and foreign direct investment (FDI) perform well below potential: there is much room for improvement. Taiwanese export and import shares with the EU are low compared with those for South Korea and Hong Kong. EU-Taiwan services trade is rather low. EU services exports to South Korea and Hong Kong are more than double EU services exports to Taiwan. A similar pattern holds for FDI: Taiwanese FDI stock in the EU is tiny; and EU FDI stock in South Korea is almost four times EU FDI stock in Taiwan.

The biggest gains from the liberalisation of EU-Taiwan commercial relations would come from "deep integration", i.e. rules that address trade-and-investment barriers "behind the border". There are peak tariffs on both sides that would need to be eliminated – on TV, video and other electronics products in the EU, and automobiles and beverages in Taiwan. But most gains in goods trade would accrue from the elimination of Taiwan's double- testing requirements and Taiwan-specific standards that diverge from international standards. This particularly affects European exports in electronics, electrical equipment, automobiles, medical equipment and pharmaceuticals. Even more gains would come from further opening Taiwan's services sectors. Estimates point to a potential 60 per-cent one-off increase in bi-

* Our thanks go to Michal Krol for his able research assistance

lateral services trade. This is much more than expected per centage gains from the EU-South Korea FTA. European services that are likely to benefit most are telecommunications, financial and business services, transport and environmental services. An accord between the EU and Taiwan could significantly boost FDI in Taiwan, in particular through services liberalisation. Such a move would help Taiwan upgrade to a more services-oriented economy.

Taiwan is not very competitive outside ICT and a handful of other manufacturing niches. This is particularly true of its services sector. It is vital for Taiwan to diversify its economy, in addition to climbing the value-added ladder in ICT. Taiwan needs to diversify strongly into services, including ICT services. This demands above all big improvements to the domestic business climate. Taiwan's World Bank overall business-climate ranking is worse than relevant East Asian comparators, notably Japan, South Korea, Hong Kong and Singapore. Narrowing this gap demands overdue domestic structural reforms. But it should be reinforced by closer economic ties with mainland China and FTAs with other key trading partners – including the EU.

China has quickly become by far the most important trading partner for Taiwan, and the current government realises that Taiwan's globalisation has to proceed via China. Hence a barrage of initiatives to liberalise cross-Straits commerce. These initiatives must go further. Taiwan still bans imports from mainland China on about 2200 products. Despite recent liberalisation, mainland Chinese investments into Taiwan remain tightly controlled. And there are restrictions on Taiwanese investment into the mainland, although these have been eased. ECFA between Taiwan and the mainland starts with fairly modest trade liberalisation. However, it should be seen as a framework for the progressive elimination of bilateral trade-and-investment barriers.

For the EU, an FTA with Taiwan, seen in isolation, would not deliver large aggregate gains given the limited size of the Taiwanese market. But it would potentially deliver much larger gains in the context of greater Taiwan-China economic integration. That would free up "triangular" (EU-Taiwan-China) trade and associated FDI, with European firms – particularly in ICT – using Taiwan as a high-value hub in Greater China and wider east-Asian supply chains.

European and other MNEs are keen to diversify their investments and production networks in East Asia while maintaining their engagement with China. Taiwan should be an attractive location for high-value production as part of East Asian supply chains – all the more so given concerns about proprietary information and other problems concerning investments in mainland China. Not least, an FTA with Taiwan could complement, indeed strengthen, the EU's FTA strategy in Asia, making its political and economic footprint in the region more visible.

The EU's professed aim is to conclude ambitious FTAs with its Asian negotiating partners. Indeed, only such an FTA would make sense between Taiwan and the EU. This should cover: comprehensive tariff elimination; strong market-opening commitments in services and investment; stronger rules disciplines (IPR, customs, government procurement, competition) than in the WTO and other FTAs; stronger sectoral disciplines on non-tariff barriers in goods trade; and stronger dispute settlement. The EU is also keen on including more non-trade issues ("sustainable development" issues) in its FTAs. This should not be a major problem for Taiwan, but Taiwan should avoid taking on commitments that would reduce market access to the EU. The EU-Korea FTA, signed in 2009 and pending ratification at the time of writing, is likely to be the main benchmark for any potential negotiation with Taiwan. Also to bear in mind are the contours of EU-Singapore and EU-Canada FTAs, which are presently being negotiated.

The EU has been extremely attentive not to do anything with Taiwan that could be interpreted as a breach of its One China policy (recognising Beijing's sovereignty over the whole of China, including Taiwan). Mainland China has risen fast to become an economic priority for the EU and its member states, particularly the Big Three (Germany, France and the UK). European multinationals are deeply involved in China. Predictably, the EU would not make overtures to Taiwan that it thinks might risk Beijing's ire. This was a clear-cut political calculus while cross-Straits relations remained hostile or strained.

However, this geopolitical template could shift with the thawing of cross-Straits relations in the past two years. Cross-Straits rapprochement was recently crowned by the signing of ECFA. ECFA provides a framework to further trade - and - investment liberalisation, and might make it easier for Taiwan to negotiate FTAs with partners in East Asia and beyond. Taiwan has been shut out of the Asian and global FTA game due to its uncertain political status. This isolates Taiwan politically, and shuts it out of tariff and other preferences among FTA members. The KMT government clearly views ECFA as a stepping stone to stronger links with its other main trading partners. A Chinese "green light" would send the signal to other governments – all committed to the One China policy and without formal diplomatic relations with Taiwan – to respond to Taiwan's FTA overtures.

Though Taiwan is not recognised as a sovereign state by most members of the United Nations (and all its major trading partners), strictly legal obstacles to signing FTAs with them are minimal. Taiwan is an independent customs territory, and a full member of the WTO, APEC and the ADB. It has bilateral investment treaties (BITs) with several Asian countries, double-taxation and intellectual-property agreements with various EU member states, and an Open Skies agreement with the USA. Ultimately, obstacles are political rather than legal. China must be reassured that any agreement that Taiwan signs is not a move towards formal statehood and independence.

Taiwan's initial challenge is to get itself on to the EU radar screen so that the EU starts to think seriously about options to strengthen EU-Taiwan trade relations. Overall, Taiwan should position itself as an attractive high-value investment and production location, not so much to serve the small local market but as a regional and global export platform. The EU will want to reassure China that any negotiations with Taiwan will be purely "economic", involving the EU with Taiwan as a separate customs territory, member of the WTO, and without "political" connotations, i.e. relating to Taiwan's political status.

## LIST OF ABBREVIATIONS

ACTA – Anti-Counterfeiting Trade Agreement
AFTA – ASEAN Free Trade Area
ARATS – Association for Relations Across the Taiwan Straits
ASEAN – Association of South East Asian Nations
ASEM – Asia-Europe Meeting
BIT – Bilateral Investment Treaty
CEPA – Closer Economic Partnership Agreement
EPA – Economic Partnership Agreement
EPZ – Export Processing Zone
FDI – Foreign Direct Investment
FOB - Free-on-Board value of a good
GDP – Gross Domestic Product
GI – Geographical Indicator
GPA – Government Procurement Agreement
GPS – Global Positioning System
ICT - Information and Communication Technologies
ITA – Information Technology Agreement
ECFA – Economic Cooperation Framework Agreement
EMC – Electromagnetic compatibility
GATS – General Agreement on Trade in Services
GATT – General Agreement on Tariffs and Trade
IEC – International Electrotechnical Commission
FTA – Free Trade Agreement
EU – European Union
IP or IPR – Intellectual Property or Intellectual Property Rights
LCD – Liquid Crystal Display
MNE – Multi-National Enterprise
MOU – Memorandum of Understanding
MRL – Maximum Residue Levels
NTB – Non Tariff Barrier to trade
OEM - Original Equipment Manufacturing
PCA – Partnership and Cooperation Agreement
QDII – Qualified Domestic Institutional Investors
R&D – Research and Development
REACH - Registration, Evaluation, Authorisation and Restriction of Chemical Substances
ROHS - Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment Regulations
ROO – Rules of Origin
SEF – Taiwan Straits Exchange Foundation
US or USA – United States of America
SOE – State-owned Enterprises
SPS – Sanitary and Phytosanitary Standards
TRIMS – Trade-Related Investment Measures
TRQ – Tariff-Rate Quotas
UNCTAD – United Nations Conference for Trade and Development
UNCITRAL – United Nations Commission on International Trade Law
WEEE - Waste Electrical and Electronic Equipment Directive
WIPO – World Intellectual Property Organization
WTO – World Trade Organization

## INTRODUCTION

Taiwan is attempting to integrate its economy further with China and the rest of the world. Like other countries in Asia, it wants to negotiate free trade agreements (FTAs) in Asia and beyond, including one with the EU. This is very difficult for Taiwan, given that it is not recognised as a sovereign state by its main trading partners. Taiwan and mainland China are negotiating an Economic Cooperation Framework Agreement (ECFA). With ECFA, the aim is to normalise cross-Straits economic relations, and use it as a bridgehead to sign FTAs with other key trading partners. In this paper we argue that there is a case for the EU to support this trend and respond positively to an FTA request by Taiwan. The key proviso is that this should complement, not destabilise, EU-China relations.

Thus far, Taiwan has hardly figured in EU policies towards Asia. It is excluded from EU-Asia mechanisms such as the Asia-Europe Meeting (ASEM), Partnership and Cooperation Agreements (PCAs) and FTAs. The EU's central Asian relationship is now with China. Hitherto hostile cross-Straits relations, and China's policy of diplomatically isolating Taiwan, make the EU understandably cautious in its dealings with Taiwan.

On the other hand, Taiwan is a central component in the world's information and communication technology (ICT) production chains. Overwhelmingly, Taiwan exports through China: probably a good half of Chinese ICT exports are produced by Taiwanese firms. Taiwan itself is a progressively higher-value hub for global ICT production. That presents opportunities for EU exporters and foreign investors – to serve regional and global markets, not just Taiwan's small domestic market. European firms are already the biggest foreign investors on the island. Looking beyond economics, Taiwan is a vibrant liberal democracy. The EU has advanced its commercial interests as well as upgraded political links with another advanced economy and liberal democracy in East Asia – South Korea. Closer ties have been cemented in a bilateral FTA. There is a case for a similar approach, focused on commercial relations, with Taiwan. It would be complementary to the EU-Korea FTA and to the EU's broader goals in Asia.

The instinctive reaction in the EU is to point to geopolitical obstacles. There is a widespread belief that China will oppose any move towards an EU-Taiwan FTA, and that the latter would upset EU-China diplomatic and commercial relations. This has prevented a serious discussion about the pros and cons of an EU-Taiwan FTA from even starting. However, cross-Straits relations have improved considerably since 2008, cemented by several bilateral agreements and initiatives, the most important of which is ECFA. This might well change the geopolitical calculus, and with it China's attitude towards Taiwanese FTAs with its key trading partners. That could open the door to an EU-Taiwan initiative.

This paper aims to start a discussion on strengthening EU-Taiwan economic relations, including the case for an EU-Taiwan FTA.

In Part I, we analyse EU-Taiwan trade-and-investment relations in the context of Taiwan's economic model based on global ICT supply chains. It points to Taiwanese economic integration with mainland China as an important condition for making an FTA with the EU worthwhile.

Part II focuses on trade policy in the EU and Taiwan, followed by recommendations for the design of a bilateral FTA – if both sides decide to proceed with negotiations. Such an agreement should be strong and comprehensive if it is to be commercially significant and mutually beneficial.

Geopolitics is probably the most important hurdle that would prevent the EU from moving in this direction. Hence Part III discusses relevant geopolitical issues, including China's potential attitude to an EU-Taiwan FTA.

## PART I – TAIWAN'S BUSINESS MODEL, ASIAN SUPPLY CHAINS AND THE EUROPEAN UNION

This section analyses Taiwan's integration in the international economy, its economic model, its trade and investment relationships with China, and why Taiwan does not trade as much with the EU as it could. It further discusses Taiwan's position in the current Asian rush to bilateral FTAs.

### (1) TAIWAN AT THE HEART OF ASIAN SUPPLY CHAINS

Taiwan is one of the Four Asian "Tigers" or Newly Industrialised Economies (NIEs), along with Hong Kong, Singapore and South Korea. Alongside Japan's spectacular growth in the post-war period, the NIEs grabbed the attention of the world for their high growth rates starting in the 1960s, with the result that they now have levels of prosperity on par with advanced industrial economies.

This success followed post-war policies combining gradual, selective import liberalisation and domestic industrial activism, all in the pursuit of export-oriented industrialisation. In Taiwan, industrial policy focused on the selective establishment of state-owned enterprises (SOEs), extensive use of tariffs and quantitative restrictions (QRs), and targeted cheap credit through a controlled financial system. But industrial policy receded, and trade and FDI liberalisation accelerated in the run-up to Taiwan's accession to the WTO in 2001. Taiwan, contrary to South Korea, has not built major conglomerates during its activist industrial policy phase. Yet, with Korea, Taiwan's model contrasts with Hong Kong and Singapore's free-port policies, where almost full-fledged free trade has been the rule since the very beginning.

**TABLE 1 – SNAPSHOT OF EAST AND SOUTH EAST ASIAN ECONOMIES**

| | GDP (2008, million $US, PPP) | GDP per capita (2008, $US, PPP) | Average annual GDP growth rate 2000-2008, in per cent |
|---|---|---|---|
| China | 7,912,850 | 5,958 | 9.99 |
| Hong Kong | 306,696 | 43,954 | 4.97 |
| Japan | 4,363,874 | 34,173 | 1.47 |
| South Korea* | 1,342,782 | 27,620 | 4.84 |
| Taiwan | 711,584 | 30,942 | 3.63 |
| | | | |
| Malaysia | 383,116 | 13,816 | 5.48 |
| Philippines | 317,258 | 3,507 | 4.79 |
| Singapore* | 244,177 | 50,456 | 5.47 |
| Thailand | 546,420 | 8,216 | 4.78 |
| Vietnam* | 240,390 | 2,788 | 7.47 |
| | | | |
| India* | 3,361,295 | 2,923 | 7.21 |

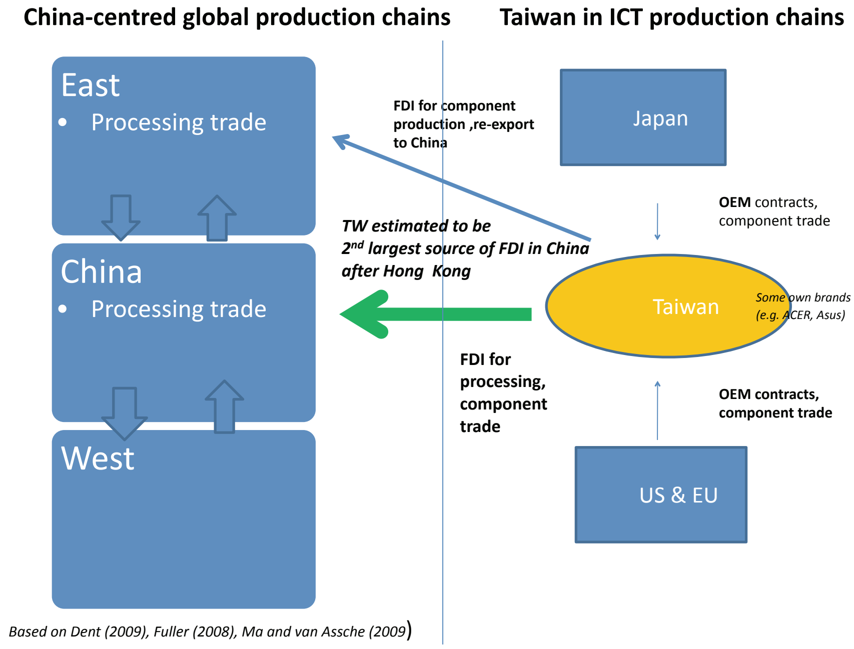
Source: Asia Development Bank (2009), author's own calculations for average annual GDP growth
* EU negotiations for a FTA agreement under Global Europe strategy

Having started its development as an import-substitution economy after WWII, Taiwan moved rapidly towards export orientation starting at the lower end of the value chain in light manufacturing. In the process of opening up to the world economy, it gradually shifted to higher-value production. Taiwan now stands out for having the highest value-added exports and highest degree of specialisation amongst the Asian NIEs. In the past decade, Taiwan has also started to move labour-intensive production to China. Taiwan is now estimated to be the second largest direct foreign investor in mainland China, after Hong Kong.[1] (See Figure 1 for this and the following paragraphs.) Taiwanese investments are heavily focused on regions with a high concentration of final assembly lines, R&D and free trade zones (FTZs), notably Jiangsu and Guangdong.

Taiwan is one of the world's top electronics producers. Taiwanese firms account for roughly 80 per cent of the production of laptop/notebook computers globally, 65 per cent of scanners, 60 per cent of monitors (including liquid crystal display panels), and 40 per cent of network interface cards. China is now the world's largest exporter of ICT products after the United States. But it is estimated that 40-80per cent of China's computer hardware is produced in Taiwanese-owned factories.[2] Copenhagen Economics (2008) estimates that Taiwanese-owned firms and subsidiaries are responsible for 10-20 per cent of China's exports to the EU.

Taiwan has a specific place in the value-added chain of ICT manufacturing production in both final products and intermediary inputs. The majority of these ICT firms are either contract manufacturers (so-called original equipment manufacturers, OEMs) like Hon Hai Precision (also known as Foxconn), Flextronics and Cellon, or specialised niche firms -- component manufacturers like customised chip foundries, processors or LED display makers. Taiwanese companies are world leaders for laptops, wifi-routers, smartphones, personal digital assistants (PDAs), customised chip foundry services and finalised LCD monitors, all in which Taiwan has more than two-thirds of global market share.[3] Taiwan accounts for 19 entries in the OECD list of the world's top 250 ICT firms.[4] In comparison, there are only 9 Korean firms on the list, and 39 from the entire EU. Taiwan's pre-crisis level of aggregate revenues in the ICT sector was more than USD152 bn with a compound annual growth rate of 28per cent since 2000. Exports grew year-on-year at 12 per cent in July 2008. Taiwanese ICT activities are increasingly R&D intensive. These focus on application processes. Interestingly, Taiwan has to date failed to make a transition into ICT services.

FIGURE 1 – TAIWAN AND GLOBAL CHINA-CENTRED MANUFACTURING SUPPLY CHAINS




## (2) WHY TAIWAN IS NOT PART OF THE EU'S FREE TRADE AGREEMENT STRATEGY IN ASIA

In late 2006, the EU launched a new trade-policy strategy under the heading "Global Europe". A key aim was to respond to a perception that European firms are losing out in terms of market access to competitors in Asia and the United States. The thrust of this strategy was to negotiate comprehensive FTAs for the first time in Asia, targeting South Korea, India and ASEAN. The criteria set were market potential, and the persistence of high barriers to trade in goods and services. The EU Commission argued that it was targeting the "most dynamic" markets. It said the EU 25 accounted only for 48 per cent of the share of global exports going to the 10 most dynamic markets in the world, against 79 per cent for the US and 76 per cent for Japan.[5] The EU listed what it considered the top 15 economies with greatest market potential. The USA, China and Japan were the top 3; Taiwan was listed as 11th after Russia and before Australia. Ukraine ranked 15th, well below Taiwan. [6]

The reasons why Taiwan was overlooked for FTAs can be summarised as follows. First, Taiwan's economy is small and it has probably not been considered a "dynamic" enough emerging market for the EU. Indeed, Taiwan's average annual growth between 2000 and 2008, at 3.6 per cent, was well below South Korea's 4.8 per cent (Table 1). Second, as we will see below, Taiwan's formal barriers to trade are, at least at first glance, lower than for comparable economies in Asia, such as Korea and some ASEAN economies. Third – and probably most important – politics intrudes in the form of Taiwan's diplomatic isolation and its historically strained relations with the mainland.

These factors have conspired to make Taiwan almost invisible on the EU radar screen. That is precisely why Taiwan receives our attention. In particular, its role in global manufacturing production is underestimated. That points to opportunites for European multinationals in terms of the efficiency of their Asian supply chains.

## (3) EU-TAIWAN ECONOMIC RELATIONS - UNTAPPED POTENTIAL

A PREVIOUS STUDY assessing the economic case for an agreement between Taiwan and the EU[7] pointed to“missing” trade and investment between Taiwan and the EU. There is plenty of evidence of a trade relationship that performs well below potential.

For example, only 11.7 per cent of Taiwanese exports go to the EU. This is a low figure compared with Taiwan's East Asian neighbours. Hong Kong's exports to the EU are 13.6 per cent of total exports. For Korea, it is 15.6 per cent (Table 2 ). A similar pattern can be found for Taiwan's imports: only 8.7 per cent of imports come from the EU, compared with 12.3 per cent for Korea.

**TABLE 2 - DIRECTION OF TRADE: MERCHANDISE EXPORTS IN PER CENT**

| | TO: | | | | | |
|---|---|---|---|---|---|---|
| **FROM:** | Asia 1990 | Asia 2008 | Europe 1990 | Europe 2008 | North and Central America 1990 | North and Central America 2008 |
| **China** | 68.3 | 40.3 | 14.7 | 23.7 | 10 | 22 |
| **Hong Kong** | 42.4 | 66.8 | 20.2 | 13.6 | 27.2 | 12.8 |
| **Japan** | 26.1 | 43.9 | 23 | 17.1 | 36.2 | 22.3 |
| **Korea** | 34 | 51 | 15.5 | 15.6 | 33.4 | 16.2 |
| **Taiwan** | 38.2 | 66.3 | 18.2 | 11.7 | 36 | 13.9 |
| | | | | | | |
| **Malaysia** | 58 | 60.9 | 16.6 | 11.7 | 18.1 | 15 |
| **Philippines** | 34.8 | 67.9 | 18.8 | 11.4 | 40.2 | 14.4 |
| **Singapore** | 47.2 | 66.1 | 17.2 | 10.1 | 23 | 10 |
| **Thailand** | 37.9 | 54.7 | 25.3 | 14.9 | 25.3 | 13.2 |
| **Vietnam** | 39.1 | 39.8 | 48.1 | 20.6 | 0.6 | 22 |
| | | | | | | |
| **India** | 21 | 35.4 | 47.2 | 22.7 | 16.3 | 15.2 |

Source: Asia Development Bank (2009),

**TABLE 3 - DIRECTION OF TRADE: MERCHANDISE IMPORTS IN PER CENT**

| | TO: | | | | | |
|---|---|---|---|---|---|---|
| **FROM:** | Asia 1990 | Asia 2008 | Europe 1990 | Europe 2008 | North and Central America 1990 | North and Central America 2008 |
| **China** | 48.6 | 39 | 24.1 | 14 | 15.8 | 8.4 |
| **Hong Kong** | 66.7 | 76 | 12.4 | 8.9 | 8.6 | 5.5 |
| **Japan** | 25.3 | 38.1 | 19.8 | 12.2 | 27.2 | 12.7 |
| **Korea** | 33.5 | 47.1 | 13.1 | 12.3 | 25.3 | 10.1 |
| **Taiwan** | 43.6 | 60.3 | 17.5 | 8.7 | 24.9 | 10.5 |
| | | | | | | |
| **Malaysia** | 50.6 | 65.8 | 17.9 | 11.5 | 18 | 8.8 |
| **Philippines** | 40 | 57.8 | 13.2 | 8.6 | 21.1 | 12.8 |
| **Singapore** | 48.2 | 53 | 15.9 | 13.8 | 16.9 | 12.1 |
| **Thailand** | 53.4 | 53.8 | 20 | 12.4 | 12.1 | 7.2 |
| **Vietnam** | 34.1 | 70 | 21.3 | 9 | 0.4 | 4.1 |
| | | | | | | |
| **India** | 17.4 | 32.3 | 41.3 | 20.2 | 12.9 | 8.2 |

Source: Asia Development Bank (2009)

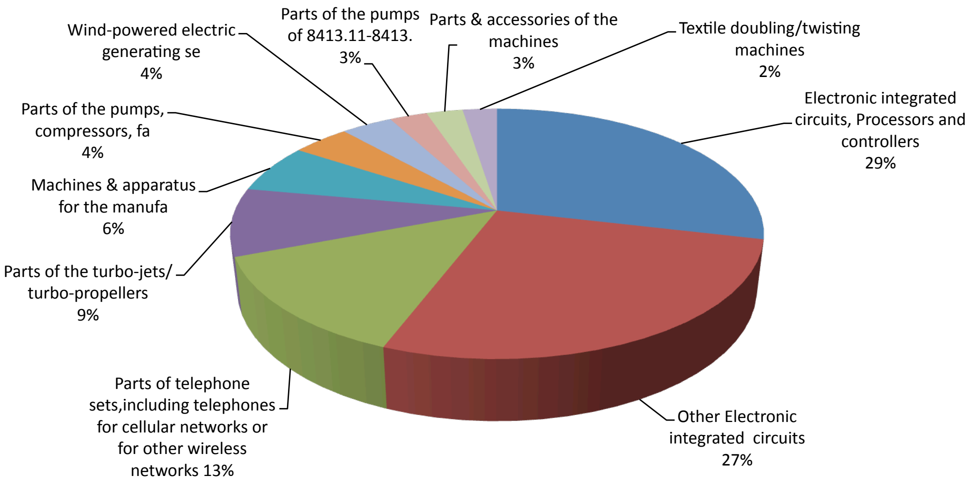
### *i. Goods Trade*

EU-TAIWAN GOODS TRADE is concentrated in ICT components. This reflects Taiwan's role in international ICT supply chains as described above (See Figures 2 and 3 and Tables 4 and 5 below).

The EU's other top exports to Taiwan are in machinery (including vehicles), pharmaceuticals and beverages. EU exports also include iron and steel, chemicals and optical/photographic products (which include medical instruments, liquid crystal devices and various electric and electronic measurement instruments). EU agricultural exports – very modest compared with its industrial exports -- are primarily in wines, and marginally in dairy and cereals. Taiwan's exports to the EU are even more concentrated in electrical machinery and electronics. It also exports bicycles and auto parts, various articles of iron or steel, plastics, toys, furniture and bedding items.

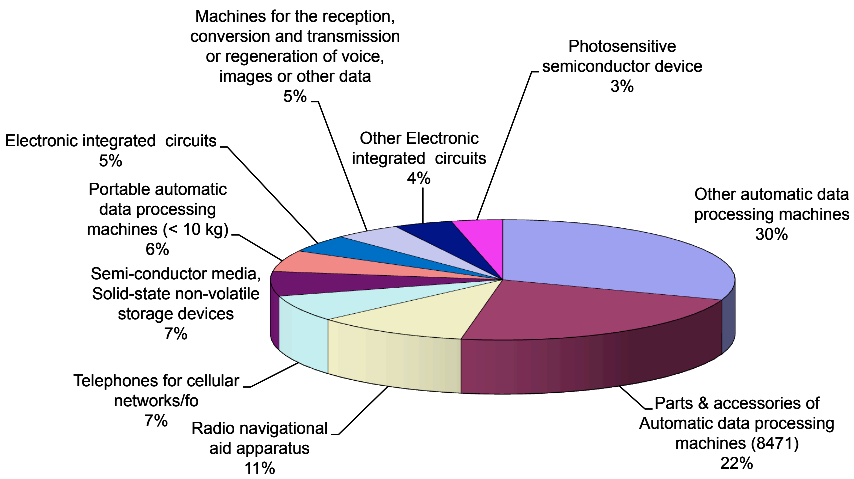
EU-Taiwan trade in electrical and electronics goods deserves a closer look (Figures 2 and 3 and Tables 4 and 5 below). The EU essentially exports parts of computer and telecommunications equipment, followed by various parts for machinery. In addition to parts and components, Taiwan also exports computers (laptops), mobile phones and radio navigational aid products.

**FIGURE 2 - TOP 10 EU ELECTRONICS AND MACHINERY EXPORTS TO TAIWAN - 2009**




Source: COMTRADE

**FIGURE 3 – TOP 10 TAIWANESE EXPORTS TO EU MACHINERY AND ELECTRONICS - 2009**




Source: COMTRADE

**TABLE 4 - TOP 20 EU 25 IMPORTS FROM TAIWAN (1000US$)**

| Rank 2009 | HS 2 digit | Category | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|---|---|---|
| 1 | 84 | Nuclear reactors, boilers, mchy & m | 11,706,775 | 9,120,096 | 9,473,251 | 9,156,166 | 8,386,532 | 2,453,561 |
| 2 | 85 | Electrical mchy equip parts thereof | 10,102,076 | 10,852,533 | 13,138,191 | 15,521,695 | 14,742,642 | 2,106,747 |
| 3 | 87 | Vehicles o/t railw/ tramw roll-stock | 1,741,088 | 1,949,911 | 2,008,930 | 2,351,086 | 2,643,543 | 609,749 |
| 4 | 73 | Articles of iron or steel | 941,629 | 980,291 | 1,080,774 | 1,455,380 | 1,542,493 | 299,170 |
| 5 | 39 | Plastics and articles thereof | 623,223 | 703,266 | 807,169 | 1,016,383 | 1,072,374 | 234,423 |
| 6 | 71 | Natural/cultured pearls, prec stone | 71,523 | 87,731 | 144,346 | 204,281 | 315,235 | 211,348 |
| 7 | 90 | Optical, photo, cine, meas, checking | 621,132 | 933,736 | 1,262,936 | 628,257 | 702,720 | 188,511 |
| 8 | 82 | Tool, implement, cutlery, spoon & f | 524,045 | 532,999 | 607,505 | 689,439 | 754,156 | 174,393 |
| 9 | 95 | Toys, games & sports requisites; pa | 450,111 | 501,219 | 456,342 | 513,565 | 528,924 | 167,150 |
| 10 | 94 | Furniture; bed-ding, mattress, matt | 456,451 | 409,267 | 441,947 | 528,700 | 549,300 | 163,515 |
| 11 | 40 | Rubber and articles thereof | 292,480 | 322,615 | 336,103 | 431,058 | 442,262 | 95,761 |
| 12 | 83 | Miscellaneous articles of base metals | 272,284 | 258,095 | 295,486 | 335,690 | 332,759 | 92,896 |
| 13 | 72 | Iron and steel | 401,029 | 316,301 | 712,870 | 1,322,235 | 1,005,205 | 79,843 |
| 14 | 27 | Mineral fuels, oils & product of th | 48,437 | 72,560 | 176,179 | 449,166 | 627,975 | 59,542 |
| 15 | 29 | Organic chemi-cals | 134,591 | 156,368 | 228,806 | 352,315 | 383,361 | 56,277 |
| 16 | 55 | Man-made staple fibres | 133,858 | 200,082 | 269,890 | 157,624 | 219,643 | 50,333 |
| 17 | 70 | Glass and glass-ware | 180,782 | 168,939 | 159,888 | 193,351 | 190,828 | 37,539 |
| 18 | 96 | Miscellaneous manufactured articles | 123,711 | 110,814 | 104,540 | 115,209 | 119,909 | 33,238 |
| 19 | 61 | Art of apparel & clothing acces-sories | 357,329 | 228,665 | 245,029 | 238,336 | 145,500 | 31,280 |
| 20 | 38 | Miscellaneous chemical pro-ducts | 47,087 | 63,436 | 91,485 | 152,370 | 169,072 | 27,352 |

Source: COMTRADE

**TABLE 5 – TOP 20 EU25 EXPORTS TO TAIWAN (1000$)**

| Rank (value, 2009) | HS 2 digit | Total | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|---|---|---|
| 1 | 85 | Electrical mchy equip parts thereof | 3,294,267.70 | 3,168,204.99 | 3,002,598.10 | 2,834,827.97 | 2,793,711.72 | 542,799.31 |
| 2 | 84 | Nuclear reac-tors, boilers, mchy & m | 2,539,045.06 | 2,477,954.39 | 2,561,718.83 | 3,910,176.11 | 3,651,427.08 | 380,620.11 |
| 3 | 30 | Pharmaceutical products | 561,822.72 | 585,289.85 | 672,100.12 | 730,071.58 | 758,508.73 | 341,414.05 |
| 4 | 22 | Beverages, spirits and vinegar | 291,917.76 | 330,126.51 | 368,429.17 | 342,529.24 | 335,926.26 | 207,355.57 |
| 5 | 72 | Iron and steel | 765,491.68 | 771,735.04 | 759,936.99 | 1,220,621.03 | 1,117,491.39 | 168,791.03 |
| 6 | 90 | Optical, photo, cine, meas, checking | 1,666,651.56 | 1,247,416.66 | 1,719,056.10 | 935,078.94 | 952,515.84 | 142,040.54 |
| 7 | 33 | Essential oils & resinoids; perf, | 213,751.83 | 227,959.15 | 227,256.55 | 245,449.44 | 230,749.21 | 122,872.28 |
| 8 | 75 | Nickel and articles thereof | 34,118.14 | 99,706.74 | 185,942.97 | 317,182.60 | 121,984.71 | 79,807.47 |
| 9 | 48 | Paper & paper-board; art of paper pulp | 262,412.12 | 266,326.36 | 264,668.38 | 259,324.59 | 248,499.89 | 71,888.21 |
| 10 | 27 | Mineral fuels, oils & product of th | 49,826.73 | 51,548.67 | 62,936.05 | 91,538.28 | 81,676.57 | 71,666.18 |
| 11 | 39 | Plastics and articles thereof | 542,664.02 | 574,380.34 | 551,443.22 | 538,146.05 | 519,537.48 | 68,307.32 |
| 12 | 38 | Miscellaneous chemical pro-ducts | 356,240.71 | 413,579.22 | 543,225.01 | 679,700.80 | 642,461.49 | 68,040.61 |
| 13 | 87 | Vehicles o/t railw/tramw roll-stock | 860,472.62 | 928,041.32 | 900,591.31 | 893,483.41 | 816,063.79 | 58,287.55 |
| 14 | 71 | Natural/cultu-red pearls, prec stone | 158,275.81 | 115,819.45 | 187,265.01 | 149,579.32 | 170,581.37 | 55,060.05 |
| 15 | 76 | Aluminium and articles thereof | 140,030.60 | 146,228.01 | 176,525.90 | 152,127.95 | 144,975.40 | 45,645.77 |
| 16 | 42 | Articles of lea-ther; saddlery/harness | 41,521.72 | 56,549.75 | 67,040.02 | 85,636.57 | 97,506.28 | 39,647.06 |
| 17 | 19 | Prep.of cereal, flour, starch/milk | 110,583.54 | 93,118.66 | 84,979.41 | 94,536.20 | 91,779.97 | 37,991.03 |
| 18 | 4 | Dairy prod; birds' eggs; natural honey | 47,807.06 | 50,322.49 | 44,512.81 | 59,163.35 | 47,483.37 | 32,331.25 |
| 19 | 29 | Organic che-micals | 609,824.68 | 631,932.97 | 592,250.73 | 882,254.64 | 827,625.81 | 31,031.51 |
| 20 | 74 | Copper and articles thereof | 108,651.60 | 120,884.46 | 145,749.72 | 142,069.66 | 94,944.84 | 29,919.42 |

Source: COMTRADE

## *ii. Services Trade*

Services trade is also below potential when measured against Taiwan's neighbours. Bilateral services trade revolves around travel and transport, and financial and business services. Around one-quarter of the value of EU exports to Taiwan is in services, in which the EU has a sizeable trade surplus (Table 6).[8] However, overall, EU-Taiwan services trade is rather low. EU services exports to South Korea and Hong Kong are more than double EU services exports to Taiwan (Tables 7 and 8).

**TABLE 6 - EU 27 SERVICES TRADE BALANCE WITH TAIWAN MN EUROS**

| | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|
| Transportation | -53.2 | -217 | -441 | -522.4 | -281.6 |
| Travel | 153.4 | 183.3 | 193.4 | 211.6 | 154.7 |
| Other Services | 1050.5 | 1129.5 | 1308.8 | 888.2 | 1200 |
| Of which: | | | | | |
| Communication | -18 | -11.7 | -8.3 | 8.9 | -29.7 |
| of which: Telecommunication | -15.6 | -12.7 | -9.4 | 8.6 | |
| Construction | 117.9 | 88.5 | 131.8 | 59.4 | 54 |
| Insurance | 44.3 | 18.7 | 16.5 | 15 | 26.8 |
| Financial Services | 286.8 | 332.6 | 352.2 | 507.5 | 428.7 |
| Computer & Information | 68.5 | 6.6 | 120 | 66.1 | 265.4 |
| Royalties and licence fees | 233.4 | 205.6 | 281.8 | 164.8 | 153.8 |
| Other Business Services | 290 | 455.3 | 383.2 | 36.4 | 273.5 |
| Personal Cultural and recreational | 1.8 | 4.8 | 0.1 | 0.8 | -0.2 |
| Government Services | 25.9 | 29.2 | 31.6 | 29.7 | 27 |
| Total | 1150.7 | 1095.8 | 1061.2 | 577.4 | 1073.1 |

Source: Eurostat

**TABLE 7 - EU 27 SERVICES EXPORTS TO KOREA - MN EUROS**

| | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|
| Transportation | 2128.2 | 2229.7 | 2843.1 | 3288.8 | 3565.1 |
| Travel | 859.4 | 429.9 | 601.5 | 596 | 569.3 |
| Other Services | 2567.3 | 3251.1 | 3522.4 | 3529 | 3711.6 |
| of which: | | | | | |
| Communication | 33.3 | 47.3 | 59.9 | 60.3 | 69.7 |
| of which Telecommunication | 19.6 | 20.9 | 37.1 | 44.1 | 49.6 |
| Construction | 83.7 | 243.9 | 215 | 162.9 | 264.8 |
| Insurance | 85.3 | 82.5 | 99.3 | 96.1 | -71.1 |
| Financial Services | 255.1 | 364.2 | 376.4 | 434.2 | 402.7 |
| Computer & Information | 100.2 | 102.3 | 117.9 | 135.6 | 140.1 |
| Royalties and licence fees | 444.7 | 443.9 | 602.8 | 712.8 | 834.1 |
| Other Business Services | 1467.5 | 1906.2 | 1975.1 | 1846.9 | 2011 |
| Personal Cultural and recreational | 75.1 | 37.9 | 54.6 | 59.3 | 43.4 |
| Government Services | 22.4 | 22.9 | 21.4 | 20.9 | 16.9 |
| Total | 5554.4 | 5912.1 | 6970.1 | 7426.3 | 7859.7 |

Source: Eurostat

**TABLE 8 - EU 27 SERVICES EXPORTS TO HONG KONG - MN EUROS**

| | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|
| Transportation | 3001.3 | 3219.6 | 2984.1 | 3758.3 | 3945.9 |
| Travel | 493.4 | 522.6 | 476.4 | 515.1 | 451.7 |
| Other Services | 3630 | 4663.3 | 3652 | 3949.8 | 4461.3 |
| Of which: | | | | | |
| Communication | 88.9 | 133.2 | 118.5 | 148.3 | 246.5 |
| Of which: Telecommunication | 60.6 | 77.6 | 85.3 | 115.8 | 212.6 |
| Construction | 50 | 89.1 | 56.5 | 37.4 | 32.8 |
| Insurance | 166.1 | 71.7 | 148.4 | 95.7 | 112.6 |
| Financial Services | 569.3 | 710.1 | 895.7 | 1225.9 | 1264 |
| Computer & Information | 84.7 | 111.1 | 151.4 | 166 | 185.1 |
| Royalties and licence fees | 174.7 | 145.7 | 156.1 | 174.8 | 158.3 |
| Other Business Services | 2447.6 | 3332.9 | 2064.8 | 2038.9 | 2373.8 |
| Personal Cultural and recreational | 41.9 | 64 | 55.3 | 57.9 | 83.6 |
| Government Services | 6.9 | 5.5 | 5.5 | 5.8 | 5 |
| Total | 7127.9 | 8408.4 | 7124.7 | 8230.4 | 8864.7 |

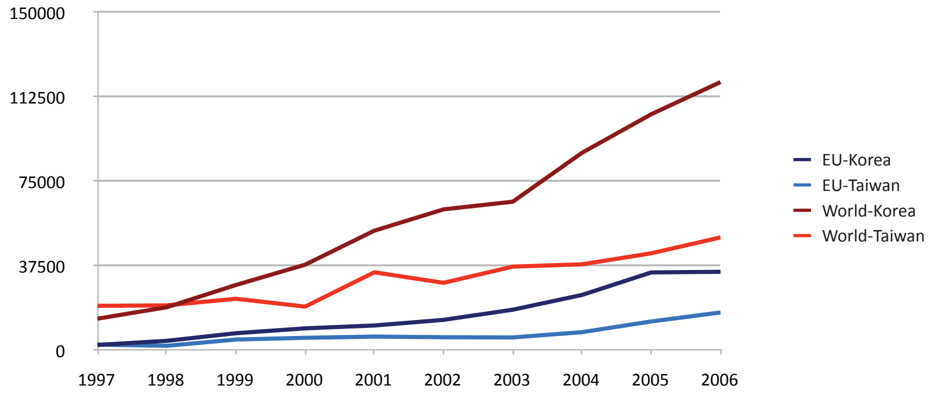
Source: Eurostat

### *iii. Foreign Direct Investment (FDI)*

THE EU LEADS on inward investments to Taiwan and accounts for 25 per cent of accumulated inflow, ahead of the U.S. and Japan. However, Taiwan receives less FDI than comparable economies such as South Korea and Hong Kong. According to UNCTAD, FDI flows to Taiwan reached USD 7.7 bn in 2007, up from USD 1.6 bn the year before. That came down to USD 5.4 billion in 2008. Hong Kong received steadily growing inflows: USD 45 bn in 2006, USD 54 bn in 2007, and USD 63 bn in 2008. South Korea received USD 4.8 bn in 2006, USD 2.6 bn in 2007 and USD 7.6 bn in 2008. In 2008, Taiwan had an accumulated stock of FDI of USD 45 bn, compared with USD 835 bn in Hong Kong, and USD 90.7 bn in South Korea.[9]

This pattern is reflected in EU-Taiwan FDI. According to its latest available data, the European Commission notes that EU FDI flows to Taiwan turned negative in 2007, with EUR 3.4 bn flowing out of Taiwan. As of 2007, Taiwanese FDI stock in the EU was insignificant: it was EUR 0.5 bn, whereas EU FDI stock in Taiwan was EUR 8.1 bn. Taiwanese companies invest much more in the United States (USD 4.7 bn stock in the US in 2007)[10]. In comparison EU direct investment flows to South Korea were EUR 1.7 billion, and South Korean direct investment flows to the EU EUR 0.3 bn, in 2007. Accumulated EU FDI stock in South Korea was EUR 30.8 bn in 2007, almost four times EU FDI stock in Taiwan. South Korean FDI stock in the EU was EUR 7.9 bn in 2007. EU FDI flows to Hong Kong were EUR 7.4 bn in 2008, with an accumulated FDI stock of EUR 87 bn.

**FIGURE 4 - INWARD FOREIGN DIRECT INVESTMENT FLOWS TO KOREA AND TAIWAN 1997-2006**

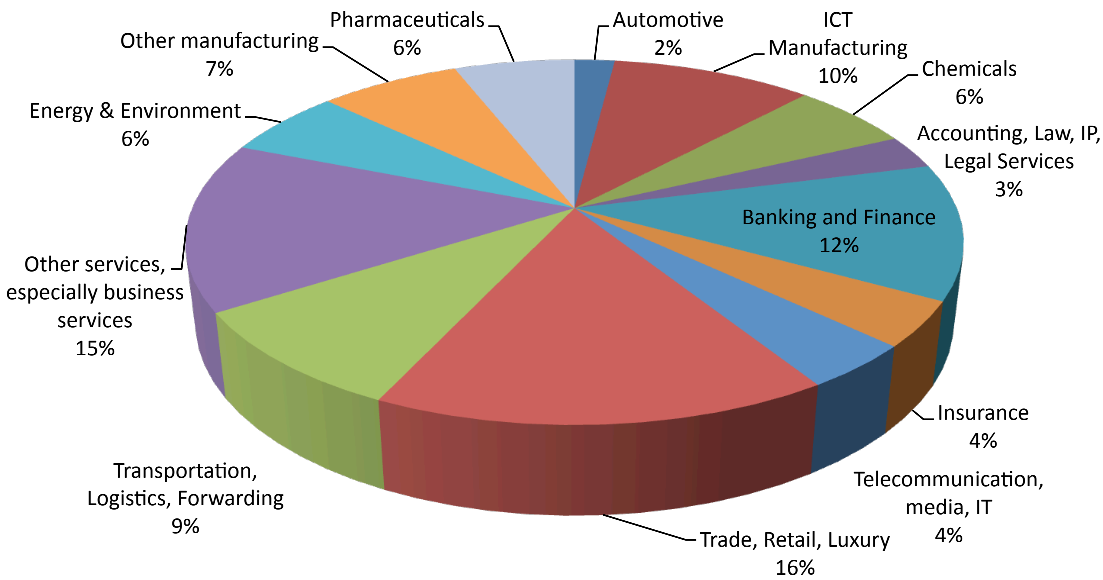



Source: Eurostat & UNCTAD FDI Statistics.

According to the EU Commission, the main focus of recent EU FDI flows to Taiwan has been chemical manufacturing, electronic and electrical manufacturing, finance and insurance, and retail. Current company membership of the European Chamber of Commerce in Taipei provides a useful complementary picture of European business activity in Taiwan. Retail, business services, banking and finance, and ICT manufacturing lead the way (Figure 5).

**FIGURE 5 – EUROPEAN CHAMBER OF COMMERCE OF TAIPEI – EU COMPANIES BY SECTOR**

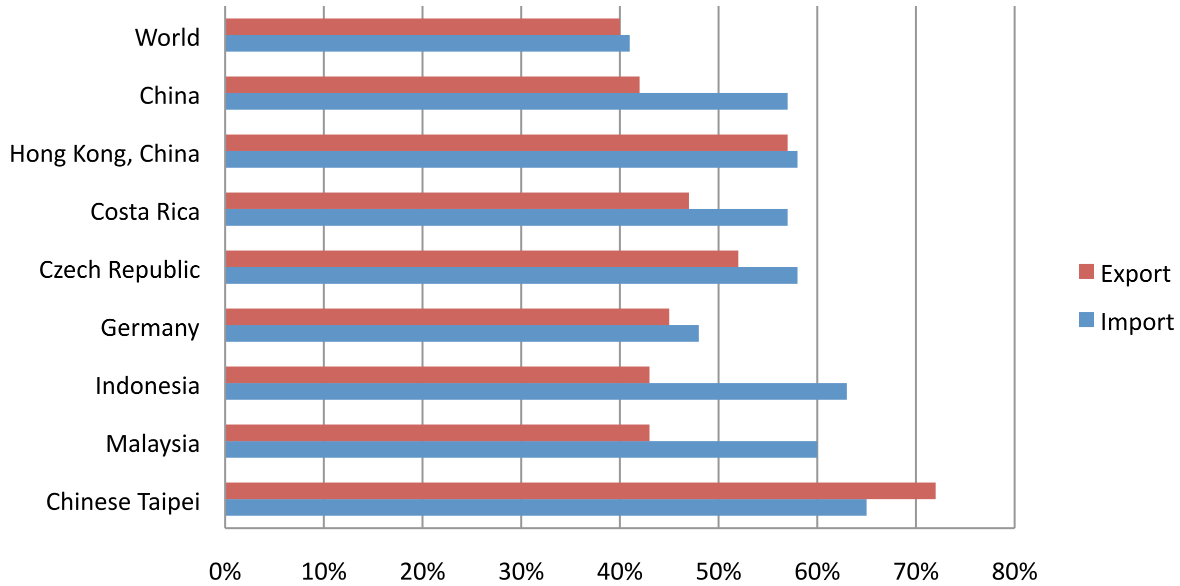
Source: European Chamber of Commerce Taipei website as of April 2010, authors' own calculations.




## (4) TAIWAN'S TRADE PROFILE: EXPORTING THROUGH CHINA AND NICHE EXPORTS

How to explain this "missing" trade and investment between Taiwan and the EU? One explanation resides in Taiwan's economic model itself and its distinctive industrial development compared with its Asian neighbours. In this section we analyse Taiwan's trade profile which helped to shape this economic model, and compare it with South Korea, which has chosen a different path but still exports similar products, notably in ICT.

**FIGURE 6. SHARE OF INTERMEDIATE GOODS IN NON-FUEL MERCHANDISE TRADE, 2008**




Source:World Trade Organization, International Trade Statistics, 2009

While Taiwan and Korea export in broadly the same category of goods, sharing the same tariff classifications, the reality of actual goods traded could not be more different. The Korean economy, dominated by large industrial groups (the famous *chaebols*), followed the Japanese export miracle of the 1950s to 1980s and quickly established brand names in household and consumer electronics, and in automobiles. Korean exports focused on standardised and mass-volume driven goods. Korean firms are predominant in memory circuits (DRAMs, flash memories etc.), a highly standardised component used in computers and MP3 players. Some experts have also argued that increased demand from the US helped to shape the differentiating patterns of trade with Korea vis-à-vis Taiwan, starting in the 1960s.[11] Buyers began to look to Korea for the provision of long production runs of relatively standardised products like men's shirts, while Taiwan supplied customised and specialised runs, like womenswear. In other words, global demand and trade shaped the output varieties of these two countries. Korea eventually turned to mass production of final consumer goods, spurred by supply and demand – Korean outsourcing to China for further cost-cutting, met by increased demand from favourable USD/Won exchange rates. Korea exports far more consumption goods (17.5 per cent of total exports), compared with Taiwan (12.2 per cent) (Figure 7).

In contrast, few consumers could even name Taiwanese brands. Instead, clusters of highly horizontally or vertically-specialised firms dominate Taiwanese exports. A vast majority of export products from Taiwan are also undertaken by contract manufacturers (OEMs), producing on behalf of consumer and technology brands from the US primarily. This also explains why cross-border intra-firm trade has surged in Korea while this type of trade is generally much less important in the case of Taiwan. When an economy is able to provide larger product variety and meet buyers' specific requirements, buyers have less incentive to invest in manufacturing capacity. On the other hand, less flexible production structures focused on longer production runs – common in Korea – lead to fewer product varieties being offered, thus making the case for inward investment in investor-specific capacities.[12]

Taiwan is also the world's leading trader of intermediate goods, which are used as inputs in the production of other goods, either final goods or partly finished goods. These are in turn used in the production of final goods.[13] WTO statistics indicate that 71 per cent of Taiwnese imports and 65 per cent of exports are such goods (Figure 6). This is a significantly higher figure compared with both a high value-adding economy like Germany (approximately 45-50 per cent for both imports and exports) and a less value-adding like China (56 per cent imports and 42 per cent exports. Significantly higher imports imply that manufacturing is focused on final stage manufacturing assembly. Our analysis of figures of UN Broad Economic Category (BEC) (Figure 7) classifications leads to a similar conclusion: parts and components make up 33.9 per cent of Taiwan's exports, compared with 28 per cent for Korea.

Taiwan also specialises in products that involve customisation; manufacturing processes involve a great variety of small, tailor-made quantities of differentiable items. For example, Taiwanese firms make processors that are designed to perform unique, product- specific tasks rather than generic memory circuits that can be used in any computer technology product. Korean firms, in contrast, specialise in the latter category. Taiwan is a leading exporter of laptops and bicycles, which are both customised for the end-consumer from endless options of colours, sizes and configurations.

FIGURE 7 - EXPORT STRUCTURE OF KOREA AND TAIWAN (UN BROAD ECONOMIC CATEGORIES)

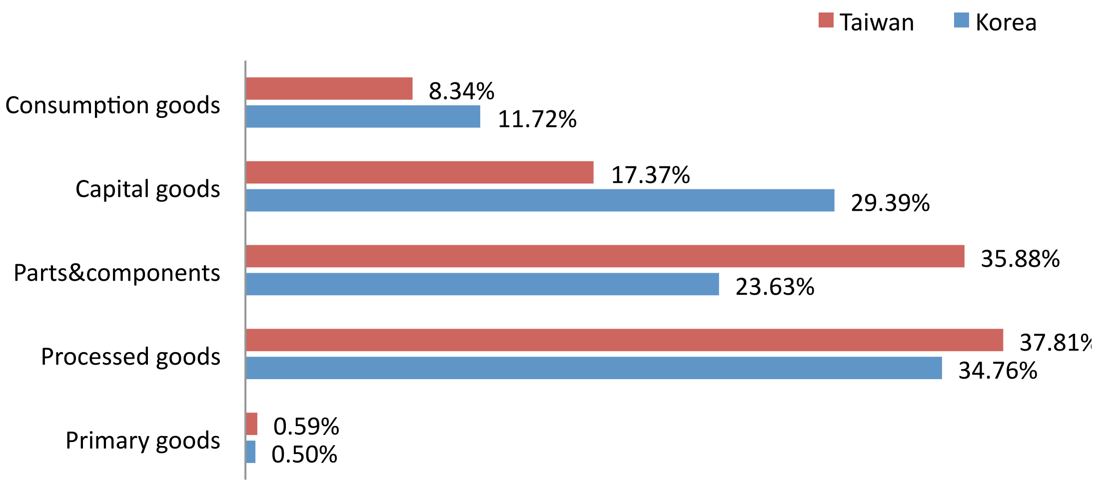
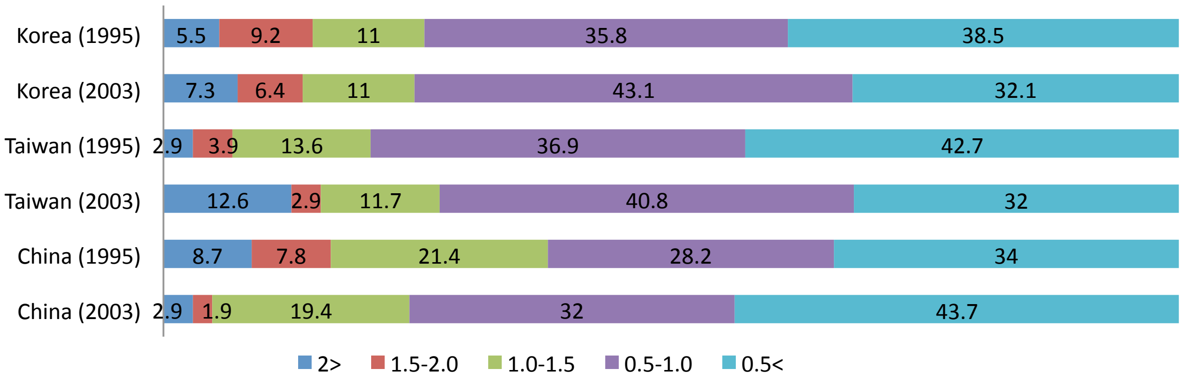


FIGURE 8 - CHANGE OF UNIT PRICE IN HIGH TECH PRODUCTS TRADE




Source: Okamoto, S. (2005), The Trade Structure in East Asia.

A final differentiating factor for Taiwan's trade is its value-added. Van Assche et al (2009) have argued that Chinese trade is largely inflated by the value of input goods that are mainly produced outside China, and then imported to China for final assembly. Figure 8 shows the share of the Unit Price Index, the ratio between export and import prices for the same goods in the hi-tech sector. A value greater than 1 indicates that a country exports products with higher added value in comparison with import goods. Therefore, if a country has a large share of items with a value of 1 or more, it indicates higher value-added in domestic production. A comparison of value-added between Taiwan and China reveals a striking difference: Taiwan has more than four times the share of of high-value added exports than China (12.6 per cent compared with 2.9 per cent in total high-tech exports). Taiwan's figure is also significantly higher than Korea's (7.3 per cent).

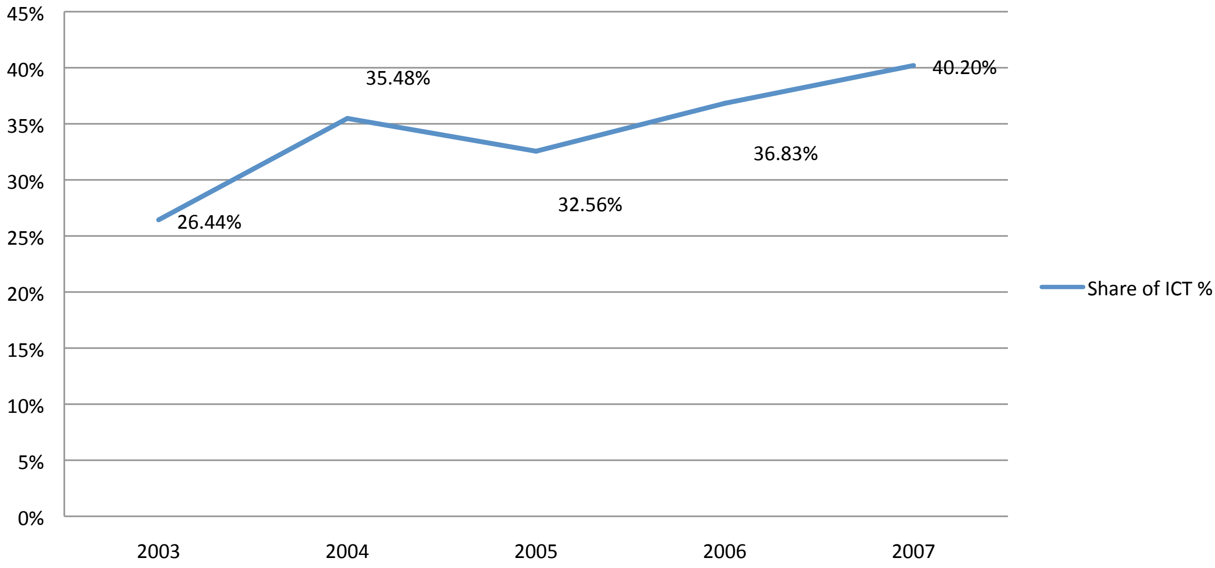
## (5) A TAIWANESE ECONOMIC MODEL IN NEED OF REFRESHING

TAIWAN'S "MISSING" TRADE and FDI with the world, including the EU, are therefore due to an economy that exports a narrow range of high-value products, with local producers engaged in contractual relationships with foreign buyers. But other forces are also at play. Taiwan's niche ICT specialisation cannot explain why there is not more high-value trade in other parts of manufacturing, nor can it explain the unusually low level of trade in services. This leads us to two important factors: Taiwan's trade-and-investment links with China and Taiwan's domestic business environment.

### *iv. Globalising With or Without China?*

SINCE THE 1990S, and in particular since both Taiwan and China acceded to the WTO, Taiwanese ICT firms (together with those from Korea and Japan) have been moving their labour-intensive production to the mainland. By 2005, 80per cent of Taiwan's notebook production was off-shored to China.[14] Opening to Taiwanese investments boosted China's ICT sector in terms of production, exports and knowledge-transfer. China's trade-and-investment links with Taiwan are arguably more important than its parallel links with Japan and Korea, in part due to the larger share of R&D that has been relocated to the mainland by Taiwanese firms. ICT accounts for more than 40 per cent of Taiwanese FDI to the mainland (Figure 9).

**FIGURE 9 - SHARE OF ICT IN TAIWAN'S OUTWARD FOREIGN DIRECT INVESTMENT TO CHINA**




Source: MOEA, Investment Commission 2008.

On the other hand, Taiwan's economy outside ICT has remained largely cut off from the mainland. Only recently has Taiwan opened transport and communications links with China and started opening up to mainland investment (on which more below). But huge cross-Straits barriers remain in place.

The most important concern that has been raised by European investors is Taiwan's continued ban on imports from mainland China on 2249 products. Trade bans include key products in the international production chain, e.g. auto parts and complete vehicles, electronic goods and textiles (such as sportswear), and above all agricultural products. This has a detrimental effect on sourcing for local manufacturing production and for local services, such as the wholesale and retail trade. There are also restrictions on mainland Chinese investments into Taiwan – an outright ban until recently.

Finally, there are restrictions on Taiwanese investment into the mainland. Until 2009, only 40 per cent of a Taiwanese firm's capital could be invested in China. But this has prompted Taiwanese ICT firms to invest in the mainland by unofficial, roundabout means, e.g. through offshore financial centres and Hong Kong. The main rationale for these restrictions was to avoid a "hollowing out" of Taiwanese manufacturing production and employment. This fear has proved to be unfounded. A recent study has highlighted that Taiwan has sustained manufacturing employment rather well.[15] In other words, offshoring production to the mainland has allowed Taiwanese ICT firms to focus on higher-value production and employment at home. On the other hand, official restrictions on trade and investment with the mainland, aimed at maintaining domestic manufacturing employment, have probably hindered a shift to employment in services in line with a high-income economy. As shown in Table 9, Taiwan's rate of employment in services, at 53.8 per cent of total employment, compares poorly with figures for Korea and Japan.

**TABLE 9 - EMPLOYMENT IN SERVICES – HONG KONG, JAPAN, KOREA, TAIWAN**

| | Hong Kong | Japan | Korea | Taiwan |
|---|---|---|---|---|
| Services value added (per cent of GDP) - 2008 | 84.4 | 63.0 | 53.5 | 60.6 |
| Employment in services (per cent of total employment) - 2008 | 86.3 | 63.8 | 63.2 | 53.8 |

Source: World Trade Organization

## *v. Business Environment*

Now let's turn to Taiwan's domestic business climate. The fact is that, outside ICT and a handful of other manufacturing niches, Taiwan is not very competitive. This is particularly true of its services sector. And it has been compounded by an absence of significant domestic regulatory reforms in the years following its WTO accession in 2002. With China now progressively catching up in its production and R&D capacities in ICT, it is vital for Taiwan to diversify its economy, in addition to climbing the value-added ladder in ICT. Taiwan needs to diversify strongly into services, including ICT services.

Foreign investors have traditionally complained about Taiwan's business environment. Recently, Taiwan has striven to do something about it. This is already reflected in its rankings in benchmarking exercises such as the World Bank's *Doing Business Report* and the World Economic Forum's *Global Competitiveness Report*. In 2009, it climbed 15 notches to rank 46th in the World Bank's rankings (Table 10). This is mainly due to reforms of procedures to start a business, and tax reforms, such as a recent reduction of corporate tax rates (from 25 per cent to 17 per cent, to come into force in 2011). Taiwan does not do too badly in the "trading across borders" category. In the World Economic Forum's Enabling Trade Report, Taiwan does quite well on trade-related business climate indicators, roughly on a par with South Korea and Japan though worse than Hong Kong and Singapore (Table 11).

Taiwan's business climate appears worse than relevant East Asian comparators (Table 10). Overall, it ranks well below Japan, Korea, Hong Kong, Singapore, Malaysia and Thailand. It does particularly badly in the "protecting investors", "paying taxes", "enforcing contracts", "getting credit", "employing workers" and "dealing with construction permits" categories.

#### TABLE 10 - WORLD BANK "DOING BUSINESS" RANKINGS 2010 – COMPARISON OF TAIWAN WITH SELECTED ASIAN ECONOMIES

| | Ease of Doing Business | Starting a Business | Dealing with construction permits | Employing workers | Registering Property | Getting credit | Protecting Investors | Paying Taxes | Trading Across Borders | Enforcing Contracts | Closing a Business |
|---|---|---|---|---|---|---|---|---|---|---|---|
| United States | 4 | 8 | 25 | 1 | 12 | 4 | 5 | 61 | 18 | 8 | 15 |
| Singapore | 1 | 4 | 2 | 1 | 16 | 4 | 2 | 5 | 1 | 13 | 2 |
| Hong Kong | 3 | 18 | 1 | 6 | 75 | 4 | 3 | 3 | 2 | 3 | 13 |
| China | 89 | 151 | 180 | 140 | 32 | 61 | 93 | 130 | 44 | 18 | 65 |
| Indonesia | 122 | 161 | 61 | 149 | 95 | 113 | 41 | 126 | 45 | 146 | 142 |
| Japan | 15 | 91 | 45 | 40 | 54 | 15 | 16 | 123 | 17 | 20 | 1 |
| Korea | 19 | 53 | 23 | 150 | 71 | 15 | 73 | 49 | 8 | 5 | 12 |
| Malaysia | 23 | 88 | 109 | 61 | 86 | 1 | 4 | 24 | 35 | 59 | 57 |
| Philippines | 144 | 162 | 111 | 115 | 102 | 127 | 132 | 135 | 68 | 118 | 153 |
| **Taiwan** | **46** | **29** | **97** | **153** | **30** | **71** | **73** | **92** | **33** | **90** | **11** |
| Thailand | 12 | 55 | 13 | 52 | 6 | 71 | 12 | 88 | 12 | 24 | 48 |
| Vietnam | 93 | 116 | 69 | 103 | 40 | 30 | 172 | 147 | 74 | 32 | 127 |

#### TABLE 11 - ENABLING TRADE IN ASIA - TAIWAN IN COMPARISON

Source: The Global Trade Enabling Report 2009, World Economic Forum

| | Global Rank (out of 121) | Market Access | Tariff Barriers | Non tariff barriers | Burden of customs procedures | Time for import | Docs for imports | Cost to import | Time for export | Documents for export | Cost to export | Border Administration |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| France | 17 | 89 | 3 | 74 | 28 | 22 | 1 | 62 | 18 | 1 | 59 | 19 |
| Germany | 12 | 90 | 3 | 75 | 20 | 9 | 15 | 32 | 8 | 5 | 33 | 11 |
| UK | 20 | 79 | 3 | 65 | 34 | 30 | 5 | 74 | 29 | 5 | 54 | 14 |
| US | 16 | 49 | 30 | 29 | 37 | 2 | 15 | 61 | 4 | 5 | 50 | 15 |
| China | 49 | 103 | 110 | 35 | 40 | 74 | 30 | 3 | 70 | 67 | 3 | 43 |
| Hong Kong | 2 | 20 | 1 | 1 | 3 | 2 | 5 | 7 | 4 | 5 | 7 | 7 |
| Indonesia | 62 | 53 | 62 | 66 | 86 | 83 | 30 | 9 | 70 | 24 | 15 | 66 |
| Japan | 23 | 115 | 40 | 88 | 43 | 22 | 15 | 44 | 23 | 5 | 49 | 13 |
| Korea | 26 | 106 | 76 | n/a | 17 | 11 | 30 | 17 | 13 | 5 | 27 | 22 |
| Malaysia | 28 | 32 | 59 | 28 | 26 | 34 | 44 | 2 | 55 | 67 | 1 | 33 |
| Philippines | 82 | 56 | 46 | 86 | 95 | 40 | 66 | 22 | 43 | 83 | 31 | 68 |
| Singapore | 1 | 2 | 2 | 38 | 1 | 1 | 5 | 1 | 1 | 5 | 2 | 1 |
| **Taiwan** | **25** | **99*** | **56** | **36** | **14** | **25** | **44** | **18** | **29** | **67** | **26** | **27** |
| Thailand | 50 | 98 | 69 | 40 | 48 | 30 | 2 | 20 | 33 | 5 | 7 | 41 |
| Vietnam | 89 | 112 | 115 | 50 | 83 | 67 | 66 | 35 | 82 | 42 | 22 | 85 |

In sum: Taiwan's trade and investment with the rest of the world, including the EU, perform below par for three main reasons. First, Taiwan's economic model is based on comparatively low-volume ICT products that involve arms-length contractual relations with foreign buyers rather than direct investment. Second, Taiwan's self-imposed barriers to trade and investment with mainland China hamper cross-Straits economic integration, and with it Taiwan's diversification into non-ICT high-value manufacturing and into services. Third, Taiwan's domestic business climate does not compare well with its East Asian peers.

## (6) TAIWAN'S ATTEMPT TO GO GLOBAL WITH CLOSER LINKS TO CHINA AND FTAS

Since he was elected in 2008, President Ma Ying-Jeou has sought to rectify Taiwan's competitive weaknesses by accelerating its global integration – via China. China has quickly become by far the most important trading partner for Taiwan, and President Ma realises that Taiwan's globalisation has to proceed via China hence a barrage of initiatives to liberalise cross-Straits commerce. Furthermore, he hopes that "normalisation" of cross-Straits economic relations, especially through ECFA, will pave the way to FTAs with Taiwan's other major trading partners.

### *vi. Taiwan-China Rapprochement*

President Ma's administration has negotiated an opening of Taiwan to mainland Chinese tourists, and established direct maritime, air-transport and postal links. Financial services and capital markets have started opening up both ways. In 2009, Taiwan introduced a list of 192 sectors in which Chinese investors may apply for investment. This involves more than 60 manufacturing and more than 100 services sectors[16] – with exceptions remaining in defence, telecommunications, aviation and construction (Box 1).

In 2009, the Taiwanese authorities raised ceilings on authorised investment to the mainland from the original 40 per cent cap of equity to 60 per cent. For individuals, the ceiling was raised by USD 5 million per year from USD 80 million originally. Ceilings for small and medium enterprises were raised to USD 80 million, or 60 per cent of net worth, up from 20-40 per cent originally. The new ceiling for non-SMEs is also 60 per cent of net worth. Companies that have obtained special certification from the Industrial Development Bureau that their operational headquarters are in Taiwan do not face restrictions.[17] In early 2010, the government accordingly authorised the top producer of LCD panels and various companies in semiconductors, chip testing, packaging, real estate, telecommunications, wind power and solar energy to invest in China under the condition that their most advanced plants stay in Taiwan and that they keep equivalent investments on the island.[18] Also – and significant for foreign investors in Taiwan – Taiwanese subsidiaries of multinational enterprises no longer face restrictions on their investments to the mainland.

Bilateral trade negotiations with the mainland were launched with a view to concluding an Economic Cooperation Framework Agreement (ECFA). The latter is supposed to lead to a progressive opening of goods and services trade. Substantive talks have focused on an "early-harvest" list of tariff eliminations and reductions. An agreement was signed in late June 2010. It is very partial – indeed far from meeting the "substantially all trade" and "substantial sectoral coverage" criteria of GATT- and GATS-compatible RTAs. (Box 1) But its ultimate shape could come to resemble the bilateral FTAs (called Closer Economic Partnership Agreements

– CEPAs) China has signed with Hong Kong and Macau. These have relatively strong provisions on trade in goods and services, as well as on the mutual recognition of qualifications (Box 2).

The ECFA process is very contentious in Taiwan. The main opposition party, the DPP, is against ECFA and has demanded a referendum on it. It opposes ECFA on economic grounds, fearing for vulnerable production and employment in Taiwan if these sectors are opened to Chinese competition; and it fears that ECFA will lead to a change in Taiwan's political status.

**BOX 1 - CROSS-STRAITS NEGOTIATIONS SINCE 2008**

**Air links:** Cross-Straits liberalisation received a boost with a first agreement struck in June 2008, which opened direct charter flight links. Later in the year, these provisions were extended after the conclusion of several agreements between the Taiwan Straits Exchange Foundation (SEF) and the Association for Relations Across the Taiwan Strait (ARAT).[19] Charter flights were extended to weekdays and their number raised to 270 a week. The number of destinations was increased to 8 cities in Taiwan and 21 cities in the mainland. Private business jets are now allowed to fly. Sixty direct cargo flights per month were established.

**Tourism:** The June 2008 agreement opened Taiwan to mainland tourists. Quotas at the time of writing stood at 4,300 persons per day.

**Maritime transport:** The 2008 ARAT-SEF agreements introduced direct maritime shipping connections. Direct cargo shipments were allowed between 11 Taiwan seaports and 63 ports- coastal and along China's main rivers - in the mainland (ships are not allowed to fly the national flags). Taiwan opened 11 ports to Chinese ships.

**Postal services:** These agreements further established direct postal links, which previously had to go via Hong Kong.

**Food safety:** These agreements established a cross-Straits platform for dialogue on food safety - on exchange of information and a mechanism to increase protection of victims' rights.

**Finance and investment:** In late 2009, the financial authorities of both parties signed a second set of agreements, three much-awaited financial supervision Memorandums of Understanding (MOUs). These focus on supervisory cooperation in banking, securities, futures and insurance. They provide for thresholds and preferential policies for both sides to invest in each other's markets, in particular in the financial sector. These will allow seven Taiwanese bank offices currently operating in China to be upgraded as branches. MOU discussions have also led to the decision in Taiwan to open for the first time the Taiwan stock exchange to Chinese securities investments. But there is an upper global ceiling on Chinese investment of USD 500 million, and a 10per cent cap for individual shares listed on the stock and OTC markets; for "special businesses"[20] the ceiling on investment by single QDIIs is 5per cent, and for marine transport services the maximum investment by single QDIIs and all QDIIs is 8per cent. Direct (as opposed to portfolio). Chinese investment in Taiwan has been opened to more than 100 individual sectors, although Taiwan's security, construction, aviation, and telecommunications industries are not open to investment from mainland China.

**Trade:** ECFA negotiations resulted in an agreement signed on June 29, 2010. So far, ECFA eliminates tariffs on an "early harvest" list of goods. China will eliminate 539 tariffs in 2011, with another 467 items following in 2012 and 2013. Taiwan will eliminate tariffs on 267 items starting in 2011. Sectors covered include petrochemicals, auto parts, and raw materials. China opened investment to Taiwanese firms in 11 services sectors, including computer services, the film industry, banking, accounting, insurance, and hospitals. The talks have so far not addressed Taiwan's import ban on 2249 Chinese products. China has accepted Taiwan's condition not to include its agricultural sector in the negotiations, and agreed not to discuss mainland Chinese labour migration to Taiwan. ECFA so far falls well below the standard of a "serious" FTA that is GATT and GATS-consistent. However, it is conceived by both parties as a framework for progressive elimination of bilateral trade-and-investment barriers, and negotiations are set to continue.

**BOX 2 - THE CHINA-HONG KONG CLOSER ECONOMIC PARTNERSHIP AGREEMENT (CEPA)**

The 2003 Hong Kong-China CEPA opened the Chinese mainland market to Hong Kong exports and service suppliers beyond China's WTO commitments. There was minimal extra Chinese access to Hong Kong, which is a free port and largely open to services and investment. Subsequently, annual agreements have progressively extended the scope of liberalisation initially agreed. The main thrust of the agreement focuses on tariff eliminations for goods, liberalisation of services and related investment, recognition of professional qualifications, and trade and investment facilitation.

**Goods trade:** CEPA provides for duty-free entry for all Hong Kong-produced goods, pending agreement on the rule of origin of every single product. So far, agreement has been reached on approximately 1500 products at the 8-digit product level. These goods include processed foods, fisheries products, textiles (mainly yarns), intermediary products for manufacturing (pumps, compressors, filters), medical devices and electrical machinery. The agreement also eliminates tariff rate quotas and abolishes the use of anti-dumping. Potential safeguards must be previously notified and be accompanied by a consultation procedure. This makes little difference to Hong Kong since – unlike Taiwan -- it has a vestigial industrial base (about 5 per cent of GDP).

**Services trade:** The services approach has also been incremental and based on a positive list that is extended annually. It caters for the recognition of qualifications of Hong Kong professionals in law, architecture, financial services and medicine. Business services from Hong Kong may establish themselves without restriction on the mainland. In telecommunications, construction, distribution, financial services, tourism/hotels, transport (road and maritime), establishment rules were negotiated individually. These range from allowing joint ventures to free establishment, at times with minor restrictions. The 2004 agreement also allows mainland state-owned banks and joint-equity banks to relocate their international treasury and foreign exchange trading activities to Hong Kong, allows mainland banks to acquire businesses there, and use financial intermediaries from there. Mainland insurance companies were allowed to list in Hong Kong. In later negotiations, the Hong Kong Stock Exchange and Clearing Office was allowed to open a representative office in Beijing. Each year, the commitments are deepened and extended to other sectors, which include marketing research, management consulting, cleaning, translation and interpretation, conventions, insurance, environmental, social or sports services.

CEPA contains agreements on the **mutual recognition of qualifications**. Their highlight is the possibility for Hong Kong professionals to take mainland examinations. In parallel to CEPA, China introduced an Individual Visitor Scheme allowing visitors from Guangdong province to visit Hong Kong for seven days. The scheme was extended to inhabitants of all 21 cities of Guangdong and to 9 other cities in Jiangsu, Zhejiang and Fujian provinces in July 2004.

A China-Macau CEPA was signed in 2003 and is modelled on the China-Hong Kong CEPA.

The Ma administration also views ECFA as a stepping stone to stronger links with its other main trading partners. Thus far Taiwan has been excluded from FTAs in Asia and much of the rest of the world – mainly due to Chinese opposition. The Ma administration hopes that ECFA will translate into a political green light to launch FTA negotiations with third countries – in its East Asian neighbourhood, but also with the United States and the European Union.

## *vii. Taiwan and the Asian Rush to FTAs*[22]

FTAs have proliferated like wildfire across Asia in the past decade. By early 2010, East Asia plus India (the ADB's "integrating Asia") had 88 FTAs concluded and in effect, up from 25 in 2000. Two hundred and twenty one FTAs in the region are proposed, under negotiation, or concluded. Currently, there are 49 proposed initiatives.[23] Many – indeed the majority for China, India, Singapore and South Korea – are with extra-regional partners.[24] The major Asian players – China, India and Japan – are involved, as are South Korea, Australia, New Zealand, the ASEAN countries, as well as other South Asian countries. The USA is involved with individual Asian countries, as are some Latin American countries and South Africa. The EU has concluded FTA negotiations with South Korea (though the agreement has not yet been ratified), with ongoing negotiations with India and ASEAN members. The most important FTA in the region is the China-ASEAN FTA, which came into effect in January 2010.

What do these FTAs look like? The reality is that most of these agreements are weak-to-very weak, especially by US and EU standards. At the weaker end of the spectrum, FTAs are limited to preferential tariff cuts on a limited range of goods. The stronger FTAs take 90 per cent of tariff lines down to zero (more or less). They also contain provisions on tackling non-tariff barriers (NTBs) and liberalising services and investment. In some agreements these are "WTO-plus", i.e. they go beyond WTO commitments. But that means little in practice, for WTO disciplines on export restrictions, services, investment, government procurement and a host of other regulatory barriers are also weak to very weak. In addition, Asian FTAs are bedevilled by differing ROOs within and between agreements. Not surprisingly, business utilisation of FTA tariff preferences is rather low, with estimates ranging from 3-22 per cent in East Asian FTAs. MNEs with regional and global production networks usually pay the MFN duty, which costs them less than complying with ROOs in multiple FTAs, or move production into duty-free export-processing zones. Smaller firms are even more burdened by compliance costs.[25] Hence even headline tariff elimination – the core of Asian FTAs – is not likely to deliver advertised gains.

In sum, most FTAs have been limited to tariff cuts, but have made little dent into non-tariff regulatory barriers. The latter, more than the former, impede regional economic integration – for MNEs with their cross-border manufacturing supply chains, for home-based firms, for agricultural and services suppliers, and for final consumers. That applies particularly to East Asia, where tariffs have come down to relatively low levels. The China-ASEAN FTA fits this pattern; it is no exception.

Nevertheless, FTA proponents argue that Asian FTAs are stepping stones to wider, more ambitious initiatives that will spur regional economic integration. At the top of this list are the APEC FTAAP (Free Trade Area of the Asia-Pacific), ASEAN Plus Three (China, South Korea and Japan), the Japanese-inspired East Asian Community (ASEAN Plus Three plus India, Australia and New Zealand), and the Australian-inspired Asia-Pacific Community. But all these initiatives have not gone beyond vague statements of intention. Formidable political and economic obstacles prevent them from becoming viable propositions in the short to medium term.

Where does this leave Taiwan? Taiwan is a member of APEC, but the latter has not delivered extra trade-and-investment liberalisation, nor is it likely to do so in the foreseeable future. Taiwan has signed FTAs with a handful of countries that continue to recognise it as a sovereign state. These are with Honduras and El Salvador (jointly), Guatemala, Panama and Nicaragua (separately). They are modelled on DR-CAFTA signed with the United States, although, contrary to the latter agreement, they do not liberalise trade among the Central Americans. They carve out crucial agricultural products such as sugar, and have stringent rules of origin on textiles. Services are covered, with a negative list of exclusions. They contain strong arbitration procedures for trade and investment, and investor-state dispute settlement. But these are minor agreements with perhaps more diplomatic symbolism than commercial significance.

In reality, Taiwan has been shut out of the Asian and global FTA game due to its uncertain political status and strained cross-Straits relations. Politically, it further isolates Taiwan, especially in its East Asian neighbourhood. On the economic front, the effects are probably more mixed. Since FTAs in the region are "trade light" in terms of tackling non-tariff and regulatory barriers, they may make little difference to Taiwan. But Taiwan is shut out of tariff preferences among FTA members. That is a cause for concern, particularly with the China-ASEAN FTA. One additional reason for a cross-Straits FTA is to minimise trade diversion from the China-ASEAN FTA.

Where does Taiwan's state of play leave the EU? How could and should the EU respond to a Taiwanese request for an FTA? This is the subject of the next section.

## PART II – TOWARDS A FREE TRADE AGREEMENT – WHAT SECTORS AND HOW?

This section weighs the case for an FTA between the EU and Taiwan. It first provides an overview of Taiwanese and EU trade policies towards each other and identifies the most important trade-and-investment barriers. This is followed by an assessment of the costs of existing barriers, and potential gains from their elimination. The third part is a benchmarking exercise of the EU's recent FTAs, with a focus on the EU-Korea FTA. Then follow proposals for the design of a potential EU-Taiwan FTA.

### (7) TAIWAN'S TRADE POLICIES

At first glance, the Taiwanese economy does not reveal as many headline trade-and-investment barriers that could be negotiated away in a bilateral FTA, compared with the EU's other FTA targets in Asia, including South Korea. However, as the analysis below shows, Taiwan retains not-insignificant barriers in sectors where the EU has strong export interests.

#### *viii. Tariffs and Import Prohibitions*

Taiwan generally applies low tariffs to its goods imports. Its tariff structure is relatively simple and transparent as a result of its WTO commitments (Table 12). According to the WTO, the average applied tariff rate stands at 6.1 per cent -- lower than other East Asian countries except Hong Kong and Singapore, and only a little higher than for the USA, EU and Japan. This is also the picture with average applied manufacturing tariffs (4.5 per cent), though agricultural tariffs are much higher (16.9 per cent).The average bound tariff is 6.5 per cent, with all tariff lines bound. The trade weighted average tariff is extremely low (1.8 per cent) by regional and global standards. There is negative tariff escalation in Taiwan – -5.3 per cent according to the latest *Global Enabling Trade Report* of the World Economic Forum.[26] This means that processed goods enjoy more favourable duty treatment than basic commodities and raw materials (See Tables 13 and 14).

Taiwan applies a duty drawback system on raw materials and components for goods that are exported. According to Taiwan's Department of Customs, 1100 tariff lines are eligible for tax exemptions.[27] There are free trade zones near harbours and the main airport for final processing and packaging for re-export. These enjoy duty free treatment. Duty drawbacks were important when Taiwanese tariffs were relatively high. Many of these schemes were removed when Taiwan joined the WTO. Now, given low tariffs, the impact of remaining duty drawbacks is slight – in contrast with South Korea, which retains higher MFN tariffs.

Peak tariffs (above 10 per cent) apply to agricultural products, textiles and motor vehicles. Alcoholic beverages and motor vehicles have tariffs of 25 per cent and above. This is of course of great concern to EU exporters. Taiwan applies tariff rate quotas (TRQs) to passenger cars (30 per cent out-of quota rates, 26.1 per cent in-quota rates), which it has promised to eliminate by 2011 in line with its WTO accession commitments. Taiwan frequently applies safeguards on agricultural imports.

The main blemish on an otherwise open-trade tariff profile is the ban on imports from mainland China on 2249 products.

**TABLE 12 - TARIFF PROFILES - TAIWAN IN COMPARISON**

| Country/ Economy | Year | Tariff Binding Coverage in per cent (all goods) | Simple Average Final Bound | Simple Average Applied Tariff (manufacturing) | Simple Average Applied Tariff (agriculture) | Simple Average Applied Tariff (all goods) | Trade Weighted Average (2007/2006) | Maximum MFN Applied Duties | Applied tariff escalation (per cent diff. raw to finished, all goods) (2008/2007) |
|---|---|---|---|---|---|---|---|---|---|
| *EU* | *2008* | *100* | *5.5* | *4* | *16* | *5.6* | *2.7* | *236* | *1* |
| *US* | *2008* | *100* | *3.5* | *3.3* | *5.3* | *3.5* | *2.2* | *350* | *1.6* |
| *Japan* | *2008* | *99.6* | *5.4* | *2.6* | *23.6* | *5.4* | *2.2* | *781* | *−6.4* |
| Hong Kong | 2008 | 45.8 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| China | 2008 | 100 | 10 | 8.7 | 15.6 | 9.6 | 4.5 | 65 | 1.9 |
| **Taiwan** | **2008** | **100** | **6.5** | **4.5** | **16.9** | **6.1** | **1.8** | **500** | **−5.3** |
| Indonesia | 2007 | 96.6 | 37.1 | 6.7 | 8.5 | 6.9 | 3.9 | 150 | 3.3 |
| Korea | 2008 | 94.6 | 17 | 6.6 | 49 | 12.2 | 7.5 | 887 | −18.5 |
| Malaysia | 2008 | 83.7 | 25.7 | 8 | 14.7 | 8.8 | 4.7 | >1000 | 5.4 |
| Philippines | 2008 | 66.8 | 25.6 | 5.7 | 9.7 | 6.3 | 4.5 | 65 | 1.5 |
| Singapore | 2008 | 69.2 | 10.7 | 0 | 0.2 | 0 | 0 | 115 | 0 |
| Thailand | 2007 | 74.7 | 28.6 | 8.2 | 25.2 | 10.5 | 4.8 | 360 | 1.5 |
| Vietnam | 2007 | 100 | 11.4 | 15.7 | 24.2 | 16.8 | 11.7 | 150 | 7.5 |

Source: WTO and Global Enabling Trade Report 2009

**TABLE 13 - TAIWAN - TARIFF STRUCTURE, 2005 AND 2009 (PER CENT)**

| | | MFN 2005 | MFN 2009 | Final bound[a] |
|---|---|---|---|---|
| 1. | Bound tariff lines (per cent of all tariff lines) | 100.0 | 100.0 | 100.0 |
| 2. | Simple average applied rate | 7.8 | 7.8 | 8.2 |
| | Agricultural products (HS01-24) | 23.8 | 23.7 | 24.9 |
| | Industrial products (HS25-97) | 4.4 | 4.3 | 4.5 |
| | WTO agricultural products | 22.3 | 22.1 | 23.4 |
| | WTO non-agricultural products | 5.0 | 5.0 | 5.2 |
| | Textiles and clothing | 8.9 | 8.8 | 8.9 |
| | ISIC 1 - Agriculture, hunting, fishing | 17.9 | 17.9 | 18.1 |
| | ISIC 2 – Mining | 0.6 | 0.6 | 1.0 |
| | ISIC 3 – Manufacturing | 7.2 | 7.2 | 7.6 |
| | Manufacturing excluding food processing | 4.4 | 4.4 | 4.5 |
| | First stage of processing | 15.7 | 16.3 | 16.6 |
| | Semi-processed products | 5.1 | 5.0 | 5.4 |
| | Fully processed products | 7.5 | 7.4 | 7.7 |
| 3. | Tariff quotas (per cent of all tariff lines) | 1.5 | 1.2 | 0.9 |
| 4. | Domestic tariff ”peaks” (per cent of all tariff lines)[b] | 5.0 | 5.2 | 4.9 |
| 5. | International tariff ”peaks” (per cent of all tariff lines)[c] | 9.3 | 9.3 | 9.6 |
| 6. | Overall standard deviation of tariff rates | 28.7 | 29.4 | 30.1 |
| 7. | Coefficient of variation of tariff rates | 3.7 | 3.8 | 3.7 |
| 8. | Duty free tariff lines (per cent of all tariff lines) | 30.9 | 30.1 | 28.8 |
| 9. | Non-ad valorem tariffs (per cent of all tariff lines) | 1.8 | 1.8 | 1.8 |
| 10. | Non-ad valorem tariffs with no AVEs (per cent of all tariff lines) | 0.6 | 0.0 | 0.0 |
| 11. | Nuisance applied rates (per cent of all tariff lines)[d] | 4.8 | 4.4 | 3.6 |

Source: Taiwan authorities

## *ix. Non Tariff Barriers for Goods*

### Agriculture and processed foods

Taiwan has a highly protected agricultural sector. High tariffs and costly sanitary procedures are the main instruments of protection. US sources complain about a very costly import authorisation procedure for rice, costly regulations on Maximum Residue Limits (MRLs), some labelling issues, and remaining quotas. EU exporters have complained about non-recognition of EU disease-free status, annual and non-risk assessment-based on-site inspections, and inconsistent sanitary border inspections. Exports affected include pork and poultry, beef, fruit and vegetables. Taiwan does not recognise Central and Eastern European member states for accreditation of organic produce.

### Standards and accreditation procedures for manufactured products

While agriculture plays only a marginal role in EU-Taiwan trade, non-tariff barriers in manufacturing have a much bigger effect on EU exports. Taiwan's regime for technical standards is the overarching concern of EU exporters. Indeed, it affects the EU's most competitive exports: electronics, electrical equipment, automobiles, chemicals, pharmaceutical and medical equipment, and beverages.

First, crucial standards diverge from international norms. This is partly explained by Taiwan's exclusion from international standard-setting bodies, leading to national standard setting that diverges from international norms. But it is also a legacy of past industrial policies. According to the Taiwanese authorities, three-quarters of Taiwanese standards are aligned with international standards. But there are outliers, such as an equivalence of only 37.9per cent for electrical engineering (See Table 14 below).

The second major issue is Taiwan's testing regime. It is restrictive in accepting third- party certification by private bodies. It does not recognise private international certification bodies. And it requires compulsory translation of safety reports into Chinese, which amounts to duplicative testing.

In electronics, Taiwan applies duplicative testing requirements for safety and electromagnetic compatibility (EMC) for industrial and home appliance products. It also does so for chemicals, e.g. on hazardous substances such as lead, mercury, hexavalent chromium, polybrominated biphenyls, and polybrominated biphenyl ether in electro-technical products.[28]

Taiwan's protectionism in automobiles extends to various discriminatory regulatory hurdles. These include accreditation of EU test laboratories, smoke-test and emission standards for diesel engines, parts-marking requirements, Safety Type Approval grace periods, and vehicle classification.[29]

Foreign manufacturers face significant hurdles in Taiwan's pharmaceutical and medical-devices sectors, which is of major concern to EU exporters. These hurdles include discriminatory pricing and reimbursement practices, a lengthy pharmaceutical registration process, and burdensome approval processes for medical devices. Taiwan requires mandatory testing for medicated cosmetics. Taiwan's import ban on Chinese manufactures also affects Western multinationals that assemble medical equipment products in China.

In the beverages sector, new inspection regulations for alcoholic beverages introduced in 2006 are considered an unnecessary obstacle by EU exporters.

**TABLE 14 – TAIWAN - DOMESTIC STANDARDS AND THEIR EQUIVALENCE TO INTERNATIONAL STANDARDS, END-MARCH 2009**

| Area | Total domestic standards | Existence of international standards[a] (A) | Number of national standards equivalent to international standards (B) | Domestic standards equivalent to international standards (B)=(C)+(D) | | Rate of equivalence (E)=((B)/(A))x100 |
|---|---|---|---|---|---|---|
| | | | | Mandatory technical regulation (C) | Voluntary standards (D) | |
| Civil engineering and architecture | 668 | 63 | 58 | 4 | 54 | 92.1 |
| Mechanical engineering | 2,196 | 412 | 280 | 19 | 261 | 68.0 |
| Electrical engineering | 1,103 | 668 | 253 | 71 | 182 | 37.9 |
| Electronic engineering | 878 | 227 | 183 | 3 | 180 | 80.6 |
| Automotive and aerospace engineering | 498 | 32 | 28 | 4 | 24 | 87.5 |
| Railway engineering | 88 | 14 | 14 | 0 | 14 | 100.0 |
| Shipbuilding engineering | 397 | 29 | 10 | 0 | 10 | 34.5 |
| Ferrous materials and metallurgy | 390 | 161 | 151 | 2 | 149 | 93.8 |
| Non-ferrous materials and metallurgy | 276 | 88 | 37 | 0 | 37 | 42.0 |
| Nuclear engineering | 48 | 1 | 1 | 0 | 1 | 100.0 |
| Chemical industry | 2,872 | 185 | 183 | 40 | 143 | 98.9 |
| Textile industry | 353 | 85 | 82 | 0 | 82 | 96.5 |
| Mining | 344 | 89 | 49 | 0 | 49 | 55.1 |
| Agriculture | 454 | 81 | 61 | 32 | 29 | 75.3 |
| Food | 529 | 191 | 161 | 20 | 141 | 84.3 |
| Wood industry | 79 | 33 | 32 | 14 | 18 | 97.0 |
| Pulp and paper industry | 209 | 63 | 55 | 0 | 55 | 87.3 |
| Environmental management | 23 | 21 | 21 | 0 | 21 | 100.0 |
| Ceramic industry | 419 | 101 | 59 | 0 | 59 | 58.4 |
| Domestic wares | 341 | 9 | 9 | 0 | 9 | 100.0 |
| Medical equipments and appliances | 388 | 139 | 122 | 4 | 118 | 87.8 |
| Information and communication | 738 | 482 | 480 | 0 | 480 | 99.6 |
| Industrial safety | 221 | 40 | 30 | 0 | 30 | 75.0 |
| Quality control | 73 | 41 | 39 | 0 | 39 | 95.1 |
| Physical distribution and packaging | 185 | 30 | 19 | 0 | 19 | 63.3 |
| General and miscellaneous | 559 | 214 | 178 | 8 | 170 | 83.2 |
| **Total** | **14,329** | **3,499** | **2,595** | **221** | **2,374** | **74.16** |

a: Number that have corresponding international standards.
b: A domestic standard that is identical with or modifies corresponding international standards is considered as equivalent to international standards.
Source: Taiwan authorities.

### *x. Customs Procedures*

Frequent complaints about Taiwan's customs procedures concern a burdensome export declaration process, frequent technical and process failures in the clearance system, and weight limitations on express consignments (India is the only other country in Asia that applies the latter policy). Furthermore, cargo declaration requirements for shipping are out of step with international practice. There is an obligation to file for tariffs with the Keelung Harbour Bureau run by the Ministry of Transport and Communication, which has the power to reject shipping lines' requests. This, argue EU exporters based in Taiwan, adds uncertainty to the process.[30]

### *xi. Government Procurement*

Taiwan joined the WTO's Government Procurement Agreement in mid-2009. It has significantly streamlined its practices with most developed economies. More significantly, its local content requirements of 30-40 per cent have gone. However, according to the European Chamber of Commerce in Taiwan, there continue to be problems regarding the terms and conditions for progress/milestone payments in infrastructure contracts; the dispute resolution process; the custom of using lowest price award criteria instead of a broader measure of quality-to-price; and inadequate limitation of liability clauses and deficiencies in project planning that put European public infrastructure project providers at a disadvantage. Furthermore, the electricity authority in Taiwan has not eliminated a ban on buying 28 foreign electrical items that was due to be eliminated by 2008.[31]

### *xii. Intellectual Property Rights*

Taiwan established an Intellectual Property Office in 1999, which is responsible for formulation of IP policy, enforcement, inter-agency coordination and dispute settlement. Taiwan is considered to be in broad compliance with the WTO's TRIPS agreement. Taiwan has significantly improved its IPR enforcement regime, and both European and US sources confirm this trend.

Furthermore, Taiwan has signed some twenty bilateral cooperation agreements on intellectual property protection, including with EU member states (Austria, France, Germany, Spain, the Netherlands and the United Kingdom). Taiwan – for reasons that have to do with its political status - is not a member of World Intellectual Property Organisation.

Remaining issues of concern are counterfeiting in pharmaceutical and agro-chemicals. European industry complains that Taiwan is a frequent trans-shipment hub for counterfeited goods, and has problems with the following: lax trademark protection; insufficient guarantees in the legislation process for compulsory licensing; the handling of trade secret cases; frequent infringement of cases under bankruptcy protection; insufficient legal protection of copyright; absence of internet enforcement of copyright protection; continued laxity in criminal cases; and deficiencies in the enforcement of civil remedies in criminal cases. Furthermore, Taiwan does not apply a European-style regime for the protection of geographical indicators.

### *xiii. Investment and Services*

Taiwan has a fairly liberal regime for inward investment in goods and services – except towards mainland China (see Part 1). Manufacturing is generally open to FDI. There are sector-specific restrictions in services.

Taiwan's trade and investment policies in services are on par with advanced emerging market practice. Its GATS commitments are stronger than they are for most advanced emerging markets. Taiwan has made commitments in eleven services sectors: business services, communications services (only international courier services), construction and related engineering services, distribution services, education services, environmental services, financial services, health and related social services, tourism and related travel services, recreational, cultural and sporting services (other than audiovisual), and transport services. More details on specific sectors are provided below. However, as a general rule, Taiwan has open cross-border services and establishment, with restrictions the exception rather than the rule. That said, there is substantial scope for opening in many sectors, especially in energy and utilities, postal services, financial services, telecommunications, information services, and air, rail, maritime and road transport, where state-owned companies or monopolies dominate the market.

On establishment, Taiwan's legal regime is relatively open. Taiwan's 2002 GATS schedule states that "Foreign business and individuals may directly invest in Chinese Taipei, unless otherwise falling into the measures of limitations specified in the specific sectors". Furthermore, "no limitations exist, except as otherwise specified in this schedule for specific sectors".

Restrictions on foreign investment occur in agricultural production, chemical manufacturing, bus transport, public utilities and postal services. There are foreign equity caps of 50 per cent for shipping companies registered in Taiwan and for merchant ships engaged in international shipping, and 33 per cent for those engaged in domestic shipping. Foreign equity caps of 49 per cent apply to satellite television broadcasting, power transmission and distribution, piped distribution of natural gas, high speed railways, airport ground handling firms, air cargo terminals, air catering companies, air cargo companies. There are also caps of 49.99 per cent on airline companies, with individual (non-corporate) foreign investors subject to an ownership limit of 25 per cent.

Taiwan has signed several Bilateral Investment Treaties (BITs), mostly with Asian countries or other countries that recognise Taiwan as a sovereign state. According to UNCTAD, agreements are in force with the following countries: Costa Rica, Dominican Republic, El Salvador, Guatemala, India, Macedonia, Malawi, Malaysia, Nicaragua, Nigeria, Panama, Paraguay, Philippines, Singapore, Thailand and Vietnam.

GATS Mode 4 regulations (on the cross-border supply of labour) apply horizontally and are not locked into specific sectoral commitments in Taiwan's GATS schedule. Taiwan applies a classic regime for business visitors (90 days' stay) and intra-corporate transferees (restricted to senior staff), and allows contract service suppliers in most business services.

### Business services

Cross-border trade and establishment are allowed in principle for a wide variety of business and professional services. But there are restrictions in legal, taxation, accounting, architectural and professional engineering services. Only locally certified and incorporated firms may provide these services in Taiwan. This is a major concern for European businesses.

### Financial services

FOREIGN BANKING, ASSET management and insurance firms are allowed to enter Taiwan and are not discriminated against by law through foreign equity caps, for example. Exceptions are Chinese financial institutions, and financial institutions that are not listed among the world's top 1000 in capitalisation. The main concerns non-Chinese foreign investors have in Taiwan have less to do with discrimination than with overall domestic regulation of financial services.

One such issue is a moratorium on the issuance of new bank licences. This is meant to deal with a perceived problem of "overbanking" and to help consolidate the sector. In fact, it only perpetuates the number of licensees and averts market-based consolidation. This deters valuable investment and upgrading of the banking sector.

Insurance is another sector where European investors face problems. Life insurers have pulled out because of capital requirements that diverge from international norms and have proven to be very costly. For branches, there is a minimum capital requirement for the parent company (of NT$ 2bn). Taiwan's WTO commitments in the insurance sector allow cross-border provision of insurance only in maritime shipping, commercial aviation and goods in international transit. Mode 2 (consumption abroad) is only allowed for life insurance. Commercial presence is permitted through branches, subsidiaries, joint ventures and representative offices.

The securities sector is generally open to foreign investors, except China – but this has begun to change (see Part I above).[32] Foreign firms complain about too-burdensome regulations on cross-border capital transactions. Taiwan maintains restrictions on derivatives trading. Hedge-fund trading remains tightly regulated.

### Telecommunications services

TAIWAN'S GATS SCHEDULE commits it to an open regime for cross-border telecommunications, with exceptions in the audiovisual sector. But Taiwan maintains various restrictions on foreign ownership of telecommunications services. The ownership limit on wireless and wire-line telecommunications is restricted to 60 per cent, with a foreign equity cap of 49 per cent. Taiwan justifies these equity caps partly on national security grounds – there are fears of investment from mainland Chinese operators. Taiwan also imposes minimum capital requirements for integrated network telecommunications operators.

Most other problems with telecommunications services provision can be pinned down to the monopolistic practices of the local fixed-line incumbent, Chonghua Telecom. Other operators face problems with interconnection conditions and discriminatory fees. Satellite-based cross-border mobile communications services are subject to restrictions. Cable and internet television services providers suffer from non-market based price competition from the incumbent. Total foreign ownership on cable television broadcasting is 60 per cent, and one foreign shareholder may not own more than 20 per cent of shares. Satellite television broadcasting is subject to a 49 per cent foreign equity limit.

Taiwan's relatively new National Communications Commission has been trying to ease terms of access and interconnection to Chonghua Telecom's network. However problems remain: Local Loop Unbundling prices are excessive and stifle competition. Furthermore, there is a requirement to use Chonghua Telecom's digital data transmission technology backbone network for competitors to interconnect with the local exchange facility. This is all the more problematic as the regulator has been using its power to control retail prices in the mobile market.

Current policies to allocate Radio Frequency Identification (RFID) spectrums diverge from international practice such as long-term evolution (LTE), with restrictive effects on licence allocation. There are delays in approving new technologies for network infrastructure.

### Distribution services

Taiwan has no formal restrictions on cross-border supply and, more importantly, establishment in wholesale and retail services, commission agents' services and franchising. But there are restrictions on land allocation and retail development in both industrial and residential zones that are detrimental to investment, and are a cause of concern to European retailers.

### Transport services

Taiwan's GATS commitments in transport services are the following. In air services, maintenance and repair of aircraft face no restrictions, as is the case with selling and marketing of air services and computer reservation systems. In rail transport, passenger and freight transport is open, as is maintenance and repair of rail transport equipment. In road services, Taiwan has made commitments in passenger transport, freight transport, and maintenance of road transport equipment. Services auxiliary to all modes of transport (cargo handling, storage and warehousing, freight transport) are open.

Foreign equity caps of 49 per cent apply to high-speed railways, airport ground handling firms, air cargo terminals, air catering companies and air cargo companies. There are foreign equity caps of 49.99 per cent on airline companies and 50 per cent on shipping companies. Any individual (non-corporate) foreign investor in this sector is subject to an ownership limit of 25 per cent.

US sources also point to cabotage restrictions in maritime transport. The most important restrictions concern maritime links with the mainland. These have partly been lifted in an accord signed in late 2008 (See Box 1). In air transport, Taiwan has an Open Skies agreement with the United States, but not with European countries, although recently the United Kingdom and Taiwan signed an air services agreement that increases the number of flights between both countries.[33]

### Energy and Environment

Taiwan's GATS commitments do not include the energy sector. Environmental services commitments only apply to sewage services, refuse disposal services, sanitation and similar services, and consulting services incidental to nature and landscape protection.

Taiwan's power sector is in the hands of a monopoly, Taiwan Power Co (TPC). Taipower's monopoly status technically ended after a 1994 measure which allowed independent power producers (IPPs) to provide up to 20 per cent of Taiwan's electricity. IPPs are required to sign power purchase agreements with Taipower, which distributes electricity to consumers. Privatisation of Taiwan Power has long been discussed in Taiwan, but delayed to date.

Water distribution and management is in the hands of Taiwan Water Supply Corp (TWSC). Plans to privatise TWSC are on hold. There are contracting out opportunities for competitors, and current public infrastructure plans include possibilities to involve the private sector for public-private partnerships. However, given that water and waste-water prices are subsidised, and that current tendering procedures (see the section on Government Procurement) are not necessarily favourable to providers of high-quality services, there is not much incentive for foreign suppliers to bid for projects.

## (8) EU TRADE AND INVESTMENT REGIME AND CONCERNS FOR TAIWAN

The EU has low average tariffs and border NTBs on goods trade, and fairly open markets in services, investment and government procurement. Its main attraction for external trade partners is its huge Single Market. But pockets of protection remain: peak tariffs on some industrial goods; trade remedies, especially anti-dumping (AD) measures; domestic regulatory barriers in services (including intra-EU barriers in a far from integrated single market); some of the most onerous technical and food-safety standards in the world; and, not least, the Common Agricultural Policy (CAP).

The EU has not responded to the global economic crisis with up-front protectionism. Far from it. But there are signs of creeping regulatory interventions, e.g. in financial services and on the climate-change agenda, that could spill over the border into protectionism and be difficult to contain.

### *xiv. Tariffs*

The EU's simple average applied tariff is 5.5 per cent (only slightly below Taiwan's simple average tariff), with a weighted average of 2.7 per cent (a little above the Taiwan average). EU average applied tariffs in manufactures and agriculture are similar to Taiwan's. There is more tariff escalation in the EU (Table 12).

The EU maintains comparatively high tariffs in consumer electronics (TV, video and other image and sound-reproducing items, such as LCD screens) that can reach 14 per cent, light manufactured products such as textiles and garments (up to 14.5 per cent), automobiles (10 per cent), and, in particular, agriculture. Among Taiwan's top 20 exports to the EU, three categories are most affected by the EU's higher tariffs: bicycles (14.7 per cent), video-recording apparatus (13.9 per cent), and screws and bolts (13 per cent).

Taiwan's main interest is of course in electronics. Most ICT products are covered by the 1997 Information Technology Agreement (ITA) in the WTO and are duty-free. However, the ITA has left out a certain number consumer electronics items (TV and video, for example), and items such as navigational devices (radar, GPS). In the meantime, technological convergence has led to a blurring of lines between products covered by the ITA (and therefore duty-free) and those left out (and still dutiable). This has led to customs classification controversies. EU customs authorities have classified some goods – notably LCD screens, set-top boxes and multi-functional printers – as items outside ITA coverage and therefore dutiable. This has led Taiwan, along with the United States and Japan, to bring a case to the WTO's dispute settlement mechanism. The case is on-going.

Taiwan is also a not infrequent target of EU anti-dumping actions. Between 1999 and 2009, Taiwanese products have been subject to 22 anti-dumping investigations. Taiwanese exports of steel, chemicals and textiles fibres have been affected.[34]

## *xv. Non-Tariff Barriers to Trade in Goods*

### Import restrictions and licensing

Most EU import restrictions apply to agricultural products. But manufactured products such as textiles and steel continue to be subject to surveillance and double-checking.

### Subsidies

Forty per cent of the EU Community budget is dedicated to agricultural subsidies, some of which still distort global agricultural trade. The EU re-introduced export subsidies for dairy products in 2009. Taiwanese agricultural exports to the EU are minuscule.

### Agriculture

Taiwan's agricultural exports to the EU are minimal. The main concerns are high tariffs in the fisheries sector (tilapia), the EU's SPS system for fisheries, the recognition of plant varieties for Taiwan's internationally competitive orchid exports, and accreditation for organic food production.

### Selected regulations on product and process standards affecting manufacturing exports of interest to Taiwan

The EU's standardisation process for goods is complex and cumbersome. It basically entails either centralised harmonisation of standards or mutual recognition among EU member states. Both processes are to date incomplete, and incongruities and divergences in application of rules continue to pose challenges within the EU's internal market. This situation also affects foreign exporters to the EU who face uncertainty and varying costs.

Some recent EU regulations have caused extra uncertainty for foreign exporters. Of particular concern to Taiwanese exporters are the EU's REACH regulations, the 2003 WEEE (hazardous waste) and ROHS (hazardous substances) regulations, and the Ecodesign Directive of 2005.

The REACH regulations on chemicals came into force in 2007. But there are not yet adequate procedures in place to identify "hazardous substances" in products.[35] The major issues of concern for exporters to the EU include: differential enforcement of REACH across the member states; continued uncertainty regarding the scope and applicability of provisions relating to products; transparency issues in the development of REACH implementation projects; protection of business proprietary information in the supply chain and in the Substance Information Exchange Forums (SIEFs); operation of, and potential trade ramifications caused by, the *Only Representative* provision; and high costs imposed by the regulations, particularly for SMEs.

**BOX 3 – "REACH" OF REACH**

The EU's new chemicals regulations, REACH (Registration, Evaluation, Authorisation and Restriction of Chemical Substances), entered into force on June 1, 2007. The aim of REACH is to reduce health hazards for human beings, improve environmental and animal protection, and to encourage the substitution of unsafe substances. It requires authorisation for use or restriction of SVHC (substances of very high concern), a list of which is provided by the new Helsinki-based European Chemicals Agency. REACH impacts virtually every industrial sector, notably ICT.

REACH puts the responsibility on industry to provide safety information for substances and to properly manage the risks arising from their use. Under REACH, manufacturers and importers have a duty to register substances for each legal entity they own, or in preparations that they produce or import in quantities over 1 tonne per year. This means that small quantities of a chemical substance found in, for example, electronic circuits would have to be notified. Foreign suppliers are encouraged to set up an "Only Representative" system within the EU to coordinate reporting on chemicals. The Commission proposed a regulation to align the current EU system of classification of chemical substances and mixtures to the United Nations Globally Harmonised System. The proposal is making its way through the European Parliament and the Council. After entry into force, the proposed deadline for substance reclassification will be 1 December 2010, and for mixtures 1 June 2015.

RoHS requires the substitution of various heavy metals and chemicals in electrical and electronic equipment. There is still uncertainty as to the full product range involved by the Directive. The authorisation process for exemptions is seen as non-transparent by many foreign producers, with long and unpredictable approval procedures. RoHS is managed at the member-state level without uniform and harmonised standards and test methods. WEEE renders producers responsbile for taking back, treating and/or recycling electrical and electronical equipment. But implementation rules diverge, raising uncertainty about costs. The Ecodesign Directive regulates the energy efficiency and other environmental considerations at the design phase of a product. This imposes costs and delays in product development and imposes extra layers of administrative burden that many industries have complained about.

### xvi. Government Procurement

EU GOVERNMENT PROCUREMENT is regulated by Brussels above certain thresholds and is in line with the EU's commitments in the Government Procurement Agreement's (GPA) in the WTO. Below these thresholds, government procurement regulations and practices are left to the member states. European defence procurement, where electronic and telecommunications equipment play a significant role, is largely exempted from GPA provisions.

### xvii. Services and Investment

EU MEMBER STATES do not have many formal restrictions in FDI, least of all in manufacturing (except in nuclear energy). However, across the board EU establishment restrictions concern real-estate investment funds (UCITS), national-flag vessels, and agriculture and fisheries. In the member states, restrictions on competition in services lead to *de facto* limits on foreign investors in a wide range of sectors (e.g. finance, telecommunications, energy, business services, education and healthcare). This leads to quite a number of reservations in the EU's GATS schedule. Regulation of services in the EU remains largely in the hands of the member states, among which there remain significant differences.

The EU's Revised Offer on services in the WTO's Doha Round, tabled in 2005, provides an approximate indicator of the EU's willingness to bind services commitments at the multilateral level. Of particular interest to Taiwan are transport – especially maritime – services. Here the EU remains timid[37].

In future, direct investment disciplines are likely to move up the priority list in EU trade policy. The Lisbon Treaty, which provides the new institutional framework for EU trade policy, has brought FDI into the fold, giving the EU Commission full competence in trade negotiations. This could mean that the EU might propose “post-establishment” rules, such as investor-state dispute arbitration that are common in US FTAs, and EU-wide bilateral investment treaties (BITs). This is something the EU Commission was not able to do in the past.

Hitherto, investor protection (as part of post-establishment rules) was dealt with by the EU’s member states individually via their individual BITs. The EU’s 27 member states have signed about 1700 BITs, of which around 1450 are in force. A process to integrate these into Community law is ongoing. The EU Commission will prepare a proposal on how to proceed with a “grandfathering process”. The EU would need to clarify its legal status with bodies such as the World Bank or UNCITRAL to be able to refer investor-state dispute arbitration to these bodies in the future.

## (9) A FREE TRADE ACCORD BETWEEN THE EU AND TAIWAN – WHAT GAINS, IF ANY?

This section assesses potential gains and costs from a free trade agreement between the EU and Taiwan. Among other factors, it compares these gains with existing estimates on the EU-South Korea FTA.

### *xviii. Existing Aggregate Estimates*

Expected potential gains from an FTA between the EU and Taiwan are relatively modest.[37] For instance, EU exports could increase by 11.8bn Euro within 2-5 years (using last offers of the Doha round as a baseline).[38] Total welfare gains are expected to be between 1 and 2bn Euro (depending on the level of ambition of the agreement).[39] This means a gain of only 4 Euros per capita and 0.02 per cent of current GDP – at best. In comparison, gains from EU-Korea are estimated at about 5 bn Euro. This is largely due to the differences in size of the two economies: Taiwan’s GDP is about 40 percent of Korea’s. Correspondingly, welfare gains for the EU from an EU-Taiwan FTA are estimated at about 40 per cent of gains from the EU-Korea FTA.

Tariff barriers between Taiwan and the EU are relatively modest. So are gains from tariff reductions. Our analysis shows that Taiwan’s applied tariffs on EU exports, weighted by current trade volumes, are around 2.02 per cent. The equivalent figure for Korea is more than three times higher, at 7.07 per cent.[40] This is not surprising since most trade between the EU and Taiwan occurs in goods covered by the Information Technology Agreement, which provides duty-free treatment for most ICT goods. Most gains from liberalisation of goods trade would come from the elimination of NTBs. These barriers were discussed in more detail in previous sections. EU electronics, automotives, pharmaceutical products and medical equipment would be the biggest beneficiaries of lower NTBs.

The biggest boost to trade in any potential FTA would come from services, although services barriers are relatively low (Table 15). Estimates provided to the authors by one of Taiwan’s leading think tanks, the Chong-hua Institute, based on a methodology developed by Professor Joe Francois, reveal that Taiwan’s level of openness to services trade (in terms of WTO commitments) is at 56 per cent, well above both Korea (38 per cent) and the EU (49 per cent).

However, an attempt at quantifying openness of services based on formal WTO barriers does not give an accurate picture. Copenhagen Economics[41] concludes that restrictions on services in Taiwan would amount to an overall tariff equivalent of 37.31 per cent, which is twice the level of EU services protection of EU (17.26 per cent), though below that of Korea (46.41 per cent).

Existing estimates show that most gains from services liberalisation would accrue to the EU. These gains represent a 60 per-cent increase in EU services exports over existing levels, and a more than 150 per-cent increase in the EU's bilateral services trade surplus (Table 15).

Table 15 summarises the findings of previous studies by Copenhagen Economics, measuring potential gains from EU-South Korea and EU-Taiwan trade agreements. In the categories Beverages, Tobacco and Motor Vehicles, there would be more EU gains in Taiwan than in Korea. Similarly, there is more to gain for Europe in services (six times more and ten times more for Taiwan than for Korea), and Trade Services, and in particular Financial Services (This sentence makes no sense. It does not accord with the Table) (Alternative sentence follows). The EU stands to gain more from services liberalisation in Taiwan than in Korea, especially in the Trade Services and Financial Services categories. Overall, these studies indicate that EU exports to Taiwan would increase 60 per cent from current levels, mainly thanks to the effect on services. This would add 11.8bn Euro to current EU exports of approximately 18 bn Euro.

**TABLE 15 - TRADE EFFECT OF EU-KOREA AND EU-TAIWAN FTAS BASED ON COPENHAGEN ECONOMICS MODEL (PARTIAL TEM SCENARIO - MEASURED IN VALUE OF TRADE, MN EUROS)**

| | Korea Exports to EU25 | EU25 Exports to Korea | Taiwan Exports to EU25 | EU25 Exports to Taiwan | **Net EU/ Korea** | **Net EU Taiwan** | **Consolidated** |
|---|---|---|---|---|---|---|---|
| Beverages, Tobacco | 20 | 5 | 13 | 879 | **-15** | **866** | **851** |
| Textiles and clothing | 547 | 680 | 712 | 485 | **133** | **-227** | **-94** |
| Motor | | | | | | | |
| Vehicles | 644 | 747 | 210 | 1633 | **103** | **1423** | **1526** |
| Electronics, machinery | 571 | 312 | 4814 | 1686 | **-259** | **-3128** | **-3387** |
| Other manufacturing | 747 | 880 | 1752 | 739 | **133** | **-1013** | **-880** |
| Trade | | | | | | | |
| Services | 906 | 1015 | 270 | 940 | **109** | **670** | **779** |
| Transport Services | 758 | 2038 | 707 | 1405 | **1280** | **698** | **1978** |
| Financial Services | 270 | 269 | 209 | 529 | **-1** | **320** | **319** |
| Business Services | 3123 | 4240 | 609 | 1976 | **1117** | **1367** | **2484** |
| Other Services | 1354 | 1413 | 552 | 1557 | **59** | **1005** | **1064** |
| Total | 14626 | 19115 | 9847 | 11831 | **4489** | **1984** | **6473** |

Source: Copenhagen Economics (2007 & 2008)

What long-term, dynamic gains can be expected from closer economic integration between Taiwan and the EU?

### *ii. Intermediate Goods Trade*

Closer integration of Taiwan and EU ICT industries would allow EU firms to better access existing Taiwanese networks for niche products that would be too costly to build at home due to insufficient gains from scale.

Intermediate goods trade tends to be correlated with higher GDP growth rates, according to OECD research.[42] Trade in intermediate goods between Taiwan and the EU is much lower (52 per cent of total trade) compared with Taiwan's trade with North America (64 per cent of total trade) and with the rest of Asia (73 percent).[43] This suggests that there is room for further development of intermediate goods trade between the EU and Taiwan. Further fragmentation of production in the ICT sector is likely to result from the cost pressures incurred by firms in the 2008-2009 economic crisis. This is an opportunity for Taiwanese and EU firms to outsource less efficient production and work more closely at the higher end of the value chain. For the EU, given that hardly any production of key Taiwanese products (e.g. laptops, wifi-routers, PDAs and finalised LCD monitors) actually takes place in Europe, there would be very few employment losses or employment displacement. EU firms and consumers would benefit, with no significant political or economic costs.

### *iii. Investment*

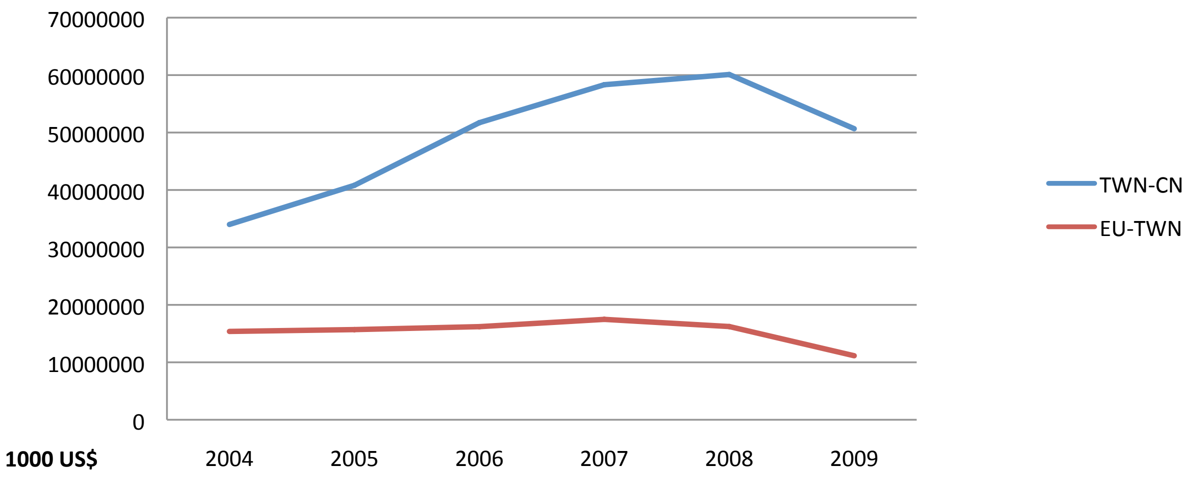
Trade could also be enhanced by increased investments. More FDI tends to generate trade.[44] In the case of Taiwan, FDI in services is where most gains would be made, because, contrary to the depressing effect of the OEM model on FDI (see Part I), services tend to require local presence to be provided efficiently. Taiwan's business, financial and transport/infrastructure services in particular would receive a major boost.

As discussed earlier in this study, Taiwan hardly invests in Europe. Interestingly, Taiwanese firms' investments in the EU are a means to avoid high tariffs on some electronic products. Many of these investments are in Central and Eastern Europe. Very few EU manufacturers have merged with, acquired or been acquired by Taiwanese firms or formed OEM-partnerships with them. Removal of EU trade barriers – whether done multilaterally or bilaterally – would potentially redirect Taiwanese investment towards high value-added segments of the EU ICT sector. This would foster more efficient allocation of capital away from low-end final assembly of some consumer electronics, artificially maintained in the EU through tariff protection.

### *iv. "Triangular" Trade – EU, Taiwan, China*

A similar problem exists with "triangular trade" between the EU, Taiwan and China. Figure 10 shows that Taiwanese exports to China have increased dramatically, while they have not for EU exports to Taiwan. Economic integration between China and Taiwan is bound to deepen. The EU should build on this trend by linking EU-Taiwan trade and FDI with Taiwan-China trade and FDI. That would be given a boost by eliminating EU-Taiwan trade and FDI barriers. It is too early to make an assessment of where exactly the gains would accrue from triangular trade and associated FDI in the aftermath of ECFA. It is clear, however, that with greater Taiwan-China integration, there will be opportunities for EU firms to better serve the "greater China" market and to allocate production more efficiently in east Asia. Using Taiwan as a high-value hub in East Asian supply chains should be part of this strategy. That should be of interest to EU firms attracted by Taiwan's high-value ICT production – including services providers that can plug into ICT production for regional and global markets.

**FIGURE 10 - EXPORTS OF GOODS BETWEEN EU-TAIWAN AND TAIWAN-CHINA**




Source: COMTRADE

## (10) AN EU-TAIWAN FREE TRADE AGREEMENT – BENCHMARKS

### *xxii. Preliminary Remarks - EU FTAs in Asia*

In late 2006, with the Doha Round of trade negotiations in the World Trade Organization floundering, the EU abandoned a *de facto* moratorium on signing bilateral trade agreements. As part of its *Global Europe* strategy, it announced plans to negotiate better market access to key Asian economies. The EU's negotiating strategy in Asia was also designed to be commercially focused, with less emphasis on political and other non-trade objectives the EU has in bilateral trade agreements with less developed countries – notably former colonies in the ACP (Asia-Pacific-Caribbean). The thrust of this strategy was to negotiate comprehensive free trade agreements with South Korea, India and ASEAN. The criteria set were market potential, and the persistence of high barriers to trade in goods and services. Conspicuously, China and Japan – the EU's two biggest trading partners in Asia – were not targeted for FTAs.[45]

The EU's FTA strategy in Asia has had mixed results so far. Its one success is the EU-Korea FTA, which is a relatively strong "deep-integration" FTA (see below). But it had to be diluted due to EU defensiveness in automobiles, and (at the time of writing) it has still to be ratified by the European Parliament. But there are no other "wins" to report so far. India has, predictably, proved much more defensive than South Korea. And the EU has been unable to negotiate with ASEAN collectively. Both India and ASEAN have been reluctant to negotiate a "strong" FTA as seen through the EU's prism: comprehensive tariff elimination (except agriculture), significant services commitments, strong trade-related rules (e.g. in government procurement0, and elimination of key NTBs in goods trade. Also, the EU's insistence on negotiating "trade and" provisions, notably labour standards, has slowed down negotiations with India. Finally, EU competence on services and investment was divided before the entry into force of the Lisbon Treaty, and EU markets in these areas remain fragmented. That weakens the Commission's bargaining power to negotiate market access for EU services exporters and foreign investors with FTA partners.[46]

## *xxiii. Recent Trends in the Content of EU FTAs*

This section provides an analysis of the two most important FTAs concluded by the European Union in terms of their innovative content compared with previous EU FTAs, and their potential interest from a Taiwanese perspective. These are the Economic Partnership Agreement (EPA) with the Caribbean countries (CARIFORUM), signed in late 2008, and the EU-South Korea FTA (Box 4 for highlights), signed in late 2009. The EU has ongoing FTA negotiations with two relatively small, prosperous economies, Singapore and Canada. Resulting agreements are expected to be ambitious in services commitments and disciplines on non-tariff barriers in goods. No serious analysis of these two FTAs is possible as they are still under negotiation.

### Tariffs

In both the EU-CARIFORUM and EU-Korea agreements, the EU agrees to eliminate virtually all tariffs, and maintains only a very limited subset of exceptions in agriculture. It allows its partners greater phase-in periods for their sensitive items, but the EU has secured elimination of tariffs in sectors where it has significant export interests. In the EU-Korea FTA, high Korean tariffs on sensitive machinery items and medical devices, for example, will be eliminated over a period of up to five years.

### Rules of origin

The EU's rules of origin in its preferential arrangements are complex and tend to be restrictive. There is no across-the-board approach; rather a preference for product-specific requirements (though this might be changing). EU ROOs tend to be more restrictive in labour-intensive manufacturing. These ROOs are more restrictive than average Asian ROOs. The China-Hong Kong CEPA generally allows for 30per cent local value-added (FOB) in most manufacturing products, and ASEAN and Japan ROOs tend to settle for 40per cent local content. The ASEAN Free Trade Area (AFTA) and the China-ASEAN FTA have ROOs with across-the-board 40per cent local content. In the EU-Korea FTA, the general qualifying requirement is 45per cent of the ex-works price of the product as maximum non-local content (i.e. 55per cent local content). For some electronics products, even 50per cent applies.[47]

The EU has allowed Korea's duty drawback policy to continue, although the EU had insisted on the elimination of such measures in its other FTAs. However, the agreement contains rules to prevent drawbacks creating distortions or being abused. The drawback system is subject to revision after five years of entry into force of the agreement.[48]

### Services

THE SERVICES SCHEDULE of the EU-Korea FTA, which is similar to the US-Korea agreement, contains more commitments than services schedules negotiated by the EU so far. Compared with Asian FTAs, it is comprehensive. Only Singaporean services schedules can be considered equivalent. Annex 1 shows South Korea's services commitments in as far as they go beyond its existing commitments in the WTO. Commitments made by Korea concern establishment in legal, accounting and real estate services, significant opening of business services (incidental to manufacturing, mining, agriculture), retail and wholesale trade, and some environmental services. Despite announcements of important liberalisation in the telecommunications sector, in fact these remain rather timid. If cross-border satellite TV and radio are opened to cross-border trade, the elimination of foreign equity caps on telecommunication services providers will only take place in five years and, above all, will not affect the current monopoly incumbents. Furthermore, these commitments do not go much further than the existing WTO services schedule for Taiwan.

In contrast, the EU has not gone much beyond its revised services offer in the Doha Round (See Box 4). Extra commitments include the following. In telecommunications, the EU eliminates remaining reservations on establishment (Mode 3), and takes on commitments on cross-border transmission of satellite services. On maritime transport, it eliminates establishment restrictions (except on national flag vessels), and liberalises several auxiliary services. Services auxiliary to rail and road transport are also liberalised. There is some further opening in air transport (catering, storage and warehouse services, freight transport agency services). In financial services, cross-border insurance services are not substantially opened further.

Both the EU and South Korea remain restrictive on the temporary movement of labour (Mode 4). The EU's most wide-ranging commitments in Mode 4 are in the EU-CARIFORUM agreement.[49] There are commitments on Contract Service Suppliers and Independent Professionals. This covers several business services, with many member state reservations, however.

### Investment

FDI HAS BEEN integrated slowly in EU FTAs. The EU-CARIFORUM EPA and the EU-Korea FTA provide a basic framework for unrestricted local establishment by foreign investors.[50] This covers manufacturing (except nuclear energy) and, in principle, services. However, this clause presumably does not apply to services sectors excluded from the "positive list" of scheduled commitments in the services chapter of the FTAs. As a general rule, the agreements prohibit numerical quotas, monopolies, exclusive rights or economics needs tests, output limitations, limitations on foreign capital participation, restrictions on branching, and forced joint-ventures. Investment liberalisation is conditional on the maintenance of ethical standards such as the prohibition of bribes.

### Rules

THE EU INCLUDES a long list of regulatory requirements in its FTAs. These involve intellectual property rights, technical standards, sanitary regulations, competition policy, anti-dumping and safeguards, government procurement, customs and trade facilitation.

## Intellectual Property Rights

The EU-Korea FTA contains the strongest IPR provisions seen in an EU FTA so far. It requires the parties to participate in relevant international conventions. These are the Paris Convention of 1967, the Rome Convention of 1961, the Berne Convention of 1971, the 1991 International Convention for the Protection of New Varieties of Plants, the 1994 Trademark Law Treaty, the WIPO Copyright Treaty of 1996, the WIPO Performances and Phonograms Treaty of 1996, the 2000 Patent Law Treaty, and the Singapore Treaty on the Law of Trademarks of 2006.

On copyright, the FTA follows in the footsteps of the US-Korea FTA by requiring that protection shall be for a minimum of 70 years after the author's death, and 50 years for the rights of broadcasting organisations.

The EU has used FTAs to promote its preferences for the protection of geographical indicators (GIs). Specifically, the EU has used FTAs to eliminate the exceptions granted in Article 24 of TRIPS, which allows for the continued use of GIs that had been used "in good faith" before TRIPS provisions came into force. Early bilateral agreements concentrated on wines and spirits, but in recent FTAs this has been extended to a broader list of products. A major feature of the EU-Korea FTA is its coverage far beyond wines and spirits: it contains a list of 60 EU agricultural products (of which cheeses, sausages and pork meats, and olive oil are the most prominent), and 63 Korean products.

There is precise and legally binding language on domestic enforcement of IPRs through the court system, including the right to introduce provisional and precautionary measures, the right to seize counterfeit products, criminal prosecution of trademark, copyright and GI counterfeiting, and liability of online service providers (but no general obligation to monitor the latter).

The agreement permits the use of the Doha Declaration and the Protocol amending the TRIPS agreement on patents and public health. Overall, on patents, the agreement does not go beyond TRIPS.

## Non tariff barriers in goods – international standards

In the EU-Korea FTA, the EU has negotiated for the first time concrete measures on NTBs to trade in manufactured goods, especially in the electronics and automotive sectors, as well as, more cautiously, in pharmaceuticals and medical equipment. In electronics, the FTA eliminates duplicative testing for health and safety standards, and aligns both sides' standards on EMC and safety to ISO, IEC and ITU standards. In automobiles, the approach is to harmonise standards based on international UNECE criteria. Exceptionally, automotive standards are subject to the FTA's dispute settlement mechanism and have a sector-specific accelerated procedure. The agreement reached on pharmaceuticals and medical devices focuses on procedures to make the process on listing for reimbursement more transparent. In chemicals, there is language on transparency and a Working Group on Chemicals.

## Sanitary and Phytosanitary Standards (SPS)

The EU remains rather defensive on SPS issues in its bilateral trade agreements. It explicitly includes its interpretation of the "precautionary principle" for risk assessment in its FTAs. This is arguably in conflict with the WTO's reliance on a more science-based approach in the SPS Agreement – and in conflict with US FTAs. SPS is not subject to the dispute settlement mechanism in the EU-Korea FTA. The most extensive provisions and procedural disciplines the EU has developed on SPS are in its FTA with Chile, signed in 1999 (Table 16).

**TABLE 16 - SPS PROVISIONS IN EU CHILE AND EU SOUTH KOREA FTAS**

| **WTO consistent rules** | **EU - Chile** | **EU South Korea** |
|---|---|---|
| Reaffirmation of WTO SPS obligations | yes | yes |
| General cooperation in SPS | yes | yes |
| Harmonisation of SPS standards as an objective | yes | |
| Cooperation towards development of international standards | - | yes |
| General exception possible similar to GATT Art XX | yes | |
| Provision for specific technical assistance in the SPS field | yes | |
| **Procedural WTO – Plus measures** | | |
| Establishment of a joint committee on SPS | yes | yes |
| Detailed rules for determining equivalence | yes | |
| Guidelines for conducting verifications, checking imports and certification of testing | yes | |
| Schedules for reporting and consultation | yes | |
| Specific rules on import administration | yes | |
| Requirement to exchange information | yes | |
| Provisional approval of certain establishments | yes | |

## Competition policy

The EU's FTAs include clauses on competition policy. The broad principle the EU demands from all its partners is the prohibition of cartels. Some FTAs include reference to the prohibition of state subsidies; and to the requirement that public monopolies (or private companies granted special or exclusive rights) operate according to commercial criteria (rather than competing unfairly by subsidising activities in competitive markets with rents from monopoly operations). In the EU-Korea FTA there is an obligation to provide a degree of transparency in the distribution of subsidies. Both parties are obliged to report annually "the total amount, types and the sectoral distribution of subsidies which are specific and may affect international trade".[51]

## Anti-dumping and safeguards

The EU position on trade remedies in its FTAs is to follow WTO provisions under Art VI GATT for anti-dumping and countervailing duties, Art XIX of GATT for safeguards, and Art 5 of the Agreement on Agriculture for agricultural safeguard actions. The EU does not support the suppression of anti-dumping actions between signatories to an FTA. In the case of the EU-CARIFORUM text, however, the parties are obliged to seek "constructive remedies", and the EU is required to notify CARIFORUM before it adopts a definitive anti-dumping duty against CARIFORUM exports. Safeguard measures under the agreement can only be taken after conciliation efforts in the Trade and Development Committee of the EU-CARIFORUM. The EU-Korea FTA permits provisional safeguard measures, presumably as a safety valve for domestic interests that might be affected by tariff elimination.

### Government Procurement

The EU-Korea FTA reiterates both parties' commitments in the WTO's GPA. A few provisions go beyond the GPA. Korea, still nominally a "developing country" in the WTO, is not allowed to benefit from Special and Differential Treatment. The parties also extend coverage to build-operate-transfer (BOT) contracts, which are subject to national treatment and transparency disciplines.

### Customs and trade administration

Most EU FTAs contain rules on customs administration. The EU-Korea FTA dedicates a chapter to rules on expedited procedures, streamlined administration, electronic clearance, customs cooperation, confidential data handling, transparent and predictable procedures, and appropriate risk management, all based on the *International Convention on the Simplification and Harmonisation of Customs Procedures of 1999*.

### Political, social and environmental clauses

In its FTAs, the EU includes lengthy chapters on "sustainable development". In the EU-Korea FTA, sustainable development is made an "overarching objective". Political, environmental and social clauses generally include requirements to adhere to ILO conventions, UN human rights conventions, and environmental conventions. There are two genuine novelties compared with previous FTAs. The EU-Korea FTA contains a requirement to adhere to the Kyoto Protocol on climate change. And it introduces a mild form of legal dispute resolution. Government consultations are provided for should concerns arise as to the other party's adherence to the principles outlined in the chapter on sustainable development. Should consultations fail after 90 days, an Expert Panel will be convened, which must produce a report within 90 days. However, implementation of recommended measures is on a "best endeavours" (non-binding) basis.

### Dispute settlement

The EU-Korea FTA introduces a US-style panel arbitration system for goods trade and most other regulatory disciplines, and which also covers financial services and automotive standards. Other services, anti-dumping and safeguards, non-tariff measures and SPS issues are excluded.

**BOX 4 - HIGHLIGHTS OF THE EU-KOREA FREE TRADE AGREEMENT**

*Signed October 2009 – Ratification pending at time of writing*

**Tariffs:** EU eliminates almost all tariffs on entry into force of the agreement. South Korea benefits from more exemptions in agriculture. Tariffs will be eliminated in all manufactured goods, with phase-in periods of up to five years in some sensitive manufacturing goods for Korea.

**Rules of origin:** The general qualifying requirement is 45 per cent of the ex-works price of the product as maximum non-local content (i.e. 55 per cent local content) – EU more liberal than before, but not as liberal as other Asian ROOs. For some electronics products, even 50 per cent applies.[51] EU allows South Korea to continue to apply duty drawback, albeit with restrictions on further expansion and close monitoring as to effects on imports into the EU.

**Services:** Establishment in telecommunications and financial services on both sides is generally free. There is progress on establishment in business services and maritime services on both sides. South Korea opens its retail and environmental (sewage; industrial waste) sector to establishment; financial information and satellite broadcasting services are opened to cross-border provision.

**Investment:** Establishment in both services (in principle) and manufacturing (except nuclear production) liberalised. As a general rule, the agreement prohibits numerical quotas, monopolies, exclusive rights or economics needs tests, output limitations, limitations on foreign capital participation, restrictions on branching, and forced joint ventures.

**Intellectual property rights.** Copyright protection extended to 70 years. Geographical Indicators -EU list of protected goods extended to 60 products beyond wine and spirits and to more than 50 Korean agricultural goods.

**Non-tariff barriers & technical standards.** For the first time in EU FTA history, sector-specific disciplines on NTBs in goods are adopted. In *electronics*: elimination of duplicative testing for health and safety standards, alignment of both sides' standards to international standards. In *automobiles*: standards harmonisation based on international UNECE criteria. Automotive standards are subject to the FTA's dispute settlement mechanism and have a sector-specific accelerated procedure. *Pharmaceuticals and medical devices*: focus on procedures to make the process on listing for reimbursement more transparent. *In chemicals*: language on transparency and a Working Group on Chemicals.

**Sustainable development:** Kyoto Protocol on Climate Change included for first time in an EU FTA.

**Dispute settlement:** US-style panel arbitration system for goods trade and most other regulatory disciplines, and which also covers financial services and automotive standards. Other services, anti-dumping and safeguards, non-tariff measures and SPS issues are excluded.

In sum, the two EU FTAs analysed above reveal the following trends: comprehensive tariff elimination; stronger rules disciplines (IPR, customs, government procurement, competition); stronger sectoral disciplines on technical barriers to trade; more non-trade issues ("sustainable development" issues); more legal bite (dispute settlement). But commitments are still not as strong as they are in US FTAs (e.g. negative lists for services, and no investment-protection rules nor investor-state arbitration). The EU-Korea FTA is likely to be the main benchmark for any potential negotiation with Taiwan.

## (11) SUMMING UP – DEFINING CRITERIA FOR AN EU-TAIWAN FREE TRADE AGREEMENT

### *xxiv. An EU Taiwan FTA – Under What Conditions?*

Based on the preceding economic and trade policy analysis, we think there is a case for an EU-Taiwan FTA (or whatever it is to be called). If both sides decide to proceed to negotiations, they should aim for a strong, comprehensive, deep-integration FTA that captures direct market access gains from bilateral opening, as well as unlocking dynamic gains from triangular (EU-China-Taiwan) trade and investment in ICT supply chains. It should eliminate tariffs on goods trade; eliminate key NTBs in industrial sectors; have deep commitments in services and investment; go for WTO-plus rules in government procurement, IPR and a few other trade procedures; and make sure that ROOs are not too restrictive – especially so that they do not impair seamless EU-China-Taiwan trade in regional and global supply chains and beyond. Only a deep integration FTA would make sense. An Asian-style FTA that eliminated tariffs but was "trade-light" on non-border and regulatory barriers would deliver very modest gains and would not be worth the effort.

Aggregate FTA gains would have a modest effect on the EU economy given the small size of Taiwan's economy. But it could deliver not-insignificant gains in ICT sectors and some services sectors. As important, it would strengthen the EU's political and economic presence in East Asia. And costs in terms of trade diversion and labour displacement would be minimal. For Taiwan the gains would be bigger, again due to its small economy in relation to the EU's gigantic economy. For both parties, an FTA should not be seen in isolation; rather it should be seen in the context of cross-Straits trade and investment integration. Dynamic gains from an FTA would increase in the event of an ECFA and subsequent agreements that would eliminate a large chunk of remaining trade and investment barriers across the Taiwan Strait. Also, there is already a template for negotiations: the EU-Korea FTA -- without hypersensitive sectoral obstacles (automobiles in particular).

As important, Taiwan should see the ECFA, and FTAs with the EU and other key trade partners, as opportunities to unlock new domestic, unilateral, non-discriminatory structural reforms. Some of these would involve trade and investment liberalisation, notably in services sectors such as telecoms and the utilities. But most measures would be intrinsically domestic and aimed at improving the business climate for foreign and domestic traders and investors alike. They would include licensing, labour-market practices, taxation, credit allocation, property rights and contract enforcement (all indicators in the World Bank's *Doing Business Report*). FTAs on their own, including the ECFA (which is in essence a mini FTA), would not be a panacea; and they would lock in distortions that accompany discriminatory trade in the Asian "noodle bowl". But unilateral, non-discriminatory reforms, in addition to FTAs and Taiwan's WTO membership, would deliver much larger gains and be a true global-integration strategy.

What follows are our recommendations for an EU-Taiwan FTA that would make economic and commercial sense. This should be seen in the context of cross-Straits trade and investment integration (especially the ECFA), the EU-Korea FTA and future Taiwanese unilateral reforms.

### *xxv. Tariffs and Import Prohibitions*

TARIFFS SHOULD BE eliminated completely. Most should be abolished as soon as the agreement comes into force, with short transition periods for remaining tariffs lasting up to five years (as in the EU-Korea FTA). Tariff-rate quotas (TRQs) and longer transition periods, together with a special safeguard mechanism, could be envisaged for sensitive agricultural products. But TRQs should be phased out. Reciprocal benefits would flow from the abolition of peak tariffs in industrial products: notably Taiwanese tariffs on automobiles; and EU tariffs on ICT products not covered by the ITA or subject to customs classification controversies (LCD screens, set-top boxes, multifunctional printers), and on some machinery items and bicycles.

It is vital that ROOs do not seriously impair the benefits of bilateral tariff elimination, or restrict the expansion of triangular supply-chain trade in the event of cross-Straits liberalisation. This will have to reconcile EU demands (perhaps based on ROOs in the EU-Korea FTA) with Taiwan-mainland China ROOs (which may follow China-ASEAN FTA practice). As has been highlighted above, the EU tends to have more complex ROOs than many Asian FTAs. The EU should consider including Taiwan in a discussion with other East Asian partners, aimed at acknowledging the realities of global production today and harmonising ROOs to make them more liberal and user-friendly.

The EU-Korea FTA appears to have set a precedent that would permit Taiwan to maintain duty drawbacks, but the EU might demand that these be subject to detailed disciplines.

On trade remedies, Taiwan could follow precedents in the EU-CARIFORUM and EU-Korea FTAs. It could ask for a special working group on trade remedies and demand consultations before AD actions are initiated.

### *xxvi. Non Tariff Barriers*

THE EU SHOULD focus on duplicative testing problems in Taiwan's electrical, electronic, pharmaceutical and automotive sectors. It should follow provisions in the EU-Korea FTA on transparency, elimination of duplicative testing for health and safety standards and alignment with international standards, but be more ambitious and wide ranging.

In turn, Taiwan should insist on stronger cooperation and information procedures to comply with onerous EU regulations such as REACH.

Procedural disciplines on SPS to minimise frictions in agriculture, e.g. on quarantine requirements, could also be useful. The EU-Chile FTA could be a benchmark, since it goes beyond the EU's usual approach, which is to state existing WTO obligations and set up a joint committee. The EU-Chile FTA sets out rules and guidelines on determining equivalence, conducting verifications, checking imports and certification of testing, schedules for reporting and consultation, and specific details on import administration. It also includes a requirement to exchange information, and integrates a list of approved certification establishments.

### *xxvii. Services and Investment*

THE FTA SHOULD follow the US-Korea and EU-Korea FTAs in having a negative-list approach to "establishment" for foreign investors in goods and services (the latter covered by Mode 3 of supply in GATS and FTA services chapters). For both manufacturing and services, establishment should simply be stated as permitted and free of equity restrictions, except for sectors excluded from liberalisation or subject to specific restrictions (such as equity caps). The negative list should be limited. Strong investor protection provisions should be incorporated. The EU Commission should be in a position to negotiate stronger investment provisions than in previous EU FTAs given its new powers under the Lisbon Treaty.

Taiwan should open its telecommunications sector to EU operators. That should mean removing equity caps (or at least allowing majority ownership) for "Type 1" operators in basic and some value-added services. Local incorporation in Taiwan should be allowed in professions such as the law, accounting and engineering, with a process set up for mutual recognition of qualifications. Taiwan should open its utilities to EU operators, particularly allowing third-party access in power generation.

In maritime transport, there should be removal of cabotage restrictions. EU shippers would be particularly interested in direct Taiwan-mainland China connections, especially a direct Taiwan-Shanghai route, so that there can be seamless passage of EU-Taiwan-China cargo. The EU and Taiwan should also negotiate Open Skies agreements, though this will have to be done outside an FTA. Taiwan and the USA have an Open Skies agreement. Both sides would benefit from the new opening of direct air routes between Taiwan and the mainland. Both sides could also be ambitious in express delivery, R&D and higher education services.

## *xxviii. Rules*

### Intellectual property rights

Provisions could follow those in the EU-Korea FTA. The EU is likely to insist on GI protection extending well beyond wines and spirits. And it may request Taiwan to join ACTA or to introduce ACTA-consistent legislation. Given the EU Commission's new powers under the Lisbon Treaty, it could demand stronger, TRIPS-plus patent protection than in previous EU FTAs. If, for political reasons, Taiwan cannot become a signatory to various international IPR treaties and conventions, these could be written directly into the FTA.

### Government procurement, customs administration, competition rules and subsidies

The EU and Taiwan could set up a joint mechanism to improve transparency and resolve outstanding issues in government procurement. Something similar could be established for customs administration. The EU can be expected to seek agreement that cartels and the abuse of market dominance are incompatible with an FTA. This would be more a general commitment to enforce national policies in these areas rather than "hard" top-down rules. All the above would follow provisions in the EU-Korea FTA. The latter also allows for discussions of transparency in the administration of subsidies. Both sides should be open to strengthening subsidy disciplines beyond the WTO Agreement on Subsidies and Countervailing Measures (as is normal in US FTAs).

### Trade and sustainable development

The EU's lengthy sustainable development language in its FTAs is not likely to pose major problems for Taiwan. It is possible that the European Parliament, with its wider powers in trade policy since the Lisbon Treaty came into effect, will insist on stronger clauses on political, labour and environmental standards in new EU trade agreements. Taiwan should be watchful to ensure that market access and rules commitments are not undermined by non-trade clauses. For example, on the climate change agenda, it should make sure it does not bind itself to commitments that would oblige it to follow EU-style policies, or find itself needlessly in conflict with Beijing policies on climate change.

### Dispute settlement

The dispute settlement mechanism should be modelled on that of the EU-Korea FTA. But its coverage could be extended to cover services and investment comprehensively, and include investor-state arbitration provisions.

## PART III – GEOPOLITICS

We now cover the geopolitical dimensions of a possible EU-Taiwan trade agreement. The rationale for this supplementary analysis is Taiwan's peculiar international political status: its non-recognition as a sovereign state by the great majority of governments around the world, including EU member states; and complex security issues in Taiwan-mainland China relations. This has made the Taiwan Straits one of East Asia's security hot spots.

Unlike the United States, the EU has no security role in East Asia generally, nor in cross-Straits relations in particular. So far Taiwan has not featured as an economic or strategic priority for the EU; indeed it barely features on the EU radar screen. The EU has been extremely attentive not to make moves that could be interpreted as a breach of its One China policy. Mainland China has risen fast to become an economic priority for the EU and its member states, particularly the Big Three (Germany, France and the UK). It is now the EU's second biggest trade partner and the leading source of goods imports into the EU. European multinationals are deeply involved in China. Predictably, the EU would not make overtures to Taiwan that it thinks might risk Beijing's ire. This was a clear-cut political calculus while cross-Straits relations remained hostile or strained.

However, this geopolitical template could shift with the thawing of cross-Straits relations in the past two years. There is no question of the EU diluting its One China policy. But cross-Straits rapprochement, especially if it is crowned by an ECFA, might give Taiwan a green light to negotiate FTAs with trade partners in East Asia and beyond. Beijing might look at such initiatives favourably – or at least not unfavourably. That would send the signal to other governments – all committed to the One China policy and without formal diplomatic relations with Taiwan – to respond to Taiwan's overtures. And that might just focus minds in the EU on the economic complementarities with Taiwan that were highlighted in the previous two papers. Moreover, European and other MNEs are keen to diversify their investments and production networks in East Asia while maintaining their engagement with China. Taiwan should be an attractive location for high-value production as part of East Asian supply chains – all the more so given concerns about proprietary information and other problems concerning investments in mainland China.

Finally, an FTA with Taiwan could complement, indeed strengthen, the EU's FTA strategy in Asia, making its political and economic footprint in the region more visible.

That said, major obstacles stand in the way of an EU-Taiwan FTA negotiation. One obstacle is the EU's innate caution, given its imperative not to "rock the boat" in its relations with China. Another is China's stance of blocking FTAs with Taiwan. That has been the case in the past. It would have to change for the EU to consider a shift in its own stance. And Taiwan's initial challenge is to get itself on to the EU radar screen so that the latter starts to think seriously about options to strengthen EU-Taiwan trade relations.

### (12) TAIWAN'S INTERNATIONAL STATUS AND SECURITY IN THE TAIWAN STRAITS

Taiwan saw its international political standing deteriorate in the 1970s after the United States established diplomatic links with Communist China and Taiwan lost its seat as the sole representative of China in the United Nations. Since then it has lost its recognition as sovereign state by the majority of the world's countries. Today, only twenty three countries recognise Taiwan and have official diplomatic ties with it: Burkina Faso, Gambia, Sao Tome and

Principe, Swaziland, Vatican City, Kiribati, Marshall Islands, Nauru, Palau, Solomon Islands, Tuvalu, Belize, Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Nicaragua, Panama, Paraguay, Saint Kitts and Nevis, Saint Lucia, and Saint Vincent and the Grenadines. These countries carry minuscule weight in international politics and economics.

China's main concern with Taiwan is the risk that it will declare formal independence. China's ultimate goal for Taiwan is reunification. It wishes Taiwan to accept Chinese sovereignty and join the fold along lines comparable to Hong Kong and Macau, which retain political and economic autonomy according to the "one country, two systems" principle.

For Taiwan such a perspective is not appealing. Taiwan has democratised since the 1980s and has held open, multi-party elections since 1996. It is a liberal democracy in the region, alongside South Korea and Japan. It retains a security alliance (of sorts) with the USA. And it has a distinctive identity. Between 1990 and 2008, bilateral political relations were tense and often hostile, despite increasingly tight cross-Straits economic links. This was especially the case under the pro-independence DPP administration. Its attempts to steer Taiwan towards formal independence prompted China to issue its Anti-Secession Law in 2005. The law states that if Taiwan declares formal independence, China will resort to the use of force.

In 2008, the Kuomintang Party (KMT) came back to power under the leadership of Ma Ying-Jeou. The Ma administration rapidly moved to improve cross-Straits relations, though it is sensitive to an electorate that is divided on the issue, and generally wary of radical measures that would compromise Taiwan's de facto independence. That, in the context of bitterly polarised Taiwanese politics, has dictated a pragmatic, incremental course to cross-Straits rapprochement. Economic issues dominate the bilateral agenda, starting with easier (less contentious) items and moving gradually to harder (more contentious) ones. Issues relating to Taiwan's political status are, at least officially, left out of the discussions. However, the opposition DPP has strong reservations about recent bilateral negotiations generally, and the ECFA in particular. Citing the secretive nature of the talks, pro-independence leaders fear that China will demand concessions on Taiwan's political status, and that the KMT government will move in this direction.

Where does the USA fit into the picture? By way of compensation for cutting diplomatic ties with Taiwan in 1979, the US Congress passed the Taiwan Straits Act which committed the USA to defend Taiwan's territorial integrity. Fundamentally, the US's policy since then has been to avoid getting dragged into an armed conflict over Taiwan. Its diplomatic efforts have focused on trying to convince Taiwan not to provoke China by, for example, declaring formal independence, while at the same time selling arms to Taiwan to maintain its defence capability. Regular arms sales lead to quasi-ritualistic official protests from China, as happened again with the US approval of a sale of Patriot missiles to Taiwan in early 2010. Still, the USA remains concerned about the general build-up of China's military capacity and the effects it might have on cross-Straits relations.

That said, first the Bush administration and now the Obama administration welcome the recent improvement in cross-Strait relations. Above all, it lowers the risk of military conflict into which the US would be dragged. And the US administration also welcomes stronger cross-Straits economic ties, which would benefit US companies in the region and spur closer US-Taiwan commercial ties.

## (13) THE EU, CHINA AND CROSS-STRAIT RELATIONS

The EU's relationship with China is generally driven by commercial considerations; it is the economic relationship that takes priority. But other considerations intrude, such as the EU's desire to promote its values on human rights, democracy, labour and environmental standards, and climate change. This led to the EU's imposition of an arms embargo on China, jointly with the USA, in response to the Tiananmen massacre in 1989.

The Lisbon Treaty, which since December 2009 provides the framework for the EU's external policy, stipulates in its General Provisions on the Union's External Action (Title V, Chapter 1, Article 21) that:

> The Union's action on the international scene shall be guided by the principles which have inspired its own creation, development and enlargement, and which it seeks to advance in the wider world: democracy, the rule of law, the universality and indivisibility of human rights and fundamental freedoms, respect for human dignity, the principles of equality and solidarity, and respect for the principles of the United Nations Charter and international law.

Commercial policy is conceived as a tool to achieve this wider ambition. Article 207 (Part V, Title II) of the Lisbon Treaty stipulates that:

> The common commercial policy shall be conducted in the context of the principles and objectives of the Union's external action.

This approach is reflected in the Preamble and the "sustainable development" chapter in the EU's bilateral trade agreements, as discussed in Part II.

The official EU-China relationship, following a series of bilateral accords in the 1980s and '90s, was crowned by a "strategic partnership" in 2004. There was an attempt to create a "techno-political linkage", involving cooperation in space, satellite navigation, science and technology, aerospace, and even including defence sectors. The EU even proposed to lift the post-Tiananmen arms embargo, which was keenly sought by China.[53] The EU proposed to replace the arms embargo with a general code of conduct on arms sales that would be legally binding, contrary to the arms embargo declaration, and set criteria for authorising international arms sales without necessarily targeting or stigmatising a single country.[54]

However, the embargo carries strong symbolic significance. Taiwan supports its continued application. And Taiwan was the main reason why the European move to lift the arms embargo was actively opposed by the United States. The Bush administration thought this would encourage China's military build-up, with destabilising effects on cross-Straits relations. The EU reversed the policy and did not go ahead with removing the arms embargo.

EU-China relations have continued to deepen. That is particularly true of ground-level trade and investment links. At the official level there are over fifty bilateral dialogues, all the way from issue-specific cooperation on a wide range of sectors and topics to high-level overarching policy dialogues. At the apex of this pyramid are EU-China summits involving heads of government, as well as the High Level Dialogue on economic and trade issues. The latter, at commissioner and ministerial level, is supposed to mirror the US-China Strategic and Economic Dialogue, originally set up under the Bush administration to resolve conflicts on economic issues. But these dialogues and summits, including the High Level Dialogue, have not got beyond talking shops and photo opportunities. It is abundantly clear that Beijing takes them much less seriously than high-level dialogues with Washington. These mechanisms are certainly not strong enough to contain or resolve tensions and conflicts on specific issues. Trade and macroeconomic spats between the EU and China have increased, indeed before the onset of the global economic crisis. This mirrors trends in the US-China relationship. But EU allegations of "unfair trade" against China and threats of retaliation remain lower key than in the USA. Overall, despite occasional flare-ups and the extra pressures generated by the global economic crisis, EU-China trade relations, though more strained, have not been derailed. There have been occasional political flare-ups as well, e.g. China's cancelling of an EU-China Summit in 2008 after President Sarkozy decided to meet the Dalai Lama. Cooperation with China in sensitive issues such as satellite navigation has been scaled down.[55] But again, this has not fundamentally weakened bilateral relations.

In this context, what is the state of EU-Taiwan relations?

EU-Taiwan relations are framed by the European Council *Guidelines on the EU's Foreign and Security Policy in East Asia*, which date back to 2007. The guidelines identify three major security threats in the region: North Korea, "competitive nationalism" in the region, and the dispute across the Taiwan Strait. In this regard, the document aligns the EU's strategy with that of the United States:

> The US's security commitments to Japan, the Republic of Korea and Taiwan and the associated presence of US forces in the region give the US a distinct perspective on the region's security challenges. It is important that the EU is sensitive to this. Given the great importance of transatlantic relations, the EU has a strong interest in partnership and cooperation with the US on the Foreign and Security policy challenges arising from East Asia.

The document contains a special section on cross-Straits relations. Here the EU restates its One China policy: the People's Republic of China is recognised as sovereign, but not Taiwan. The EU states that it is ready to encourage initiatives aimed at promoting dialogue, practical cooperation and confidence building, and that it encourages both sides to pursue "*pragmatic solutions to questions regarding the position of Taiwan in specialised international organisations.*"

In practice, the EU is extremely cautious in its dealings with Taiwan and ensures that it does not undertake measures that could in any way be interpreted as recognition of Taiwan's statehood. It does not actively support Taiwanese membership of specialised international bodies if China opposes such moves. This was the case in the run-up to the Copenhagen Summit on climate change when the EU opposed Taiwan's accession, with observer status, to the United Nations Framework Convention on Climate Change (UNFCCC). The European Parliament, in contrast, formally supports such inclusion[56]. But even after the entry into force of the Lisbon Treaty, the European Parliament will only have a marginal role in shaping EU foreign-policy decisions of this kind.

What are the options for an EU-Taiwan FTA in light of the geopolitics of EU-Taiwan relations? The following analysis focuses on political and legal matters.

## (14) ARE THERE LEGAL HURDLES TO A BILATERAL AGREEMENT BETWEEN THE EU AND TAIWAN ON TRADE AND INVESTMENT?

In general, Taiwan is not a member of intergovernmental organisations. China sees to it that Taiwan cannot join United Nations affiliated bodies. The major exceptions are the Asian Development Bank, the World Trade Organization and the Asia Pacific Economic Cooperation (APEC). This is possible because these organisations do not necessarily require statehood as a condition of membership. To be a member of the WTO, for example, it is enough to be a separate customs territory. That is why Hong Kong is a member of the ADB, WTO and APEC as well. Taiwan joined the World Health Assembly as an observer in 2009, without meeting Chinese opposition. China opposed Taiwan joining the World Health Organization in the wake of the SARS crisis in 2003, which strongly affected Taiwan. Taiwan also joined AITIC (Agency of International Trade Information and Cooperation) as "contributing member" in 2009. This was easier to do given that China is not a member of AITIC.

Bilateral and regional free trade agreements are formal treaties. Current international law and practice tend to reserve the signing of formal treaties to sovereign states, or to entities that have been given the legal personality to do so. The latter is the case of the EU and other international organisations. Since Taiwan is not recognised as a sovereign state by most governments, in principle it is not subject to large swathes of international law. Taiwan's FTAs are with five countries (El Salvador and Honduras, Guatemala, Nicaragua, and Panama), all of which recognise Taiwan's statehood.

But international law is not clear-cut. The framework treaty regulating international treaties, the *Vienna Convention on the Law of Treaties* of 1969 stipulates in its Article 3 on "international agreements not within the scope of the present Convention" that:

> The fact that the present Convention does not apply to international agreements concluded between States and other subjects of international law or between such other subjects of international law, or to international agreements not in written form, shall not affect …. the legal force of such agreements.

This means that an unusual entity in the international sphere such as Taiwan is not excluded from signing legally binding international agreements. And it has done so. This includes bilateral investment treaties (BITs) with some Asian countries that do not formally recognise Taiwan's statehood. Taiwan has signed various double-taxation agreements with countries that have not recognised it as a state, including European member states. This comes on top of Taiwan's Open Skies agreement with the United States, the recent air services agreement with the United Kingdom, and the bilateral treaties on cooperation on intellectual property rights with twenty countries, some of them members of the European Union (Austria, France, Germany, Spain, the Netherlands and the United Kingdom), all mentioned in the previous sections.

In March 2010, Hong Kong, WTO member but not a sovereign state, and New Zealand, signed a "Closer Economic Partnership Agreement". The latter is an FTA covering goods, services, government procurement, movement of business people, rules of origin, customs cooperation, trade remedies, sanitary and phytosanitary measures, technical barriers to trade, intellectual property, competition, electronic commerce and dispute settlement. The agreement sets a legal precedent that could well serve Taiwan in the future: although a WTO member is not recognized as a sovereign state, it can, in its capacity as independent customs territory, sign binding bilateral trade agreements.

Ultimately, Taiwan's ability to sign bilateral agreements given its current status depends on politics. Legal obstacles are minimal. But given mainland China's sensitivity to Taiwan being involved in international organisations and treaties that could imply or lead to recognition of Taiwan's statehood, Taiwan and its partners have kept to low-key, technical, sectoral and issue-specific agreements. In essence, potential partner countries should be willing to sign agreements with Taiwan if their relations with China are not jeopardised. China must be reassured that any agreement Taiwan signs is not a move towards formal statehood and independence. This is a challenge, for the more Taiwan accumulates international treaties, the closer it comes to being seen as a 'normal' state.

## (15) WHAT COULD TILT THE POLITICAL BALANCE IN THE EU IN FAVOUR OF AN AGREEMENT WITH TAIWAN?

A FORMAL FTA between the European Union and Taiwan is very likely to have much greater political symbolism than, say, a double-taxation agreement with an individual EU member state. It could meet opposition from China if the issue is not handled with care. There are three developments that could lead to a change in the EU's approach to Taiwan. One factor, the China-Taiwan relationship, is critical; the other two, concerning the EU-China relationship and intra-EU policy making, are much less important but still potentially complementary.

First – by far the most important factor – is cross-Straits rapprochement and the prospect of an ECFA. That might persuade Beijing to give the green light to Taiwanese FTAs with East Asian neighbours, the USA and EU. But that raises another question: is the current thaw in cross-Straits relations sustainable? Now pragmatism is the name of the game, driven by the KMT government in Taipei and the present leadership in Beijing. That does not rule out a stalling or indeed a reversal of recent trends. That could happen with a powerful political backlash in Taiwan or a hardening of Beijing policy. All depends on locking in and extending cross-Straits liberalisation.

Second, European MNEs complain of increasing difficulties in doing business in China, e.g. protecting proprietary information, standards discrimination, access to services markets and exclusion from public procurement contracts. The European Chamber of Commerce in Beijing argues this is occurring in a climate of growing economic nationalism in China. These arguments are echoed by US MNEs and the American Chamber of Commerce in China. The President of the European Chamber of Commerce in China, Joerg Wuttke, recently published an article in the *Financial Times* tellingly entitled "China is beginning to frustrate foreign business".[57] He argues that:

> For the first time I hear of companies contemplating leaving the country altogether. They consider this not because they cannot compete with local rivals – but because they are weary of slogging through an unpredictable business environment where the odds seem deliberately stacked against them....I also hear of big companies preparing strategies to route part of their future investment away from China and into other Asian countries, where a more transparent and predictable market environment means safer and healthier investment opportunities.

A note of caution is in order. MNEs are not about to flee China or dilute their stakes in the Chinese market. They have spent far too much time and money to do that; and most MNEs either continue to make healthy profits in China or see the near-term prospect of doing so. China is integral to their global strategies. That means they will put up with a considerable amount of hassle. But MNEs are looking to diversify their investments in East Asia, partly because they are already heavily involved in China and see potential to expand elsewhere, and partly for reasons of political insurance. Hence they look to Vietnam and Indonesia as locations for labour- or resource-intensive low value adding activity, especially given rising labour and other costs of production in China's coastal regions. And they will be looking to other more advanced countries in the region for higher value investment and production. Taiwan should position itself as such an attractive location, not so much to serve the small local market but as a global export platform. That requires a regional as well as global-integration strategy: strong unilateral reforms to reduce domestic distortions and improve the business climate; reduction and removal of barriers to trade and investment with the mainland; and perhaps bilateral FTAs. By offering a safe environment for European investors and their intellectual property, *and* an open door to business with mainland China, Taiwan stands a better chance of getting business and political support in the EU for a bilateral FTA.

Third, the European Parliament (EP) will scrutinise EU trade policy in more detail with the passage of the Lisbon Treaty. It now has equal power with the member states in ratifying bilateral agreements; and it will have a greater say in trade policy making. The EP has been more sympathetic to Taiwan's ambitions to be admitted to international organisations than the Commission and the member states. Members of the European Parliament are likely to have more say in EU trade negotiations on human rights, democracy, and social and environmental policies. On these issues Taiwan is clearly more palatable to MEPs than China and Vietnam, for example. Furthermore, Taiwan poses no significant competitive threat to entrenched protectionist interests in the EU agricultural, textiles and automotive sectors.

Even if Taiwan succeeds in making its case to the EU along these lines, the EU will want to reassure China that any negotiations with Taiwan will be purely "economic", involving the EU with Taiwan as a separate customs territory, and without "political" connotations, i.e. relating to Taiwan's political status.

## CONCLUSION

Taiwan's initial challenge is to get itself on to the EU radar screen so that the latter starts to think seriously about options to strengthen EU-Taiwan trade relations. The signing of ECFA now provides a window of opportunity for Taiwan to pursue FTAs with its key trading partners, including the EU. The time may soon be ripe for such an initiative. But it will not succeed if there is no "green light" of sorts from China, or if the EU feels it would compromise its all-important relationship with China. Therefore, Taiwan must reassure both the EU and China that any EU-Taiwan negotiations will be purely commercial and without wider political implications.

An FTA between the EU and Taiwan with the sole aim of serving each other's domestic markets would deliver modest gains; and it would be difficult to mobilise political support for it in the EU. However, if seen in the context of deepening Taiwan-China economic integration, potential gains would be more significant; it would be a much more interesting proposition for the EU. Overall, Taiwan should position itself as an attractive high-value investment and production location, not so much to serve the small local market but as a regional and global export platform. That requires a regional as well as global-integration strategy: strong unilateral reforms to reduce domestic distortions and improve the business climate; reduction and removal of barriers to trade and investment with the mainland; and bilateral FTAs. By offering a safe environment for European investors and their intellectual property, and an open door to business with mainland China, Taiwan stands a better chance of getting business and political support in the EU for a bilateral FTA.

In this context, an EU-Taiwan FTA should be comprehensive and ambitious. Apart from eliminating border barriers, it should focus on "behind-the-border" barriers – especially NTBs in goods, and regulatory hurdles in services and investment. The design of such an agreement should be based on the EU-South Korea FTA and potentially go further.

Such an agreement should be part of an EU strategy to tap into Taiwan's global production network at the higher end of ICT production and related business services. Also, given that Taiwan's most competitive exports are not concentrated in highly sensitive EU sectors such as automobiles, garments and agriculture, there is likely to be little if any domestic interest-group opposition in the EU to such a deal.

## ANNEX 1

### SECTORS WITH "WTO PLUS" COMMITMENTS BY SOUTH KOREA IN THE EU-SOUTH KOREA FTA

Yes = "no reservations"; No = "unbound". Italics = Already in Revised Offer in Doha Round. Bold= Concessions to EU specifically

| | Mode 1 | Mode 2 | Mode 3 |
|---|---|---|---|
| **Legal services** | **yes** | **yes** | **Only in JV and only in 5 years** |
| **Accounting auditing** | **no** | **no** | **Equity cap, only possible in 5 years** |
| **Taxation services** | **no** | **no** | **Equity cap, only possible in 5 years** |
| *R&D services – natural sciences* | *yes* | *yes* | *no* |
| *R&D services – social sciences* | *yes* | *yes* | *yes* |
| *R&D services – interdisciplinary* | *yes* | *yes* | *no* |
| *Real estate services – brokerage and private appraisal* | *no* | *no* | *yes* |
| *Rental/leasing services without operators relating to ships* | *yes* | *yes* | *Yes ('Unbound for the establishment of a registered company for the purpose of operating a fleet under the national flag of Korea')* |
| *Leasing or rental services concerning personal or household goods* | *yes* | *yes* | *yes* |
| *Market research and public opinion polling* | *yes* | *yes* | *yes* |
| *Consulting services related to agriculture and animal husbandry* | *yes* | *yes* | *yes* |
| *Services incidental to mining* | *yes* | *yes* | *yes* |
| *Services incidental to manufacturing* | *yes* | *yes* | *yes* |
| *Placement services of personnel* | *yes* | *yes* | *Yes (incorporation requirement)* |
| *Packaging services* | *yes* | *yes* | *Yes* |
| **Courier services – air and sea only** | **yes** | **no** | **No** |
| **Satellite TV and radio** | **yes in two years** | **yes in two years** | **No** |
| *Facilities-based public telecommunications services* | *no* | *no* | *In 2 years foreign equity cap of 49per cent dropped. Except for incumbents KT and SK* |
| *Value-added telecommunications services* | *yes* | *yes* | *Yes* |
| **Telecommunications related services (equipment rental)** | **yes** | **yes** | **Yes** |
| **Higher education** | **no** | **yes** | **Applicable to all private higher education institutions, except: medicine, law, virtual universities. Possible restriction on number of students in the fields of medicine, pharmacology, veterinary, medical technicians, vocational training as well on number of education institutions located in Seoul.** |
| Condition upon establishment (national treatment): Board of Directors: at least 50per cent of Korean national members, except the situation when foreign part contributes more than 50per cent of property, then foreigners are allowed to take up to 75per cent of seats in BoD | | | |

| | | | |
|---|---|---|---|
| Adult education | No for 'health and medicine-related' | yes | Applicable to all private adult educational institutions excluding: services which recognise or confer education qualification, vocational training supported by government, virtual universities. Limitations on the type of establishment: allowed types: institutes related to lifelong and vocation education (non-gov). They must be annexed to workplaces, NGOs, schools, media or related to development of knowledge and human resources. They must not operate for the purpose of recognising educational qualification or conferring diplomas |
| *Wholesale trade* | *Yes (no pharma, functional foods)* | *yes* | *Yes (economics needs test for used cars, gaseous fuels)* |
| *Retail trade* | *Yes (no pharma, functional foods)* | *yes* | *Yes (economics needs test for used cars, gaseous fuels)* |
| *Sewage* | *No (market access) yes (national treatment* | *yes* | *Yes* |
| *Industrial refuse disposal services* | *No (market access) yes (national treatment* | *yes* | *Yes* |
| *Collection and treatment services of non-industrial waste water* | *No (market access) yes (national treatment* | *Yes* | *Possibility for EC suppliers to be "party in competition procedures for management contracts"* |
| **Insurance – maritime shipping reinsurance, services aux to insurance,** | **Yes** | **Yes** | **General on insurance (Market Access) Yes. Only two employees of a commercial bank, mutual saving bank or securities company may sell insurance products at only one time at a single location. For transparency purposes, the manner of windows in a single bank location devoted to the sale of insurance will be restricted and limitations will be imposed on the per centage of insurance sold by a bank that may be underwritten by a single insurer.** |
| **Insurance - air transport** | **Yes** | **yes** | |
| **Insurance – advisory and auxiliary services** | **yes** | **yes** | |
| **Insurance intermediation** | **no** | **no** | |
| **Financial information** | **yes** | **Yes** | **No 'the following types of business may not be conducted by a branch of a financial service supplier: credit union, mutual savings banks, specialised capital finance companies, merchant banks, foreign and won currency capital brokerage firms, credit information companies, general fund administration firms, indirect investment vehicle appraisal companies and bond appraisal companies. No information in GATT** |
| **Data processing/software** | **Yes in 2 years** | **yes** | |
| **Financial advisory services (e.g. credit rating)** | **Yes in 2 years** | **yes** | |

| | | | |
|---|---|---|---|
| **Banking** | **no** | **no** | **"Yes "limitations in various banking institutions, certain electronic financial services (only as a subsidiary), interbank brokerage, stock exchanges, securities depository; derivatives and securities settlement; National treatment: individuals and non financial institutions may not hold more than 4 and 10per cent respectively of Korea-incorporated banks. "Each branch location in Korea of a bank constituted under the laws of another country requires a separate licencese. A branch of a banking subsidiary, including one owned or controlled by investors of another country does not require such a license."; some capital requirements; and some non national treatment for Housing finance.** |
| | | | |
| **Entertainment services** | **no** | **yes** | **Yes for market access, no for national treatment** |
| **News agency services** | **Via national agencies only** | **yes** | **Only for collection of information, not distribution. Limitations on ownership by individuals or foreign government. No for radio stations** |
| **Recreation park services** | **yes** | **yes** | **Yes** |
| *Maritime freight forwarding services* | *yes* | *yes* | *Yes – obligation to incorporate as joint stock company* |
| *Rental of vessels with crew* | *yes* | *yes* | *Yes, except for the establishment of a registered company for the purpose of operating a fleet under the national flag of Korea* |
| *Pushing and towing services* | *no* | *yes* | *Yes, except for the establishment of a registered company for the purpose of operating a fleet under the national flag of Korea* |
| *Tally measurement* | *no* | *yes* | *Yes* |
| **Rental of aircraft with crew** | **yes** | **yes** | **Yes. Aircraft used by a Korean air carrier has to be registered in Korea. Registration: Specific nationality criteria for natural person and specific criteria regarding ownership of capital and control for juridical person.** |
| **Certain services auxiliary to road transport** | **no** | **yes** | **Remaining economics needs test, licences granted only to international shipping companies** |
| **Freight forwarding (for rail)** | **no** | **yes** | **Yes** |
| *Pipelines - oil* | *Yes: Market access, No National treatment* | *Yes: Market access, No National treatment* | *Yes* |

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2. Dent (2009), p. 123.
3. Copenhagen Economics (2008).
4. OECD (2006).
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16. WTO (2010), p. 32.
17. Council for Economic Planning (2009b).
18. The New York Times (2010),
19. ARATS and SEF have formed an institutionalized negotiating platform for face-to-face talks on "institution-to-institution" and "official-to-official" basis. See also Chen, Chien-Hsun (2008)
20. Council for Economic Planning and Development (2010b).
21. Tax News (2010).
22. This section draws on Sally (2010).
23. http://aric.adb.org/
24. Kawai and Wignaraja (2009), pp. 5-8.
25. Menon (2009), pp. 19-21, Kawai and Wignaraja (2009), op cit., pp. 11-14.
26. Tariff escalation is the per centage in difference in tariffs applied to raw as compared to finished goods.
27. http://doca.mof.gov.tw/public/Attachment/962310154839.ppt#321,7,I. Organization & Functions
28. There are some exceptions here and there. For example, Taiwan accepts reports in English for EMC (electromagnetic compatibility) certification for ICT products certified within the IECEE CB Scheme (which aims to foster mutual recognition of national electrotechnical equipment and components standards based on International Electrotechnical Commission (IEC) standards).
29. Copenhagen Economics (2008), p. 57.
30. European Chamber of Commerce in Taipei, "Logistics", and "Maritime" in 2007-2008 Position Papers.
31. European Chamber of Commerce Taipei, "Electrical Engineering and Equipment", 2009-2010 Position Papers.
32. The last restrictions of USD 5 million on foreign individual investors were lifted in late 2008. Clifford Chance (2008).

33. Ministry of Foreign Affairs of Taiwan (2009).

34. Taiwan has seen duties imposed following such investigations in stainless steel fasteners, tube and pipe fittings of iron or steel, compact discs, synthetic staple fibres of polyester, glyphosate, disposable lighters, PET (polyethylene products), polyvinyl alcohol (PVA) and peroxodisulphates. Duties imposed have been in the 15-20-25 per cent range, with peaks such as 38.5 per cent on glyphosate. In 2009, a proceeding on polyester yarn was launched affecting Taiwanese exports. However, it should be added that these are relatively minor export categories to the EU, certainly compared with ICT products.

35. Euractiv (2010).

36. EU Revised Offer in WTO 2005, Transport services: Liner shipping and bulk, tramp and other international shipping, including passenger transportation, are offered for opening. Restrictions on establishment remain on establishment of a fleet under an EU national flag. Maritime cargo handling is not generally opened except in some Baltic states, and an economics needs test or monopoly rights are maintained for investment in most member states. A similar approach is taken in storage and warehousing services. Maintenance and repair services, pushing and towing services, and supporting services for maritime transport remain uncommitted for cross-border services and establishment. Establishment is possible in most member states for customs clearance, container station and depot services, maritime agency services, maritime freight forwarding services, and rental of vessels with crew. Air, rail, road, pipeline and internal waterway transportation remain, barring some auxiliary services, “unbound”, i.e. not committed for opening. (TN/S/O/EEC/Rev.1)

37. Copenhagen Economics (2008).

38. Ibid., p.73.

39. Ibid., p.66.

40. Based on latest available figures (2009), UN COMTRADE.

41. Copenhagen Economics (2008).

42. Miroudot, Lanz, Ragoussis (2009).

43. Ibid., Table 12.

44. The theoretical framework has been explored in Miroudot, Lanz, Ragoussis, Ibid.

45. See Sally (2007).

46. Erixon, Fredrik and Sally, Razeen (2009).

47. HS 8519 (sound recording / reproducing apparatus), HS 8523 (discs, tapes, solid-state non-volatiles storage devices etc.), HS 8525 (transmission apparatus for radio-broadcasting or television), HS8526 (radar apparatus, radio navigational aid apparatus etc.), HS 8529 (parts for previous including HS 8528 – monitors/projectors).

48. By then, if it is established that there is evidence of a change in sourcing patterns for exports destined to the EU that have “a negative effect on competition for domestic producers of like or directly competitive products”, the EU may request a limitation on duty drawback to a maximum 5 per cent of duties, or the elimination of a particular product from benefiting from duty exemptions for its components. The change of sourcing patterns will be assessed on the basis of whether the rate of increase of dutiable imports for goods that are exported to third countries without an FTA with Korea is higher than for the EU. Exceptions are made if these imports are for domestic consumption or have high value added. The agreement lays down detailed rules for the establishment of evidence, and for a binding arbitration procedure in case of disagreement. In this context, imports will be monitored, and the parties are obliged to provide detailed statistics on the input-import structure of various products. Products covered include above all the automotive sector, and – of particular interest for Taiwan – electronic products HS 2007 headings 8522, 8527, 8529, 8521 and 8525 through 8528.

49. Sauve and Ward (2009).

50. At the time of writing, the new agreements with Peru and Colombia had not been published. However, it appears that similar provisions are included there too. See de Gucht (2010).

51. The coal industry (prohibited subsidies) and fisheries (transparency) are explicitly excluded from the agreement's disciplines on subsidies.

52. HS 8519 (sound recording / reproducing apparatus), HS 8523 (discs, tapes, solid-state non-volatiles storage devices etc.), HS 8525 (transmission apparatus for radio-broadcasting or television), HS8526 (radar apparatus, radio navigational aid apparatus etc.), HS 8529 (parts for previous including HS 8528 – monitors/projectors).

53. See Casarini (2009), e.g. p. 3.

54. See House of Lords (2009) and Grant and Barysch (2008), p. 63-64.

55. See Casarini (2009).

56. European Parliament (2009).

57. Joerg Wuttke (2010).