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## Policy Conclusions

The overall welfare gains from a US-Taiwan FTA would be modest, especially for the United States. However, this is the case for many potential FTAs between the United States and partners around the globe. And in fact, in absolute terms, the gains to the United States from an FTA with Taiwan would be larger than from all but two of the 12 other prospective FTAs examined by John Gilbert (2003).<sup>1</sup>

A US-Taiwan FTA would appear to be mostly trade diverting, not trade creating, primarily because the gains to Taiwan would derive almost entirely from increased exports of apparel, a sector in which the island's production and exports have been declining for years in the face of competition from lower-cost producers. To achieve the postulated gains, "sunrise" industries in Taiwan such as IT industries would likely shrink as a "sunset" industry—apparel—absorbed more labor and other resources. While preferential access to the US apparel market under an FTA would provide short-term economic benefits, it almost certainly would have adverse consequences for Taiwan's long-term economic growth and welfare.

For the United States, the biggest anticipated gains from an FTA with Taiwan are in the auto sector, although these gains also would almost certainly reflect trade diversion. US companies for many years have been losing ground in the Taiwanese car market to Japanese and South Korean

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1. The two economies are South Korea and Thailand, which Gilbert (2003, table 2) credits with \$2.7 billion and \$820 million in equivalent variation gains to the United States, compared with \$760 million for Taiwan.

producers, strongly suggesting that gains of US producers under an FTA also would be the result of trade diversion.

Setting aside for the moment the danger of misallocating resources associated with trade diversion, a US-Taiwan FTA at least in the short run would partially offset diversion away from Taiwan, assuming that cross-strait politics continue to preclude the island's participation in regional trade liberalization. However, a US-Taiwan FTA by itself will not bolster Taiwan's long-term economic growth and welfare, which depend to a considerable degree on deepening economic integration in the Asia-Pacific region.

A US-Taiwan FTA could facilitate further trade liberalization with the rest of Asia if it were to set a precedent that emboldened other countries in the region to consider bilateral FTAs with Taiwan. Of course, if Beijing were to withdraw its diplomatic pressure on other Asian nations not to negotiate bilateral FTAs, then the importance of a bilateral US-Taiwan FTA in this regard would be moot.

If a US-Taiwan FTA is the only avenue for Taiwan to join the game of competitive liberalization, the negotiations should seek to break new ground. An expanded liberalization agenda would presumably increase the economic benefits of an FTA well beyond the limited gains projected by economic models. That, in turn, would make the bilateral agreement more attractive to political supporters of trade liberalization. Obvious areas of negotiations include agriculture and intellectual property protection.

For the United States, beyond facilitating Taiwan's participation in intra-Asian trade liberalization, a US-Taiwan FTA takes on geoeconomic and geopolitical considerations that go beyond the economic case for such an agreement. Taiwan is a long-standing US ally, a democratic state, an important US trading partner, and a willing negotiator on a range of political and economic issues. With these and so many other variables at play, ranging from bilateral effects to development in Asia, discerning trade policies that best serve US interests is as complex as the region to which they will be directed. Analyzing the economic fundamentals of a potential US-Taiwan FTA in the context of this array of issues is a critical starting point to lay the foundation for the decision making that will be needed to meet the challenges ahead.