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It is an honor for me to make my fourth appearance before this Commission. The commercial and economic relationship across the Strait of Taiwan has evolved dramatically since I first gave testimony on these developments in August 2001. I commend the Commission for its continued focus on this complex, but highly important, dynamic. As I have consistently testified, the growing economic and commercial interdependence between Taiwan and China has great significance for the prosperity and stability of the Asia-Pacific region. The U.S. stake in this dynamic is significant. U.S. prosperity and jobs depend directly upon active engagement in this region of the world enjoying the most robust current growth and the best long-term prospects for future growth. U.S. security also depends directly on maintaining the stability of the region and further advancing the prosperity supporting the region's stability. While far from Main Street, the Strait of Taiwan is a fulcrum for vital U.S. interests. This Commission plays a vital role in helping illuminate the economic dynamics behind the headlines in this region.

As we meet, the triangular security relationship between the United States, China and Taiwan is again under some strain. In particular, the strain in the U.S.-China leg of the triangle has been marked overtly by a series of political events over recent months: the President's meeting with the Dalai Lama, the Taiwan arms sale package, China's intransigence as other U.N. Security Council members have moved toward sanctioning Iran for its nuclear program, the perceived spoiler role that China played in the COP15 climate change talks in Copenhagen, and the governmental parry-and-thrust over Google's disclosure of orchestrated hacking into its servers. The U.S. relationship with Taiwan, despite an overall improvement under the administration of President Ma Ying-jeou, has not been without its own recent difficulties. Most significant has been the interruption in momentum towards improving trade and investment ties as a result of legislation adopted in Taiwan in December to limit the import of certain beef products from the U.S. Meanwhile, the improvement of Taiwan-China economic and commercial relations has been both steady and strong. Prospects are good for Beijing and Taipei to sign an Economic Cooperation Framework Agreement ("ECFA") governing these improving trade and investment ties in June of this year.

The overt markers for these shifting tensions within the U.S-China-Taiwan strategic relationship have been political events, as just described. However, the tectonic forces determining these surface events have been largely economic. In particular, the global economic recession starting in September 2008 has sharply accelerated pressures long affecting each leg of this security triangle. A quick examination¹ of each leg of the triangular relationship will help demonstrate the importance of economic factors in continuing to alter the political landscape for the U.S., China and Taiwan.

¹ Selected portions of the following three sections of analysis are drawn from Terry Cooke's publication "New Strains in the U.S.-China-Taiwan Strategic Triangle" published in China Brief (Jamestown Foundation), Volume 10, No. 4 on February 18, 2010

U.S. & China: Cooperation Stalls?

Early efforts at outreach to China by the Obama Administration have revolved around a program of clean energy cooperation between the United States and China—dubbed the U.S.-China Climate Change Roadmap. According to this ‘new leaf’ approach, the single track of Treasury-led negotiations with China was not productive. Given Treasury’s mandate, the bureaucratic politics of the Bush administration SED process tended to shunt issues in the U.S.-China bilateral dialogue onto a single track – one based on the politics of yuan/dollar exchange rates. Despite a commendably patient and strategic approach, this ‘single-track,’ Treasury-led process yielded only limited results on currency issues² and produced in the public mind a perception of zero-sum negotiations leading to a cycle of blame between Chinese structural export dependence and consumer “oversaving, on the one hand, and U.S. structural deficits and over-consumption, on the other. According to the new Administration’s line of thought, a new parallel track of positive engagement with China was needed.

As a result, Obama substantially restructured, and minimally renamed the inter-agency process with China to put it on two parallel tracks of engagement. The name of the Strategic Economic Dialogue was tweaked to become the Strategic & Economic Dialogue. More consequentially, the Dialogue was re-organized on a new co-chairman basis with Treasury Secretary Timothy Geithner chairing the traditional currency and exchange rate component of these talks and Secretary of State Hillary Clinton chairing the new strategic track, which included a focus on the cooperative potential of (environmental) sustainability partnership with China.

Whatever merits this strategic re-design of the bilateral relationship may have once had, it has been massively undercut by the brute fact of global economic recession. As the nation’s -- and administration’s -- focus has switched increasingly to U.S. jobs, there has been a series of U.S. actions against imports of Chinese oil well drill pipes, steel and automotive tires³. Adding tinder to this mix, China has recently sent signals that its government procurement will favor indigenously-developed intellectual property (IP) against internationally-recognized intellectual property, lending some credence to cynical interpretations of China’s motives in refusing to accept WTO disciplines for government procurement at the time of its WTO accession in 2001⁴. This shift in mood was summed up by various reports from the just-concluded annual meeting in Davos⁵. In short, the economics of global recession have tended to trump the politics of strategic partnership in U.S-China relations.

² This process contributed to a 21.5% increase in the yuan’s value against the dollar from mid-2005 to mid-2008, but this movement then stalled with the onset of the global financial crisis in September 2008, effectively “re-pegging” the yuan’s value to the dollar throughout 2009 (CITE).

³ See “Chinese Slapped in Steel Dispute’ by K. Maher & H. Pulizzi in Asian Wall Street Journal, Dec. 31, 2009

⁴ “In November (2009), China instituted a catalog of products that receive significant preferences for procurement by Chinese government agencies. For inclusion in the catalog, products must contain intellectual property developed, owned and registered in China.) as reported in eWeek.com <http://www.eweek.com/c/a/Government-IT/Tech-Groups-Object-to-Chinas-Indigenous-Innovation-Policies-665333/>

⁵ ⁵ http://www.time.com/time/specials/packages/article/0,28804,1955058_1955463_1957399,00.html#ixzz0eNi0PdsY

China & Taiwan: The ECFA Dance Gains Pace

A general feature of the global recession has shown developed economies being slow to bounce back while large, developing markets have emerged from recession more quickly and robustly. The northern hemisphere breakdown of this has been dubbed the "LUV phenomenon" – Europe remains stagnant in an "L-shaped" post-recession pattern, North America is experiencing a slow "U-shaped" recovery, and Asia is enjoying a brisk "V-shaped" growth pattern.

Within Asia, these same global tectonics have been reshaping relations between Taiwan and China across the Strait of Taiwan. While China's emerging economy has roared back with an 11 percent projected GDP growth rate for 2010, Taiwan's advanced economy – highly dependent and tightly integrated into the global IT supply chain of the advanced economies – is expected to achieve only relatively weak growth of 3.5 percent in 2010⁶. These conditions have created an opportunity for Beijing to extend its policy of aggressive regional economic engagement to Taiwan and to court the business sector with commercial blandishments. It is estimated that, in 2009, procurement missions from China have purchased in Taiwan close to U.S. \$10 billion in consumer electronics, processed foods and other goods⁷.

In essence, the ECFA amounts to a bilateral preferential or "free" trade agreement between Taiwan and China, adjusted technically to account for sovereignty concerns on both sides. The four preceding high-level rounds of meetings between Taiwan and China, mediated by the Straits Exchange Foundation (SEF) in Taiwan and the Association for Relations Across the Taiwan Straits (ARATS) in Beijing, have already produced a series of significant economic gains for Taiwan: a doubling of direct flights between China and Taiwan to the level of 270 per week; a further boosting of mainland tourism to Taiwan beyond the recently achieved level of 3,000 visitors per day; a Financial Framework Agreement to create a supervisory mechanism for financial service companies operating in both markets; a partial opening of Taiwan's economy to direct investment in select industries by mainland firms; and regulatory agreements governing food safety inspections and cross-strait anti-fraud cooperation.

Taiwan and China initiated ECFA negotiations on December 21, 2009 and the avowed goal is to sign a formal agreement with China in the first half of 2010. Pressure is on in Taiwan to adhere to this timeline, even as its politically-polarized public struggles to absorb its implications⁸. That China's FTA with ASEAN took effect on January 1, 2010 is the main impetus for the Ma administration to get its public to rally around the ECFA quickly. In addition to giving Taiwan exporters a more level playing field in China and Southeast Asia, there is also the hope that Singapore might follow the precedent of a Taiwan-China ECFA with a Taiwan-Singapore FTA. Currently, the Taiwanese Ministry of Economic Affairs is leading the administration's efforts in this regard, identifying "early harvest lists" of sectors

⁶ Source: Asian Development Bank December 2009 revised statistics as reported by The Taiwan Economic News on December 24, 2009.

⁷ China News Agency (CNA), August 19, 2009

⁸ An October 2009 report by Taiwan's Council of Labor Affairs showed a positive impact of 0.75 percent GDP growth and a net gain of 125,000 jobs under a favorable ECFA scenario and a dip of almost 0.2 percent in GDP, accompanied by a net loss of 47,000 jobs, in the event of the ECFA not being concluded (CITE).

which stand to benefit directly from the ECFA⁹ and initially excluding from the agreement a number of product categories where direct competition with mainland firms is more politically problematic¹⁰.

In broad view, the key dynamic in all of these developments is their lesser impact for the globally-integrated and globally-mainstream sectors of Taiwan's economy (i.e., IT/electronics) and their relatively greater impact for more parochial sectors of Taiwan's traditional economy. By normalizing cross-Strait commercial relations in these 'stodgier' sectors, the ECFA makes possible an overdue structural adjustment. Along with greater competition, the agreement promises new markets in the mainland and a new level of economic integration, via the China market springboard, regionally and globally.

Perhaps the shock of an economic downturn was required to position Taiwan and China for this next level of mutual engagement and economic integration. While joint entry into the WTO was immeasurably important to both parties as a confidence-building measure, Geneva has not served as an arena for directly advancing bilateral rapprochement.

Taiwan & the U.S.: Capitol Hill Looms Large

For Taiwan, the focus of the economic relations with the U.S. has in recent years been firmly fixed on hopes for the initiation of talks for a U.S.-Taiwan Free Trade Agreement (FTA). While there are strong economic and security arguments to be made in support of a U.S.-Taiwan FTA, Taiwan's push in this direction largely stalled due to steady deterioration in the standing of former President Chen's relationship with Washington, the expiration of U.S. executive branch trade authorities during the Bush/Obama transition, new difficulties in both the existing framework of U.S.-Taiwan trade talks and in the overall political climate for free trade deals and, finally, persistent concerns over Beijing's possible reaction to U.S. entry into FTA trade talks with Taiwan

While prospects have brightened recently in some areas, the horizon for such a trade deal remains heavily clouded in Washington. The political relationship between Taipei and Washington has improved markedly under President Ma but there has been little direction shown by the Obama Administration regarding its game-plan for post-recession re-engagement with Asia, now on a growth arc. Bureaucratically, the existing machinery for bilateral trade negotiations between Taipei and Washington, the Trade and Investment Framework Agreement (TIFA) has lost traction due to a legislative change limiting U.S. beef imports into the country. Resolution of this issue and resumption of a robustly functioning TIFA process are both prerequisites before consideration for a fundamental strengthening of US-Taiwan economic ties can be possible.

More generally, President Barack Obama has so far chosen not to expend political capital to push for fast-track trade negotiating authority from Congress. Economically, the tail-end of the Global Recession has prompted closer scrutiny by Congress of all such trade deals¹¹ and has forced the Administration to more clearly reformulate executive branch policy around a jobs focus. In essence, U.S. economic engagement with Taiwan is currently held hostage, not only by the arcane and relatively unimportant beef issue but by an uncertain edifice of

⁹ Petrochemicals, auto parts and machinery, constituting 23.4% of Taiwan's cross-strait trade with China, stand to benefit. (source: Taiwan Economic Cultural Office (TECO), New York)

¹⁰ many agricultural products and certain industrial products such as steel, footwear, and white goods

¹¹ Tellingly, the fate of the Korea-U.S. FTA, which has been fully negotiated and signed but not ratified, still hangs in the balance as the new administration considers renegotiating past trade agreements, particularly for their labor and environmental safeguards.

trade policy in the region. This reflects both ambivalence toward free trade among the Democratic base and indecision about how to proceed politically in the face of growing recognition of the need to undo the 'knot' which ties together a structural jobs deficit in the U.S. with the export-led, yuan rate-boosted growth model in China. First to emerge from the global recession, China's growth model is now in overdrive. Essentially, the global recession has laid bare structural tensions which have been imbedded in the global system for decades and which are now being amplified by the unprecedented scale of China's recent development and the rate of its growth. Until the mid-term Congressional elections provide some resolution, the current logjam between the Obama Administration and Capitol Hill suggests scant hope for any strengthening of the U.S.-Taiwan leg of this triangular relationship.

The Status of the U.S.-China-Taiwan Strategic Economic Triangle

Political tensions, such as the Taiwan arms-sale package and the recent meeting between President Obama and the Dalai Lama, will likely continue to characterize U.S.-China relations throughout the year. These, however, should not distract policy-makers attention from the more deeply-embedded structural forces at work. When all three economic legs of the U.S.-China-Taiwan triangle are stable and strong, the security equation across the Taiwan Strait tends towards better balance. When, as now, there is strengthening of one leg (China-Taiwan) accompanied by relative weakness (US-China) and stasis (US-Taiwan) in the other two, the security balance is eroded. Since all three legs of the triangular security relationship depend upon growth, it would be wrong-headed for policy-makers in Washington to try to put any brake on the cross-strait normalization taking place between Taiwan and Beijing. Equally, it would be short-sighted to allow that normalization to proceed apace without paired attention to the two legs of the triangle which connect directly to the U.S. In the year ahead, the U.S. needs to find ways to address the structural defects in its economic relationship with China without becoming overly distracted by the fallout of political tremors on the surface of that relationship. Similarly, the Obama Administration is under pressure to align its party base and to rally Congress around an international trade policy which effectively reengages with its key regional trade partners in the Asia Pacific and promotes U.S. jobs more effectively through pro-growth engagement with that dynamic region.

Concluding Observations and Considerations

I would like to conclude by specifically addressing some of the questions posed in the February 26, 2010 letter inviting my testimony during today's public hearing. My specific observations are based squarely in the general analytical perspective outlined above.

- ***What is Taiwan's position in the World Trade Organization?*** Generally, China refuses to deal directly with Taiwan within the WTO format. From a U.S. policy perspective, this is regrettable since all WTO members have the right to enter into FTA discussions under WTO auspices. The current ECFA negotiations between China and Taiwan are taking place outside of WTO auspices due to China's refusal to deal directly with Taiwan within the existing WTO structure.
- ***How is the recently implemented China-ASEAN FTA affecting Taiwan?*** The China-ASEAN FTA puts considerable pressure on Taiwan's traditional industries such as petrochemicals, auto parts and machinery since competing imports to China from ASEAN FTA partners countries are now subject to lower tariffs following the entry into force of the China-ASEAN FTA on January 1, 2010. As explained in the body of

my testimony above, the China-ASEAN FTA has had relatively minimal effect for Taiwan's strategic industry sectors of IT and advanced electronic componentry.

- ***How likely is closer economic integration between Mainland China and Taiwan to lead to political integration?*** I will leave this question to the political panelists in today's hearings other than to remark that (1) the question of the political ramifications of economic integration has always been vigorously contested by Taiwan's political actors and that (2) Taiwan's public opinion has demonstrated a remarkably consistent disposition to pursue the benefits of economic integration while resisting any concomitant pressures toward political integration.
- ***What does each side seek to gain if Beijing and Taipei sign the Economic Cooperation Framework Agreement?*** There is no denying that each side has very different motivations in pursuing an ECFA agreement. Beijing is clearly hoping, in the short term, to create economic dependency; to decrease the availability of political space for advocates of de iure independence in the medium term; and to achieve political unification on Beijing's terms in the long term. For Taiwan, the motivation is to normalize their cross-strait economic engagement and further rationalize their economy's globalization without falling sway to the centripetal pressures of political accommodation. Despite this 'same bed, different dreams' disparity, there is at least one aspect of shared perspective motivating Beijing's and Taipei's economic courtship: both countries explicitly recognize benefits from the interchange of tourism, trade and people-to-people contact. This small swath of common ground between Beijing and Taipei also accords with stated U.S. policy. It is an area worth encouraging and expanding.
- ***What are the risks and opportunities for the United States in light of closer integration between Taiwan and the Mainland?*** The prepared statement submitted for my testimony makes the case that risks to the United States are not major provided that the U.S. is, in step, realizing closer economic ties with Taiwan and the Mainland. In short, the strategic triangle is strong when all three sides of the economic triangle are robust. However, if the Taiwan-China side strengthens dramatically at a time when the U.S.-Taiwan or U.S.-China leg is atrophying, political stability and security are endangered.
- ***What are the current bilateral differences that affect the possibility of a U.S.-Taiwan FTA.*** The beef issue has clearly dimmed enthusiasm in USTR, in the Executive Branch generally, on Capitol Hill and within the U.S. business community. However, since the beef products affected by the legislation represent a very small percentage of U.S.-Taiwan trade, these difficulties can be surmounted and should not pose a long-term obstacle to the possibility of a U.S-Taiwan FTA. Apart from this current distraction, there are sound and well-established economic grounds for both the U.S. and Taiwan to consider a possible FTA.
- ***How would China react to such an agreement?*** There is no question that China would react quite negatively, on political grounds, to a U.S.-Taiwan FTA. In fact, it appears that one of Beijing's motivations in pursuing an ECFA with Taiwan is to accommodate Taiwan's trade objectives with smaller economies in the region, such as ASEAN member states, while making the possibility of FTAs with larger economies outside of the region more remote. However, as my friend and former boss A.I.T. Director Raymond Burghardt has pointed out, the U.S. Government would not decline to enter into FTA talks with Taiwan, if all other factors were in place, simply

due to the fact of China's opposition. The critical factor in this equation would be the reaction of the U.S. business community. Without sufficient support for a U.S.-Taiwan FTA from the U.S. business community, it is difficult to see all the other factors necessary for a U.S.-Taiwan FTA lining up properly.

- ***Is there a logical disconnect between Taipei moving to improve economic and political relations with Beijing while continuing to seek security assurances from the United States?*** In my individual opinion, there is no logical disconnect whatsoever in this regard.