

THE U.S.-CHINA TRADE WAR AND OPTIONS FOR TAIWAN

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The 2018 U.S. National Security Strategy noted that “economic security is national security.”¹ The report stated that the White House would “no longer turn a blind eye to violations, cheating or economic aggression.”² In order to address these concerns, the Trump administration adopted a number of concrete measures aiming to weaken the link between economic and security ties that have bound U.S.-China relations tightly until now.

Economic interdependence between the two countries and the challenge posed by China’s rise as a major power has shifted relations between Washington and Beijing.³ A similar economics-security nexus can be found between Taiwan and China. While economic interdependence between Taiwan and China deepens, the security threat posed by China has persisted. Taiwan thus shares the same challenge the United States is facing: how to maintain economic relations with a security adversary.

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U.S.-China Relations: Interdependence or Overdependence

Political Mobilization to Confront China

In upholding economic interests in the name of national security, the Trump administration has mobilized political and popular support for its tough stance against China. The National Security Strategy states that “China and Russia challenge American power, influence, and interests, attempting to erode American security and property.”⁴ Faced with competition from China as well as Russia, Washington has to “rethink the policies of the past two decades—policies based on the assumption that engagement with rivals and their inclusion in the international institutions and global commerce would turn them into benign actors and trustworthy partners.”⁵ This signifies the end of a more conciliatory U.S. stance, at least under the Trump administration and solidifies the Beijing government as the “China threat.”⁶

There has also been a growing distinction between “us” and “them,” according to Washington. In the context of U.S.-China relations, the dichotomies include: market economy vs. nonmarket economy; capitalism vs. state capitalism; and democracy vs. authoritarianism. China has been defined as a non-democratic other,⁷ reflecting the idea of a “clash of civilization” advanced by Samuel Huntington.⁸ The head of the State Department’s Policy Planning, Kiron Skinner, and former national security adviser John Bolton have been reported to define U.S.-China relations in Huntington’s terms and attracted some critiques.⁹

As foreign adversaries pose a threat to the security and economy of the United States, President Trump has invoked the International Emergency Economic Powers Act and National Emergencies Act to defend

the country. Moving beyond the realm of domestic law, despite the fact that the Trump administration pays little regard to the WTO, the securitization of the U.S.-China economic relations may shield the United States from WTO scrutiny under the Article XXI national security exception.¹⁰

The Effectiveness of Policy Instruments

The Trump administration has used numerous legal rules including Section 232 of the Trade Expansion Act of 1962 and Section 301 of the Trade Act of 1974 to manage trade relations not just with China, but with other countries that are actually security partners. In June 2019, for instance, Japan surpassed China as the largest holder of U.S. Treasuries.¹¹ At the same time, Mexico succeeded China as the biggest U.S. trading partner (export and import combined).¹² In the first half of 2019, the top five trading partners of the United States were: Mexico (15 percent), Canada (14.9 percent), China (13.2 percent), Japan (5.3 percent), and Germany (4.2 percent). Taiwan was the 10th largest accounting for 2.0 percent. As such, trade relations between the United States and China have not been as closely linked as in years past. The problem, though, is deficits, according to the Trump administration. The U.S. trade deficit with China rose to 419.2 billion dollars as exports to China fell.

Options for Taiwan

Taiwan is both a security and economic partner but a trade rival for the United States. Some of Taiwan’s key industries have been directly impacted by the ongoing U.S.-China trade war, namely: textile and shoe-making; personal computers and electronics; and integrated circuits. Their responses to trade tensions have largely been determined by market access and labor cost.

The textile and shoe-making sectors were originally key driving forces of Taiwan's economic miracle and migrated to China for cheaper labor costs when China started its economic reforms. Key players in these two sectors include: Pou Chen group, Feng Tai group, Eclat Textile Co., and Makalot Industrial Co. They remain part of supply chain of United States as well as European shoe and textile groups, including Nike, Adidas, New Balance, Under Armour, Gap, and H & M. As China gradually tightens its environmental regulation and raises the labor standards, these shoe-making and textile enterprises have relocated to Southeast Asia and Mexico to keep production costs low. Such moves coincide with the Tsai Ing-wen government's "New South Bound policy" as well as the Comprehensive and Progressive Agreement on Trans-Pacific Partnership. Still, such companies made their decisions before the U.S-China trade friction flared up.

Personal computers and electronics succeeded shoes and textiles to become the drivers of Taiwan's economic engine in 1990s. They suffered from stiff Chinese competition once China entered into these fields. The key players in this sector are: ACER, ASUS, Quanta, Pegatron, Invesco, Compal and Foxconn with ACER and ASUS having their own brand products and the rest relying on contract manufacturing. The clients for contracting manufacturing include Dell, Hewlett-Packard, Toshiba, Fujitsu, and Apple. The United States is a key export destination. Following the steps of the shoe-making and textile industries and in line of Taiwan's liberalization policies, these companies relocated their main production bases abroad, mainly to China. Given that the U.S. market is the main destination for the end products of these industries, the imposition of punitive tariffs heavily impacts PC and electronic producers in particular in

view of the low gross profit margin. These enterprises that relocated to China are faced with two options: return to Taiwan or migrate to Southeast Asia just as shoe-making and textile sectors did. The Tsai administration provides investment incentive, including tax breaks and low-interest-rate loans to attract their return, but labor cost and to some degree the insufficiency of the labor force make them hesitant. Migrating to the Southeast has the risk of the underdevelopment of industrial clusters in relevant downstream and upstream supply chains. So far, a number of PC and electronic enterprises, except Foxconn, have expressed their intent to return to Taiwan and try to automatize their production processes to resolve the labor insufficiency constraint. Foxconn is an interesting case as it is the largest contract manufacturer, closed integrated in the Apple supply chains. It has expressed its intent to invest in Wisconsin shortly after Trump was sworn into office but made little progress. Its former chairman ran for the primary of the KMT and is thinking about running for presidential election as an independent candidate. Foxconn's decision-making has been swayed by both on economic and political calculations.

The integrated circuits industry is now the key to Taiwan's economic vitality. Taiwan Semiconductor Manufacturing Company (TSMC) is the biggest, but others are active in IC design, packaging, testing, and system assembly, such as Media Tek and ASE Technology. TSMC is a global supplier with its major competitor being the South Korean giant Samsung, which faces the same challenge from the U.S.-China trade war. In this context, the question TSMC faced was whether it should or could continue to supply Huawei in view of U.S. export control against Huawei, which depends both on business calculation of potential lost revenue and on

legal assessment of possible breaching of U.S. export control regulation. In the end, TSMC decided to continue to supply Huawei as it believes it satisfies the *de minimis* threshold.

The case of Media Tek is different, as Media Tek relies heavily on the Chinese market and has been considering accepting investment from China, and lobbying for this aim, to help it penetrate and expand in the Chinese market. Media Tek competes with Qualcomm, which is prevented from supplying to Huawei. Therefore, Media Tek aims to take advantage of this export control and expand its market share in China. Regardless, the outreach of U.S. export control regulation through extraterritorial effects, in particular the *de minimis* threshold, may bite Media Tek.

Taiwan's policy options

Compared to the United States, Taiwan's options to regulate the economics-security nexus are rather limited and premature. One key economic objective of the Tsai administration is to diversify Taiwan's economy from China to Southeast Asian countries. As such, the New South Bound Policy is of pivotal importance. The New South Bound Policy has two arms: trade and investment. The ultimate strategic goal of the trade arm is to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership. Therefore, targeting the Southeast Asian and Australia for free trade agreement talks is a stepping stone to this end. The investment arm of the New South Bound Policy is to modernize Taiwan's Investment Promotion and Guarantee Agreements with new-generation bilateral investment agreements which provide more substantial investment protection rules and are equipped with dispute settlement mechanisms, notably, investor-state dispute settlement.

But as the U.S.-China trade war continues, Taiwanese enterprises investing in China are faced with a dilemma: either swallow the punitive tariffs or relocate. Investment incentives are an instrument for Tsai administration to attract these Taiwanese enterprises to return to Taiwan.

Taiwan has already maintained an investment review mechanism for both outbound and inbound policies. In terms of outbound investments, Taiwan exercises its control through a list of activities eligible for investing in China. Such mechanism has already been put into force since the era of Lee Teng-hui as Taiwanese enterprises were and still are eager to invest in China. The maintenance of such a list is to prevent the hollowing-out of Taiwan's economy. The inbound investment review mechanism is rather recent and has been lightly exercised. It is in the Tsai administration that Taiwan has become increasingly cautious about Chinese investments. The legal basis for receiving inbound investment from China is the Measures Governing Investment Permit to the People of Mainland Area and the inbound investment review is conducted by Investment Commission under the Ministry of Economic Affairs.

Finally, as the trade war intensifies, Taiwan's worries about the Chinese technologic threat deepen. The Tsai administration adopted a two-fold approach to address this concern. On the one hand, in April 2019, the Executive Yuan adopted the Regulation Governing the Prohibition and Limitation of Products Threatening Taiwan's Information and Communication Security. This regulation is believed to be inspired by U.S. policies and to target Chinese products, such as Huawei. On the other hand, the Tsai administration is consulting with relevant stakeholders to explore the possible of legislating rules protecting sensitive technologies. A draft bill

had been proposed under the presidency of Chen Shui-bian in 2008 but was set aside by the Ma administration. The Tsai administration aims to revive this bill but is faced with tremendous resistance from the industries.

U.S.-China and Taiwan-China relations share a similar economics-security nexus. Economically, they are closely integrated and interdependent upon each other. In terms of security, China presents a challenge to the U.S. hegemony and constitutes an existential threat to Taiwan. The key concern is to prevent the hollowing out of Taiwan's economy and to diversify Taiwan's economy from China with a view to avoid over-dependence. As far as corporate interests are concerned, access to the U.S. market and keeping labor costs low are the key factors driving decisions about investing in China or relocating to Southeast Asian countries. For more advanced or sophisticated sectors, the existence of industrial clusters, namely, downstream and upstream producers, also have a critical role.

Endnotes

- 1 National Security Strategy of the United States of America (NSS), December 2017, 17.
- 2 NSS, p. 17.
- 3 In 2012, as a new leader of Chinese Communist Party (CCP), President Xi Jinping outlined his Chinese Dream. Xi declared that "[t]he great revival of the Chinese nation has demonstrated unprecedented bright prospects." The transcript of Xi's speech is available at <https://www.bbc.com/news/world-asia-china-20338586> (last accessed 21 August 2019). See further, Zheng Wang, 'The Chinese Dream: Concept and Context' (2014) 19 *Journal of Chinese Political Science* 1, 1-13.
- 4 NSS, p. 2.
- 5 NSS, p. 2.
- 6 On the "China threat" debates, see,
- 7 Jarrod Hayes, *Constructing National Security: U.S. Relations with India and China* (Cambridge University Press 2013) 99-158.
- 8 Samuel P. Huntington, 'The Clash of Civilizations?' (1993) 72 *Foreign Affairs* 22, 22-49.
- 9 Paul Musgrave, "The Slip That Revealed the Real Trump Doctrine" *Foreign Policy*, 2 May 2019; Paul Musgrave, "John Bolton is warning of a "Clash of Civilizations" with China. Here are the five things you need to know" *Washington Post*, 18 July 2019.
- 10 For example, in the Section 232 steel and aluminum investigation, the US contends that "the tariffs imposed pursuant to Section 232 are issues of national security not susceptible to review or capable of resolution by WTO dispute settlement, and that the consultations provision in the *Agreement on Safeguards* is not applicable". WT/DS547/7 6 July 2018.
- 11 <https://ticdata.treasury.gov/Publish/mfh.txt>.
- 12 <https://www.census.gov/foreign-trade/statistics/highlights/top/top1906yr.html>.