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March 22, 2007

Marilyn R. Abbott
Secretary
United States International Trade Commission
500 E Street, SW
Washington, D.C. 20436.

Attention: Investigation No. **332-478**, U.S.-China Trade: Implications of U.S.-Asia-Pacific Trade and Investment Trends

Dear Ms. Abbott,

The US-Taiwan Business Council appreciates this opportunity to provide comments on the above-referenced investigation. The US-Taiwan Business Council is a private, non-profit and member-based association that represents and advocates on behalf of U.S. businesses active in the Taiwan and greater China markets.

Introduction

The global economy has seen tremendous growth in the past decade, growth that has been particularly prominent in the Asia-Pacific. The most notable example has been China, whose competitive expansion has been driven primarily by coupling the extensive government focus on building out the Chinese economy with its relatively inexpensive, large, skilled, and diverse labor force. Added to that has been the eagerness by foreign companies to take advantage of what is often viewed as the world's largest potential market.

This rapid growth, then, has in turn brought substantial changes to the trade and investment patterns in the region and globally. The disquiet created by China's emergence as an economic power is forcing a global debate about investment flows, supply chain management and outsourcing, as well as about our increasing reliance on China for a myriad of goods and services.

Changing Trade Trends in the Asia-Pacific

Significant evidence for the changing trade patterns can be seen in the U.S. trade figures over the last decade. To illustrate, trade data from 1996 to 2006 shows an 11% decrease in U.S. exports to Japan, from US$67 billion to US$59 billion, coupled with a relatively small 28% increase in U.S. imports from Japan, from US$115 billion to US$148 billion. Conversely, during the same period (1996-2006) exports from the U.S. to China increased by a substantial 361%, from US$11 billion to US$55 billion, while imports from China to the U.S. have seen an astonishing 458% increase, from US$51 billion in 1996 to US$287 billion in 2006[1].

The trade patterns in general have also changed in the East Asia region. From 2000 to 2004, trade between non-Chinese Asian states and the United States slowed, with a 9% drop in Japanese exports to the U.S., a small 13% increase in South Korean exports to the U.S., and a low 6% increase in total ASEAN exports to the United States. Conversely, during the same period exports from Japan, South Korea, and ASEAN to China have risen by 98%, 135%, and 100%, respectively[2]. Like their U.S. counterparts, businesses in Japan, Singapore, Malaysia, South Korea, etc. have begun their quests to capitalize on the Chinese market,

[1] United States International Trade Commission (USITC). ITC Trade DataWeb. See dataweb.usitc.gov. Accessed: March 21, 2007.
[2] The China Business Forum. "US-China Trade in Perspective: Asia's Emerging Union and Implications for the United States." See www.chinabusinessforum.org/pdf/gresserreport.pdf Accessed: March 21, 2007.

to benefit from the Chinese labor force, and to take advantage of the increasingly pro-business environment within China.

It can be argued that overall trade between the U.S. and the Asia Pacific is growing consistently, only with China proportionally taking a larger share. It seems that the U.S has now developed a mutual interdependence of sorts with China, one that has risen along with the growth in trade. For example, of the total U.S. trade deficit, US$817 billion in 2006, over one quarter comes from the U.S. trade deficit with China, and from 2001 to 2006 this saw an increase of over 180%[3]. Other regional economies are also seeing China become an increasingly important trading partner.

China and the Technology Supply Chain

There is no doubt that the China market represents a significant opportunity, in particular for the U.S. business community. With U.S. technology exports to China amounting to over US$12 billion in 2005, it is expected that this figure will likely continue to grow in the coming years – helping fuel U.S. economic growth.

In 2005, China exported US$218 billion worth of technology goods - up over 31% from the previous year. It is noteworthy that seven of the top ten foreign-invested export companies in China are Taiwan affiliates, with Foxconn of Shenzhen leading the pack. Taiwan has become a critical gateway partner to China, and the technology hardware we depend on for productivity growth is being produced by Taiwan companies - in China - for the global market. According to China's Ministry of Commerce, foreign companies manufactured 88% of China's high technology exports in 2005.

China is a strategic player in the global technology supply-chain, serving as a base for an ever-increasing share of global technology manufacturing. Furthermore, with many of the world's largest IT companies contracting their manufacturing to OEM and ODM companies in China, the U.S. benefits more than any other global economy from promoting open and liberalized trade, and access to the China market is essential to ensuring American technology competitiveness in the global marketplace.

We have seen the mere threat of disruptions to global oil supplies bringing gasoline prices soaring. Imagine the Taiwan Strait and the surrounding sea and air space cut off as a function of a conflict between Taiwan and China. Shipments from Korea and Japan would be critically impacted, and the technology supply chain through the Asia-Pacific would be severed. Such a conflict would affect hundreds of billions of dollars worth of trade, impeding productivity growth and profoundly disrupting the global economy.

The Case of Taiwan

The uneasiness about China's economic rise is especially pronounced in Taiwan. While the cross-Strait political relationship has had its highs and lows, it has been underpinned by increased cross-Strait trade and investments and a burgeoning Taiwan business presence in China.

Like other economies in the region, Taiwan has seen a tremendous shift in its trade patterns, with China taking on an ever increasing role. Trade data from 1996 to 2006 shows a modest 15% increase in Taiwan trade with the United States, a 50% increase in trade with Japan, and a 100% increase in trade with ASEAN, while overall trade grew by 89%. During the same period, however, overall trade between China and Taiwan saw an astonishing 1,878% increase, catapulting China to become Taiwan's number one trading partner

[3] United States International Trade Commission (USITC), op. cit.

ahead of Japan and the United States. In 2000, China accounted for only 2.8% of all Taiwan exports, climbing to 19.5% in 2004 and to 22.4% in 2006[4].

Investment by Taiwan companies in China has also boomed, although much of it has taken place outside of Taiwan's legal reach, as legacy regulations prohibit a great deal of Taiwan business activity in China. However, with upwards of US$100 billion of Taiwan investment already in China – and with two-way trade surpassing US$76 billion in 2006 - the two economies are inexorably intertwined. Today, Taiwan-invested firms play an essential role in China, particularly in the success of China's technology sector.

Over the past year, we have read much regarding Free Trade Agreements (FTAs), such as the US-South Korea FTA. South Korea joins Taiwan and a long list of other Asian countries in pouring the bulk of their Foreign Direct Investment into China. While China is an enormous opportunity for them, Korea is also looking to sign FTAs with other regional and global trading partners - including this one with the U.S. - as a hedge to ensure that China does not overly dominate its economy.

Preferential trade agreements should be a viable option for Taiwan as well, except that the island differs in one important way from Korea and from any other economy - it cannot sign FTAs with its regional trading partners because China has declared that it is opposed to such deals. Taiwan's exclusion from regional bilateral and multilateral free trade agreements is undermining this key player in the global economy. Nevertheless, no country has been willing to stand toe-to-toe with China on this issue - although the possible exception in this case could be the United States. If Taiwan's economy is marginalized - as a direct or indirect function of its inability to negotiate preferential trade terms - that is not in the U.S. interest as it would result in a weaker and less stable Taiwan.

The U.S. is hugely vested in ensuring that the economies of both China and Taiwan remain vibrant and healthy, thereby offering opportunities for U.S. companies and keeping tensions at a manageable level. U.S. interests aren't limited to economic opportunities in both these important markets, it also includes a robust defense obligation that would almost certainly involve the American military in any conflict scenario.

Additional Considerations

Increased inter-Asian trade and investment is going to continue to accelerate. Liberalization inside China, e.g. the recent private property legislation passing in the National People's Congress, is further proof of China's commitment to economic liberalization. Coupled with the many subsidizes offered by the Chinese government on the national, regional, and local levels, increased liberalization will certainly serve to encourage further growth in trade between China and its neighboring economies.

It is not only the United States and the other nations in the Asia-Pacific that is seeing an increasing reliance on China. Take only the recent stock market correction in China that spawned a global ripple-effect of tumbling markets. The impact on a global scale of that Chinese correction is a real indication of the importance of the Chinese market in the global economy, and the integrated nature of our commercial relationships.

Businesses are no longer looking only at their national economies in evaluating long term investments - as they increasingly have a global footprint - and we have seen extensive Foreign Direct Investment (FDI) flow into the Asia-Pacific during the last decade, with China, Hong Kong and Singapore the three largest recipients of FDI. China has attracted substantial investments from Hong Kong, Japan, South Korea, Taiwan, Germany,

[4] Bureau of Foreign Trade (BOFT) Trade Statistics. See cus93.trade.gov.tw/english/fsce/fsc0011e.asp. Accessed: March 21, 2007.

and the United States, among others. The Asia-Pacific region is continuing to see an upswing in the amount of investments, but U.S. share of those investments is declining. In 1999, the United States accounted for a 14.59% share of FDI flowing into China, but this declined to a 5% share in 2005[5].

In addition to remaining a primary destination for investments into the region, which has been a tremendous engine of growth, China is also becoming an important investment source for other Asian economies. As of 2006, China's total holding of foreign assets exceeded US$1 trillion. The Chinese reserves, particularly if in the hands of the new Chinese government investment fund, could offer plenty of capital for investment in the future, and China has begun to utilize this supply of accumulated assets in the form of Outward Direct Investments (ODI). Notably, of the US$16 billion that China invested abroad in 2005, nearly 60% went towards other Asian nations while only 7% went to North America[6]. ODI investments by Chinese companies have driven mergers & acquisition across the globe.

The intentional undervaluation of the Chinese currency is in effect providing China with an export and jobs subsidy that is encouraging a global imbalance in China's favor. In addition, it has discouraged many other Asia-Pacific economies from allowing its local currency to float freely against the dollar for fear of losing competitive position against China.

Conclusions

- The changing trade patterns in the Asia-Pacific should not be seen as a "zero sum" game, indeed it is a tremendous opportunity for future growth. The main concern is that China is proportionally capturing more of the trade in the region and globally, meaning that the United States is potentially placing "all its eggs in one basket". This simply adds imperative to the U.S. developing a coherent and long-term plan for dealing with China's increasing role in the Asia-Pacific, both for economics and trade, as well as for national security issues.

- The real concern should be Asia-Pacific trade liberalization efforts that are gradually marginalizing the U.S. in the region, and the impact a loss of U.S. leadership on bilateral and multilateral trade liberalization issues in the region might have on our economy and national security. Signing Free Trade Agreements with economies and multilateral bodies such as ASEAN in the region, including the proposed agreement with Taiwan, could be a step in the U.S. long-term plan for engaging with China and other regional economies on issues in the Asia-Pacific.

- Technology plays an important role for U.S. businesses, and the Asia-Pacific occupies a key link of the global technology supply chain. Any disruption to trade in the region, be it based on political issues like a conflict in the Taiwan Strait or on force majeure events such as an earthquake that halts production, could have a substantial impact on our everyday lives.

  Continued peace, security, and prosperity in the China-Taiwan relationship is crucial, as they are integral to the global supply chain and therefore of immense importance to today's global companies - who also need for that chain to continue to evolve in a positive direction. The global economy is vested in having both sides of this problematic relationship working through their issues peacefully, and U.S. leadership would provide an important steadying hand by ensuring that Taiwan remains a vibrant and confident market through participation in economic liberalization and regional integration.

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[5] Foreign Direct Investment (FDI) in China, 1995-2005. US-China Business Council. See www.uschina.org/info/. Accessed March 22, 2007.
[6] National Bureau of Statistics of China. See www.stats.gov.cn/english/statisticaldata/. Accessed March 22, 2007.

- Given China's escalating demand for carbon-based energy, the demand for energy resources is driving a substantial portion of China's current ODI, fueled by its massive foreign exchange reserves. This has pushed to beyond regional investments, and recent bilateral negotiations between China and African nations - as well as in the Middle East - is further clarifying the importance of a substantive U.S. plan in place for effectively engaging with China.

- U.S. concerns over the long-term impact of a Yuan pegged to the dollar and over ballooning Chinese currency reserves are certainly valid. However, the notion that China - in an effort to limit its exposure to the dollar - will be selling off U.S. treasuries and bonds, thereby substantially weakening the U.S. dollar, is fallacious. For China, such an action would sharply diminish exports as U.S. consumers would lose spending power, and they would also then face a drop in the value of their remaining dollar assets. Given the domestic pressures to continue strengthening China's export-driven economy, the probability of such an unwise action seems remote.

- Recent domestic reforms within China has had a positive effect on U.S. businesses operating in China and in the Asia-Pacific. It is possible that in the process of developing a coherent and long-term plan for dealing with China's increasing role in the region, the U.S. could use this opportunity to encourage such actions, with a major focus on Intellectual Property Rights (IPR) protection measures and financial market reforms.

Thank you again for this opportunity to provide comments on this investigation. It is our sincere hope that you find our submission to be constructive. Please do not hesitate to contact us if you feel that the US-Taiwan Business Council can be of further assistance.

Yours sincerely,

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