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PRESIDENT'S REPORT:
The US-Taiwan Business Council & U.S.-Taiwan Relations - 2011
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The Taiwan Political Environment

In the lead-up to the January 14, 2012 presidential and legislative elections in Taiwan, the campaigning has been intense and rhetoric-prone. However, at least by Taiwan standards it has been a relatively less emotionally-heated and even slightly more rational campaigning season than during most previous presidential races.

The opposition candidate, DPP Chairwoman Tsai Ing-wen, has so far run a somewhat restrained and disciplined campaign. She has tried to focus on specific issues, and her agenda is centered on improving Taiwan's social equality and on achieving a more balanced distribution of wealth. For example, in her so-called "10-Year Agenda" released on August 17, 2011 Tsai calls for a pricing system for property sales, suggesting creating a credible and transparent real estate transaction database that would form the basis for rationalization of Taiwan's real property taxation. The ultimate objective is to tax real property owners based on the actual price of the most recent transaction at current market valuation. This is intended to help redress the uneven wealth distribution problem in Taiwan, which has been fueled in large part by land and property speculation by large, wealthy conglomerates.

In fact, the same exact themes and policy recommendations were also subsequently included in incumbent President Ma Ying-jeou's "Golden Decade" re-election platform. Clearly, both candidates are well aware of the very strong public demand for more progressive taxation as a means to check the widening wealth gap. In 2010, government statistics claimed that the disposable income gap between the richest 20% and the poorest 20% of Taiwan's population narrowed slightly – to 6.19 times from 6.34 times in 2009. However, this narrowing was predominantly due to the massive public spending initiatives and welfare subsidy programs implemented by the Ma Administration, which also greatly increased Taiwan's public debt. The gain was also modest relative to the 10.88% GDP growth Taiwan recorded in 2010.

Despite his significant achievements in cross-Strait relations, and some of the economic benefits that have accrued from those achievements, President Ma has been struggling to maintain a truly meaningful lead over his DPP rival. His leadership and decision-making style – coupled with his chronically tenuous relationship with the party old guard and the political machine they often represent or are associated with – has hurt party cohesion. Key senior Kuomintang (KMT) leaders, such as former Party Chairman Wu Po-hsiung, have even openly admitted that President Ma could use more skill and refinement in his "inter-personal relations".

In addition, lack of progress on important reforms, lingering public uneasiness with the ultimate objective of his China policy, and an apparently cooling economy have all contributed to Ma's inability to better capitalize on his incumbent advantage. Taiwan's economy slowed into the third quarter, with quarterly GDP growth at only 3.37% and with the latest revised yearly GDP growth at 4.38% – down noticeably from the 5.52% originally projected during the summer. The slowdown has been mainly due to an export market dampened by the weakening global economy, currency appreciation, and significantly reduced capital investments in the manufacturing sector.

The presidential contest has also become even more complex following the announcement by Soong Chu-yu (James Soong), former Taiwan Provincial Governor and head of the People First Party (PFP), that he will also take part in the presidential race. Soong is a former KMT heavyweight. Despite his steady fall from grace over the last few years, he still manages to attract support from a segment of the middle-of-the-road voters



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(including a not insignificant number of Pan-Blue constituents). While many perceive Soong's announcement as little more than a "spoiling action" aimed at extracting political concessions from the Ma-led KMT – which has tried very hard to deny Soong and his followers any tangible resources or support during the past 3 years – Soong still represents an unwelcome challenge to Ma's re-election bid. In a prospective three-way race, Ma's lead would narrow to around 5%, even according to the most favorable of public opinion surveys.

That difference is actually in line with the DPP's own internal estimate of the gap (3-5%) that Tsai will have to overcome if she is to have a chance of winning the presidency. The core challenges facing Tsai are twofold. First, she must effectively integrate the highly factionalized DPP party power structure, mainly through aggressive alliance-building with the heads of the various fiefdoms within the DPP. Secondly, she must offer a combined policy agenda that satisfies not only the Pan-Green's traditional core constituencies (i.e. pro-independence, pro-social welfare, pro-plebiscite/referendum, anti-nuclear power, etc.) but that can also somehow appeal to more mainstream, middle-of-the-road voters. To do so, she must also distinguish herself from the incumbent Ma Administration. The latter task has proven more difficult than it sounds, since the fundamental policy position differences between the two political parties were fine to begin with. In addition, President Ma also appears willing to readily adopt policy proposals advocated by the opposition, especially as it relates to the domestic agenda.

According to a survey published by Global Views in mid-September (a survey that also turned out to be its last on the presidential election, see below), the difference in support between Ma and Tsai was not more than 1%, a fact that held both in a two-way race (KMT vs. DPP) and in a three-way race (KMT vs. DPP vs. James Soong). In fact, the study suggested that the DPP candidate could actually carry the election in a three-way contest by a very slight (0.2%) margin. Of course, the decisive factor remains the voters who self-identify as not yet having made up their minds – this group numbers between 22.5% of voters in a two-way race, and 18.2% of voters in a three-way race. However, it may be useful to remember that the ruling KMT has been losing significant ground among such undecided (and typically middle-of-the-road) constituencies over the last several local and municipality elections.

The issues surrounding the Global Views Public Opinion Survey Center, Taiwan's most prestigious and trusted polling service, makes for an interesting footnote to the survey numbers. The Center has announced that it will no longer conduct political polls due to a change in corporate policy, instead focusing on other social and business fields. In addition, the director of the center resigned – hinting in interviews that Global Views' prediction of a possible Tsai Ing-wen victory in January 2012 (by a margin of 4-6%) might have led to outside pressure on the company to stop conducting surveys of voter support for political candidates. He also noted that, based on his team's extensive tracking and study of approval rating polls since the 2008 elections, overall support for the ruling KMT has fallen to below 50%. This is a long-term trend that could spell trouble for the KMT in the years to come, even if it does not in January.

Cross-Strait Relations

After repeated delays, the seventh semi-annual Straits Exchange Foundation/Association for Relations Across the Taiwan Straits (SEF/ARATS) meeting was finally held in October in Tianjin, China, to little fanfare. The highlight of the talks was reaching a bilateral nuclear power safety cooperation agreement. The two sides also reached some common understandings in terms of enhancing cross-Straits industrial cooperation and in preparation for the much-anticipated investment protection agreement. No definitive accords were reached on the latter, however. The issue of sovereignty has clearly been a sticking point in the investment protection agreement talks, especially concerning the type of arbitration mechanisms that would be used to settle disputes. The two sides were unable to find common ground to agree on a "gray area" that would be mutually acceptable and would fall within the framework of World Trade Organization (WTO) principles.



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Furthermore, under the Economic Cooperation Framework Agreement (ECFA) signed last year, Taipei still needs to negotiate with Beijing the tariff reductions on some 4,000 products. The two also have to come to an agreement on access to the China market for Taiwan's machine tools and service industries. There were no meaningful breakthroughs in these areas during the most recent SEF/ARATS talks, and experts expect future negotiations to be challenging as well. Despite the obvious importance of these particular initiatives to Taiwan, however, the Ma Administration decided to suspend the investment protection agreement talks and allowed the SEF/ARATS meeting to proceed with very few real deliverables on the table. Apparently, Ma was concerned that any further delays to the SEF/ARATS meeting might signal problems in cross-Strait relations and could trigger undesirable political consequences as the 2012 elections approach.

The primary focus of the presidential campaign season will be on domestic issues such as the economy, jobs, wealth distribution, and education. Nevertheless, events have shown that cross-Strait policy initiatives could still have a major political impact on the presidential race. President Ma Ying-jeou recently echoed an initiative first suggested by King Pu-tung, Ma's campaign manager and closest confidant, in early September – positing that Taiwan would consider a “peace agreement” with China. The statement by Ma on a cross-Strait peace agreement immediately caused a surge of strong reactions from the DPP and from opposition candidate Tsai. More importantly, the mere suggestion that Taiwan might engage in formal political talks with Beijing if Ma wins reelection seems to have alarmed and galvanized core Pan-Green constituents – including some more moderate voters, who may have felt compelled to “circle the wagons” and rally around the DPP candidate on this matter.

President Ma may have felt that it would be safe to test the waters on this sensitive subject matter with the Taiwan populace. Doing so could potentially have served as a goodwill gesture towards China, or – if the voters proved less than enthusiastic – it could still serve as a hint for Beijing to ease off its pressure on Taipei to initiate political dialogue. Indeed, a public opinion poll in July indicated that 50.5% of the Taiwan populace already believed that President Ma would sign a peace accord with Beijing during his second term, if he was re-elected. Nevertheless, while most Taiwan voters agree on the desirability of cross-Strait peace, they are not sure that a peace treaty with China is a high-priority issue in this election, nor if such a treaty would even necessarily guarantee the kind of peace they want.

The overwhelmingly negative reaction to President Ma's “peace agreement” statement was powerful enough that it forced him to clarify and water down his concept by adding a series of preconditions. However, some of the suggested preconditions themselves would have been ill-advised politically, the most notable being Ma proposing a referendum/plebiscite to authorize such a pact. This precondition not only failed to impress Beijing, but it also caused a few raised eyebrows in Washington – which has previously opposed cross-Strait related referendums/plebiscites, particularly when held as part of any general/national election. President Ma ended up backpedaling, finally admitting that chances are slim that a peace agreement would even take place within the next four years. The aggressive damage control efforts undertaken to reduce the impact of the backlash suggest the degree to which Ma's campaign team believes the initiative to have backfired.

Some polls, including one by the National Chengchih University, even suggested that Ma's peace agreement proposal – coupled with the announcement of James Soong's candidacy – might have reversed the lead that President Ma had enjoyed over Ms. Tsai during the previous 4 months. According to its reports, the DPP candidate actually holds a small (less than 1%) lead over the incumbent President Ma (in a 3-way race), with the two candidates each credited with a 48%-49% probability of being elected President in 2012.



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U.S. Relations

The past 3 months in US-Taiwan bilateral relations have been the most dynamic and positive during the Obama Administration. We have seen an Assistant Secretary of Commerce visit Taiwan, and Deputy Secretary of Energy Daniel Poneman is slated to visit the week of December 12. The latter represents the most senior U.S. official to visit Taiwan since Secretary of Transportation Rodney Slater visited in 2000. The congressional notification of the F-16 “retrofit” program on September 21 was also a major positive development.

The visit of Deputy Secretary Poneman prior to the Taiwan elections is an especially important commitment for the U.S. to make. The Council supports visits to Taiwan by senior U.S. officials, which helps to support U.S. business interests in the market and ensures that we have direct communication between senior level officials in the two governments.

The Administration’s overall approach seems to have changed over the past 4 months, with an improved view of support for the bilateral relationship. While it is not clear exactly why the Administration has taken these positive steps now, it is likely that they are responding to the democratic process generally – and more specifically the possibility that Tsai Ing-wen’s Democratic Progressive Party (DPP) can win in the January 14 presidential election. In the latter scenario, an un-engaged U.S. would have left Taiwan badly exposed to China should the citizens of Taiwan choose a new President.

Trade Policy

The bilateral U.S.-Taiwan trade relationship has been on hold since 2007, primarily over varying issues pertaining to beef imports. This situation has had a significant impact on overall US-Taiwan ties, as well as on the Council’s ability to serve its membership base.

Taiwan is in the midst of an increasingly important and expansive trade liberalization effort that now includes Singapore, India, Japan, the Philippines, and New Zealand. When I visited Taiwan last month, I came away believing that Australia too was keen to expand its bilateral trade relationship with Taiwan through negotiated liberalization. This ongoing effort is an increasingly significant and positive deliverable from President Ma’s cross-Strait economic policy, which has reduced tensions with China while making Taiwan a more attractive partner in regional and global trade. If President Ma is re-elected, it is likely that Taiwan will sign several additional and significant FTA-like agreements with regional traders.

The increasing traction that Taiwan is gaining on such deals in the region is changing the attitude of Taiwan’s trade negotiators and political leadership. It has tempered their emphasis on the U.S. trade relationship, and has reduced their urgency when it comes to re-engaging with the U.S. by providing concessions on primarily agricultural products (beef, pork, and rice). The U.S. government presently seems to believe that trade negotiations are likely to resume between the January 14, 2012 elections and the May 20 presidential inauguration, but I believe this view to be overly optimistic. I do not expect Taiwan to place itself in a position to overcome the latest issues on beef until the summer of 2012 at the earliest.

With the reduced importance of the U.S. market, the slippage in bilateral business ties is beginning to accelerate as Taiwan’s trade liberalization agenda focuses on other markets. Over the past 10 years, the reflexive position of the U.S. has been to treat Taiwan differently from other major trading partners (e.g. the 3-4 year freeze on IPR), and this strategy is finally coming home to roost. The implications are huge, as it will place the United States in a marginalized trade position, which will not only negatively impact our negotiating leverage but will also result in U.S. exporters underperforming in this top-10 market.



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Taiwan's desire to become a part of the Trans Pacific Partnership (TPP) potentially offers U.S. negotiators renewed leverage, because U.S. support for Taiwan's inclusion is essential. That said, however, the politics of Taiwan in Washington, D.C. – and the tenuous and highly politicized support for free trade in the Obama administration (e.g. union opposition) – makes the overall prospects for TPP questionable.

Defense Policy

When it comes to bilateral defense issues, a slow start to 2011 ramped up rapidly in the spring and summer as Congress led a charge to inject more vitality into American defense support for Taiwan. In particular, Taiwan's airpower needs remained unaddressed in the early parts of the year – we have now had consecutive U.S. administrations balking at Taiwan's request for replacement F-16s for fear it will damage U.S.-China ties. In addition, Taiwan's 145 in-fleet F-16 A/Bs require significant overhaul as they pass the half way mark in their usefulness.

Both the U.S. House of Representatives and the U.S. Senate took on leading roles on this issue, sending letters to President Obama advocating the sale of no less than 66 F-16s – letters that were signed by 181 Representatives and 47 Senators, respectively. This effort was led by Senators John Cornyn (R-TX) and Robert Menendez (D-NJ), by House Foreign Relations Committee Chairwoman Ileana Ros-Lehtinen (R-FL), and by House Taiwan caucus co-chairs Representative Mario Diaz-Balart (R-FL), Representative Phil Gingrey (R-GA), Representative Shelley Berkley (D-NV), and Representative Gerry Connolly (D-VA).

The leadership provided by Congress increased pressure on the Obama Administration to act. To press the Administration on the sale of replacement F-16s to Taiwan, Senator Cornyn placed a hold on the nomination of William J. Burns as Deputy Secretary of State. Secretary of State Hillary Clinton engaged with Senator Cornyn on how to resolve the issue, and she committed to answering both of the outstanding F-16 issues by October 1, 2011.

On September 21, 2011 the Obama Administration notified to Congress an F-16 upgrade or "retrofit" program valued at no-more than \$5.3 billion. The projected cost value allows for significant improvements on Taiwan's F-16 fleet, if Taiwan negotiates all the options on offer. However, Mrs. Clinton also committed to answering the question of whether or not Taiwan's Letter of Request for replacement F-16s would be accepted. This matter was not addressed in September – indeed, the Administration's position remains unchanged, with the matter "still under review".

During an October 2011 swing through Asia, U.S. Defense Secretary Leon Panetta noted that the United States had given China a "heads up" prior to the September 21 arms package. This suggests that China's unusually muted response was due to U.S. consideration of China's position on the issue. It appears that China figured prominently in the decision-making process regarding whether to provide Taiwan with additional replacement F-16s, as well as in the manner in which the September 21 congressional notifications were handled.

In 1982, during negotiations for the Third Joint Communiqué with China, the Reagan Administration agreed to 6 points guiding its relationship with Taiwan. The six points are:

1. The United States would not set a date for termination of arms sales to Taiwan.
2. The United States would not alter the terms of the Taiwan Relations Act.
3. The United States would not consult with China in advance before making decisions about U.S. arms sales to Taiwan.



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4. The United States would not mediate between Taiwan and China.
 5. The United States would not alter its position about the sovereignty of Taiwan which was, that the question was one to be decided peacefully by the Chinese themselves, and would not pressure Taiwan to enter into negotiations with China.
 6. The United States would not formally recognize Chinese sovereignty over Taiwan.

While all of the above points should remain standard policy in any U.S. deliberation regarding its commitment to North East Asian security, it is point 3 that stands out. The increasingly overt manner in which Chinese considerations of American security interests in the Taiwan Strait are calibrated endangers the status quo. The more able they are to influence the process, the harder China will push.

In October, in response to the continued non-consideration of additional F-16s, Senators Cornyn and Menendez also submitted the Taiwan Airpower Modernization Act (TAMA) to Congress. The legislation received a 48-48 vote (with 4 Republican Senators absent), but the Senators continue to look for opportunities to have the legislation discussed and voted on. A similar bill has been proposed in the House of Representatives by Congresswoman Kay Granger (R-TX).

2012

It is encouraging to see the Obama Administration start to execute on a Taiwan policy these past few months. The fall of 2011 has seen more US-Taiwan activity than the prior 32 months combined. It is very much the Council's hope that the Obama Administration will continue to assert American interests with Taiwan in 2012 and that there are additional priorities for continuing to move forward.

Council priorities for the New Year will include:

- Arguing for a full resumption of the Trade and Investment Framework Agreement (TIFA), without preconditions and with an agenda that identifies significant areas of liberalization. The Council does not support the continued prioritization of parochial agricultural issues at the expense of more significant bilateral trade sectors.
- Continuing to argue for the acceptance of the Letter of Request for no fewer than 66 F-16C/Ds to replace Taiwan's ancient fleet of F-5s and its retiring Mirage 2000-5s.
- Continuing to advocate for resuming U.S. cabinet level visits to Taiwan.
- Advocating for Taiwan's inclusion in the Trans Pacific Partnership (TPP).
- Continuing to advocate for moving ahead with the April 2001 U.S. commitment to assist Taiwan in procuring diesel-electric submarines.

The US-Taiwan Business Council remains committed to promoting the U.S.-Taiwan relationship. We thank our entire membership, colleagues, and friends for their support in 2011, and wish you every happiness and success in 2012.

Sincerely yours,

Rupert J. Hammond-Chambers
President
US-Taiwan Business Council