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## Loyola of Los Angeles International and Comparative Law Review

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Volume 13  
Number 1 *International Business Law  
Conference: Investment and Trade with the  
Republic of China*

Article 8

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10-1-1990

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#### Recommended Citation

Ronald A. Cass, *Prospects for a Free Trade Agreement between the United States and the Republic of China*, 13 Loy. L.A. Int'l & Comp. L. Rev. 81 (1990).

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# PERSPECTIVES ON A POTENTIAL UNITED STATES-REPUBLIC OF CHINA FREE TRADE AGREEMENT

## Prospects for a Free Trade Agreement Between the United States and the Republic of China

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### INTRODUCTION

In general, I have little confidence in predictions regarding future developments in international trade. Having been asked to offer views on the prospects for a free trade agreement ("FTA") between the United States and the Republic of China ("ROC"), I should begin by invoking all the reservations that are normally appropriate for attempts to predict the future. Indeed, extra caution is called for in this project, as analysis of prospects for a United States-ROC FTA requires considering not only the present and future relationships between the two countries, but also a number of other variables, many of which are not easily assessed.

The saving grace here, however, is that the most obvious, and probably most important, influence on the prospects for a United States-ROC agreement is the relationship between the United States and the People's Republic of China ("PRC"). Before the United States can negotiate an FTA with the ROC, it must carefully consider the likely impact of such negotiations upon its relations with the PRC. This impact is not hard to predict, and it stands squarely in the path of any possible FTA.

Before explaining why no such FTA will occur, let me briefly state the pro-FTA case. From the United States perspective, there are several advantages. The ROC has much higher average tariff rates than the United States. This makes the advantages of an FTA for

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United States exporters much greater relative to other exporters to the ROC than the FTA's advantage for ROC exporters to the United States. The opportunity to sell in the ROC is of no small value, given the ROC's extraordinary levels of savings and foreign exchange reserves. If the world increasingly divides among trade blocs, the United States would be advantaged by linking up with an expanded Asian-Pacific trading area, including the ROC. Such a relationship would give United States producers access (on terms better than some important competitors) to a large group of consumers that is expanding rapidly in numbers and wealth. From the ROC perspective, there would be significant economic and political advantages in linkage on preferential terms to the world's largest single market. And there lies the rub.

#### THE INTERNATIONAL TRADE COMMISSION REPORT

In March 1989, the International Trade Commission ("ITC") issued a report evaluating the reaction to possible FTA negotiations by the United States with several Pacific Rim countries, including the ROC.<sup>1</sup> The United States Senate Committee on Finance ("Finance Committee") requested the report just after the ITC had prepared a similar report for the Committee addressing the pros and cons of negotiating an FTA with Japan.<sup>2</sup> In accordance with the Finance Committee's request, the ITC did not perform an independent assessment, but rather solicited and summarized the views of government representatives, private industry, and academia on the potential merits of such negotiations.

In the course of this survey, the PRC, in a letter from its ambassador to the United States, formally advised the ITC that it was "firmly opposed" to any attempt by the United States to negotiate an FTA with the ROC.<sup>3</sup> The PRC has taken the position that any such contacts by United States officials with ROC authorities would violate "the spirit and principles" of three United States-PRC joint communiqués issued since the United States and the PRC resumed formal

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1. See The Pros and Cons of Entering into Negotiations on Free Trade Area Agreements with Taiwan, the Republic of Korea, and ASEAN, or the Pacific Rim Region in General: Report to the Senate Committee on Finance, USITC Pub. 2166, Inv. No. TA-332-259 (March 1989) [hereinafter Pacific Rim Study].

2. Pros and Cons of Initiating Negotiations with Japan to Explore the Possibility of a U.S.-Japan Free Trade Agreement: Report to the Senate Committee on Finance, USITC Pub. 2120, Inv. No. TA-332-255 (Sept. 1988).

3. See Pacific Rim Study, *supra* note 1, at 1-3.

government-to-government contact in 1972.<sup>4</sup> The ambassador's letter stated that by these joint communiques the United States agreed to establish and develop governmental relations only with the PRC. Further, the ambassador warned that any official contacts with ROC authorities "on the ground of resolving trade or other issues" would violate the joint communiques.

Others interviewed during the course of the ITC study expressed a different view. They opined that an FTA between the United States and the ROC could be achieved through some mechanism other than a formal agreement between governments. The existing ROC Coordination Council for North American Affairs ("CCNAA") was frequently mentioned in this context. Those suggesting such an informal agreement believed it would be dramatically less disconcerting to the PRC.

While it may be true that an informal agreement between the United States and the ROC would encounter fewer legal and political constraints, I doubt that the exact nature of the arrangement will substantially affect the prospects for a United States-ROC FTA. When considering whether an FTA is worth pursuing, the United States will weigh heavily the PRC's reaction to such an agreement, regardless of its technical structure. Any agreement, however implemented, that grants the ROC a special status in the United States—a status currently enjoyed by only two other countries—is apt to be disfavored by the PRC. An FTA which promises both closer economic ties between the United States and the ROC and a strengthening of the ROC's economy appears particularly objectionable to the PRC, even if it is not encapsulated in a document with all of the trappings typical of government-to-government agreements.

#### POSSIBLE PRC OBJECTION TO AN FTA

The real question, then, is just how heavily the PRC's objection would weigh. It appears that, regardless of the current status of relations between the United States and the PRC, the United States is

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4. See *Joint Statement Following Discussions with Leaders of the People's Republic of China* in U.S. GOV'T PRINTING OFFICE, PUBLIC PAPERS OF THE PRESIDENTS OF THE UNITED STATES: RICHARD NIXON 1972 376 (1974); *Joint Communique of the Establishment of Diplomatic Relations Between the United States of America and the People's Republic of China* in 2 U.S. GOV'T PRINTING OFFICE, PUBLIC PAPERS OF THE PRESIDENTS OF THE UNITED STATES: JIMMY CARTER 1978 2264 (1979); *United States-China Joint Communique on the United States Arms Sales to Taiwan* in 2 U.S. GOV'T PRINTING OFFICE, PUBLIC PAPERS OF THE PRESIDENTS OF THE UNITED STATES: RONALD REAGAN 1982 1052 (1983).

unlikely to risk significant damage to that relationship over an FTA with the ROC. Certainly, the political events in the PRC during the summer of 1989 were a significant setback to relations between the United States and the PRC. United States policy following these events, however, made it apparent that maintaining good relations with the PRC is extremely important to the United States. To be sure, the United States strongly condemned the PRC's reaction to the demonstrations for democracy, and critics of the Bush administration complained loudly that the executive branch moved too quickly to return United States-PRC relations to a "normal" state. Some voices still call for sanctions of at least symbolic value against the PRC. Still, if one looks beneath the rhetoric, there has been bipartisan support for the United States government's efforts to preserve the political and economic gains that resulted from the dramatic improvement in relations between the United States and the PRC over the past two decades. Accordingly, if the United States perceives any risk that FTA negotiations with the ROC would further impair its relationship with the PRC, this risk alone may deter the United States from any such discussions.

In sum, as long as relations between the United States and the PRC are good, the United States will not want to create potential new tensions. Even if relations are strained, the United States will not want to take action that increases that strain, at a minimum requiring assurance that such actions promise benefit to the United States sufficiently great to counterbalance the risks attending worsened United States-PRC relations. For the past twenty years or so, the United States' treatment of the PRC and the ROC have demonstrated the former point; governmental pronouncements over the past year and a half reflect the latter. At present, the United States expresses little interest in developing an agreement that would bring the United States closer to the ROC, regardless of the possible benefits. There are now virtually no discussions by the government indicating a movement toward an FTA with the ROC at any time in the foreseeable future. Based on correspondence between the PRC government and the ITC, obtained in the course of our recent FTA study, it appears that United States-PRC relations may, in fact, deteriorate if the United States enters into an FTA with the ROC.

#### POSSIBLE CONCERNS OF OTHER NATIONS

Even if diplomatic tensions would not be triggered by discussions

of an FTA between the United States and the ROC, it is still questionable whether the United States would consider this an opportune time for such discussions. The United States attaches great importance to the ongoing Uruguay Round of the General Agreement on Tariffs and Trade ("GATT") negotiations. Based on various public statements made by administration officials testifying before Congress and in other forums, it is clear that the GATT talks have become the administration's primary means of achieving greater international protection of intellectual property, elimination of subsidies in agriculture and steel, adoption of rules respecting trade in services, and progress on a host of other critical issues.

There is a widespread fear in the United States that other nations would perceive United States FTA negotiations with other countries—at least with noncontiguous nations, outside of North America—as an indication that the United States has lost faith in the GATT process. For this reason alone, FTA negotiations with other nations, including the ROC, are not likely to occur in the near future.<sup>5</sup> Discussion of other possible FTAs, while not ruled out, is being confined by administration officials to speculation on alternatives if the GATT round fails. In this context, it is arguable that the ROC is a special case and should be treated as such because the ROC is not a party to GATT. Intellectually, this argument carries some force. Realistically, however, it does not suffice to alleviate the United States' concern that other nations would construe any such bilateral FTA negotiations as a lack of commitment to the Uruguay Round.

For these reasons, I believe that near-term prospects for an FTA between the ROC and the United States are dim, if not hopeless. Although longer-term prospects for such an agreement are more difficult to assess, they too are doubtful. Nevertheless, several situations could arise which may lead the United States to give greater consideration to such an agreement in the future.

First, the Uruguay Round could fail. If it does, the United States may view FTAs with other countries (or combinations of countries) as a "second-best" way to remove impediments to free trade. Because the ROC has expressed interest in exploring FTA possibilities with the United States, it is possible that the ROC could then find itself on the list of potential United States negotiating partners. Alternatively, if other nations begin seriously to consider FTAs with the ROC, this would significantly increase the potential attractiveness of a United

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5. Mexico is an exception.

States-ROC FTA. In that event, the United States would have an incentive to enter into an FTA in order to avoid being placed at a competitive disadvantage in its trade with the ROC. As noted earlier, given the height of current ROC tariffs, an FTA is likely to cause trade diversion to the ROC's FTA partner and away from other current exporters to the ROC. Further, if other nations were first to initiate FTA discussions with the ROC, this perhaps might reduce the danger of an adverse reaction from the PRC government toward the United States. I do not believe, however, that either the complete failure of the Uruguay Round or serious efforts by major trading nations to negotiate FTAs with the ROC are likely.

Second, the United States may also take a greater interest in FTA negotiations with the ROC in response to the developments unfolding in Europe as the European Community ("EC") moves toward a single market in 1992. If the United States perceives that the single market process will produce a "Fortress Europe," it may seek to create a trading bloc of its own. If so, Asia is one of the most likely places where the United States will find potential members for such a rival trading group. In fact, the actual existence of a "Fortress Europe" with increased formal barriers to trade into the Community might not be a prerequisite to such a scenario. There has already been much discussion in the United States about the need for increased protectionism to counter the developments in the EC, including the widening circle of countries seeking assimilation or at least association with this broad, rich market. It is not just fear of European protectionism, but also fear of a nascent economic juggernaut occupying the European "economic space," that fuels calls for a United States-centered trade bloc. Developments in Europe to date do not provide much basis for predicting increased formal barriers to most trade into the EC, but even unfounded fears can cause nations to initiate what they view as defensive measures. Whatever the United States response to events in Europe, a response that I still expect on balance to be quite positive and supportive, a United States-ROC FTA would be improbable. If friction between the United States and the EC increases, the probability of any FTA involving the United States will increase marginally, but for reasons given above, an agreement with the ROC would remain a quite remote possibility.

Finally, changes in the political relationship between the United States and the PRC, or between the PRC and the ROC, would significantly alter the United States' assessment of the political costs and

benefits of an FTA with the ROC. It is unlikely that developments in the PRC will cause relations between the United States and the PRC to deteriorate to the point that the United States becomes relatively unconcerned about the potential negative political fallout that would result from an FTA with the ROC. As indicated earlier, this is an unlikely scenario and would certainly require a change in the United States' attitude toward the PRC and the ROC. Alternatively, and more optimistically, the PRC may come to believe that an FTA between the United States and the ROC would serve its own interests. This might be the case if the FTA were formulated in such a way as to confer substantial economic advantages on the PRC, or if the relationship between the ROC and the PRC changes in such a way that the PRC no longer objects to official ties between the United States and the ROC. These scenarios, as well, are unlikely at the moment. In light of recent events in Eastern Europe and in the PRC itself, however, I hesitate to be bold in my predictions. As these events reveal, dramatic political changes can take place quickly, and even the best informed observers are often caught off guard.

#### PAST FTAS INVOLVING THE UNITED STATES AND THEIR APPLICATION TO THE ROC

Accordingly, we cannot completely disregard the possibility that unknown future developments could remove substantial foreign policy obstacles to a United States-ROC FTA. Even if this were to happen, other substantial obstacles to such an agreement would still remain. The FTAs that the United States has entered into with Canada and Israel should not mislead anyone into thinking otherwise. Special factors made agreements with Israel and Canada possible, and these cannot be generalized.

In the case of Israel, the special factors were essentially political. Over the past two decades, the United States has sought to bolster Israel's economic viability by providing extraordinary amounts of financial aid in various forms. On many occasions, the United States also has sought to give that nation symbolic assurance that it has special status in the United States' eyes. The FTA with Israel was intended to promote both of these objectives. Moreover, from the United States' standpoint, the economic significance of the agreement was, at most, modest. As explained below, this reduces opposition to such FTAs.

In the case of Canada, the economic consequences of the agree-



ment will be considerable. However, the United States and Canada have always been the closest of neighbors in every sense of the word—geographically, linguistically, culturally, and economically. The FTA was intended further to integrate the economies of the two countries, recognizing that the integration process was substantially complete even before the agreement. The economic and political circumstances that formed the bases for the Israel and Canada FTAs were, therefore, quite different from those pertaining to the case of the ROC. While the Canada FTA might be expanded into a North American FTA, encompassing Mexico as well, extension of that framework to other nations is problematic. Even if the United States were prepared to move forward with FTAs in less exceptional circumstances, an FTA with the ROC still seems improbable for several reasons beyond the patent political issues addressed above.

First, FTA negotiations between the United States and the ROC (or any other major trading nation) would generate enormous opposition, both domestically and abroad. Certain domestic industries would benefit from such an agreement, but many others would be seriously threatened by a United States-ROC FTA. For example, the textile and steel industries have substantial political influence which they have used successfully and repeatedly to secure protection against imports. These industries would almost certainly react forcefully to even a hint that the United States was contemplating a comprehensive FTA with the ROC. Given the vague, yet widespread, belief in the United States that Asian countries are export “machines” with which United States business cannot successfully compete, it would be surprising if the pleas of these and other threatened industries went unheeded. In addition, even without considering potential PRC objections, discussion of an FTA with the ROC would likely generate opposition from many of the United States’ other Asian trading partners, unless the United States was willing to conclude FTAs with those countries as well. The latter scenario, of course, while diminishing foreign opposition would increase domestic resistance.

At the same time, the forces in support of an FTA with the ROC would be relatively limited. The ROC’s home market, while growing at an astounding rate, is still widely viewed as small and offering only limited opportunity for United States exports. The possibility that an FTA with the ROC might create new opportunities for United States business investments, as well as the possible use of the ROC as a base for other activities in the region, might appeal to some United States

business interests. But it is difficult to visualize these interests coalescing to form a formidable force in support of an ROC FTA. United States agricultural producers probably would perceive an open ROC market as a significant new opportunity. However, compared to most other Asian countries, the ROC is already relatively open to United States agricultural exports. Accordingly, the practical potential for additional agricultural exports might be limited.

Finally, the appeal to the United States of an FTA with the ROC might be dampened by the belief that the United States can achieve increased exports to, and investment in, the ROC without yielding the concessions that such an agreement would necessarily require. The ROC has been rapidly opening its domestic market even without such agreements. Furthermore, the ROC may be uniquely vulnerable to unilateral pressure by the United States aimed at securing trade concessions, because the ROC is politically isolated and dependent upon the United States for protection of its security interests. However unfortunate it may be from the ROC's perspective, the United States' desire for greater access to ROC markets is much more likely to be embodied in political pressure on the ROC than in support for a United States-ROC FTA.

## An Initial Perspective on the United States-Republic of China Free Trade Agreement

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The Republic of China ("ROC") greatly values its long-lasting, cordial relationship with the United States. In particular, the two countries enjoy a mutually beneficial commercial relationship based upon earnest trust and goodwill.

For several years, the ROC has been contemplating various ways to improve bilateral trade relations with the United States, its major and most important trading partner. For instance, the ROC has been exploring ways to protect this trade relationship from the impact of political swings in both countries. The ROC recognizes the need for a

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