

**A Path to A Chile – Taiwan FTA:
Balancing Political Risk and Economic Gains**

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With over US\$ 2.300 million in bilateral trade in the year 2011, Chile and Taiwan have developed strong economic linkages according to market interests and economic complementarity. In the current regional process of trade liberalization in the Asia Pacific, Taiwan is struggling to strike Free Trade Agreements with its trading partners. On the other hand, Chile has been the most active trade liberalization agent in Latin America, being especially active in the Asia Pacific region. The path towards an FTA between them would seem to be an obvious next step if trade liberalization leads to a strengthening of competitiveness for both sides. Why hasn't the step been taken yet? That is because this move towards and FTA would involve as many economic gains – through first mover advantages, avoiding the damages of New Zealand being the first mover, and enhancing complementarity – as politico-economic risks – since Chile's main trading partner is Mainland China. A game of tightrope walking and careful gradual progress will be necessary for Chile to be able to reach economic cooperation agreements with Taiwan, without hurting its situation of vulnerability dependence with Mainland China.

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Introduction

The prospect for a Free Trade Agreement (FTA) between Chile and Taiwan is the story about trying to strike a balance between international competitiveness and political/economic risk, which could eventually harm economic relations between Chile and the People's Republic of China (from here onwards Mainland China). Using Keohane and Nye's concept, Chile's main trading partner, Mainland China, has risen to a commercial partner position that resembles a vulnerability interdependence situation.¹ Economic interests are never detached from political means.

Nonetheless, today's world is filled with dozens of Economic Cooperation Agreements which eliminate trade barriers between trading partners, fostering trade relations between different markets. Taiwan's signing of ECFA with Mainland China has been interpreted by many countries and scholars alike to imply that countries which do not have diplomatic relations with Taiwan are now "allowed" to enter into economic negotiations with the Island.² Taiwan is an economic power worldwide, and its delicate

¹ Robert Keohane and Joseph Nye. *Power and Interdependence*. (New York, Longman Publisher, 2000)

² This is given the fact that the "one China policy" remains in place, and that trade negotiations do not entail diplomatic relations or sovereignty recognition. The ECFA modality, with negotiations using the WTO style, without actually negotiating within the WTO (Cfr. Hsieh, 2011), opens a door for other countries to behave similarly following Mainland China's example by "reducing the pressure for other countries negotiating with Taiwan" as official Taiwanese documents say:

(<http://www.taiwanembassy.org/public/Attachment/07229293871.pdf>) accessed on October 31st, 2012.

political situation is hurting its international competitiveness.³

On the other hand, Chile's trade opening has been part of a carefully-crafted macroeconomic policy of global balance and resource allocation based on market requirements. The opening up of Chile is also fundamentally motivated by its small domestic market, which cannot be compensated through its neighboring markets of similarly developing economies, most of which have strong protectionist barriers.⁴ In the past decade, with the emergence of the Asia Pacific economies as the main engines of economic growth in the world, its geographical position has been oriented to seeing and seizing the huge economic opportunities in that region. The incorporation of new products into the Chilean export basket is directly linked to the opening of Asia Pacific markets, negotiated in the multiple active trade agreements.

The following article analyzes through different stages the prospects for Economic Cooperation Agreements between Chile

³ The term competitiveness is used in this article referring exclusively to trade competitiveness. This refers to the ability of the producer in a determinate country to be able to enter another country's market in more favorable terms due to trade facilitation measures achieved through trade negotiations. Because of this reason, the analysis will not take consumers into consideration, but will rather focus on Vincent Cable's definition of the competitive state as the state that is able to generate favorable conditions for its firms in international markets. Therefore, countries are not competing against one another, but rather their companies.

⁴ In recent years, MERCOSUR countries have raised tariff and non-tariff barriers, making it harder for South American countries to foster trade relations with each other. The recently founded Pacific Alliance seems to be a neoliberal response to this trend.

and Taiwan under a novel framework, since neither side would like to use the existing WTO institutions to negotiate on a multilateral dialogue: “Theoretically, once Taiwan or China notifies the world trade body of the signing of the bilateral trade agreement, Taiwan becomes a target of Chinese exports. But so far, there has been no news of any action in this regard on Taiwan’s behalf”.⁵ This way, both parties protect their abilities to negotiate bilaterally in the different sectors of their interests, achieving leeway in the protection of domestic interests - as the strategic trade theorists would call the maximization of national welfare; and as Kastner further argues, Taiwan’s perspective proceeds from protectionism.⁶

The term Free Trade Agreement will be used for the purposes of this article, being the author aware of the fact that if an agreement is reached between both parties it will most probably have a different name, such as Economic Cooperation Agreement, Framework Agreement, or a new model to which both agree in order not to hurt political sensibilities regarding the international stance. Thus, FTA will be used as a generic term to indicate an agreement that covers the essential aspects of trade facilitation and liberalization among both economies.

First, an analysis of the motivations for the FTA will be

⁵ Jens Kastner. “Dancing Around the WTO” *Bilaterals.org*, August 16, 2010, accessed on August 2nd 2012. <http://www.bilaterals.org/spip.php?article17892>.

⁶ *Ibid.*

examined. In the second part, the current situation, and the detected push and block elements will be taken into consideration. The final part of the article will draft the stages that the FTA negotiations will have to undergo in order to be successful.

Thirst for competitiveness

To start with, it is important to point out what the motivation behind a possible FTA could be for both parties. In this regard, a concept that underlies the main motivations is that of the *competitive state*. The concept, as defined by Vincent Cable, refers to that nation that tries to strengthen the relative position of its firms in the international arena.⁷ In this regard, both Chile and Taiwan can be seen as competitive states that are pushed into dialogue by the potential relative economic gains that their firms could obtain from it internationally. Chile has positioned itself in the Taiwanese markets comfortably, with a bilateral trade of over US\$ 2.300 million yearly, and a strong surplus in Chile's favor. Trade patterns are dominated by a massive presence of copper, but non-traditional exports have gained market share, particularly agricultural exports. In the case of Chile, then, a Taiwan-New Zealand FTA – currently under negotiation – would strongly damage its gained market position in agricultural goods, since it is a direct competitor in both products and seasonality.

In the case of Taiwan, it has been left behind in the

⁷ Vincent Cable. "The Diminished Nation-State: A Study in the Loss of Economic Power." *Daedalus* 124, no. 2 (Spring 1995): 23.

liberalization process of the past decade, being unable to strike FTAs with any non-ally state due to political reasons. The FTAs that Taiwan has achieved with Central American countries do not resemble a significant portion of its total trade figures. This has generated a relative loss in competitiveness for its firms in relative terms compared with those from South Korea, Japan, or even China, all of whom have signed FTAs with Chile. Thus the search for that competitive edge that would give the advantage to national firms in international markets is the highest motivation behind the FTA, especially considering that Chile, a small market per se, could serve as a platform to tap into other Latin American or even North American markets thanks to its large FTA web consisting of 57 countries (including the European Union and NAFTA).⁸ Moreover, in the local political sense, striking FTAs has become a national goal of President Ma's Foreign Trade Policy, which was supposed to start after ECFA was finalized in 2010. However, Taiwan has yet to produce its first post-ECFA FTA that would yield some credibility to the trade policies intended and thus bring support for the current term of President Ma, which at the time of the writing stands at a 15% approval rate.⁹

Former Vice-President Vincent Siew, in a speech titled "Reviving Taiwan's Competitiveness: President Ma's FTA

⁸ See <http://www.direcon.gob.cl/pagina/1897> for reference.

⁹ Mo, Yan-Chin. "Ma's Efforts to Fight Corruption Questioned." *Taipei Times*. Taiwan, August 10, 2012.
<http://www.taipeitimes.com/News/taiwan/archives/2012/07/12/2003537550>.

Strategy in East Asia”, made it clear that in order for Taiwan to strive for competitiveness in the 21st century, it must not lag behind competitors in the race for freer trade. “A better position in the world’s community is expected to boost domestic economic growth as more countries will be willing to sign trade agreements with Taiwan”¹⁰. The context of this speech relates to Taiwan-ASEAN relations, but it is applicable to the global stage, since economic competitiveness in today’s world, with open markets and diminished transportation costs, is in the reach of all markets.

Having the motivation established for both parties, the analysis hereby presented is observed mostly from the Chilean perspective, and not from the Taiwanese perspective. If we look at the figures of Chile’s main export products to Taiwan, and its main competitors, we should realize that New Zealand is always among the top market rivals, and has had an increasing market share in the past decade. Chile’s main export products as of 2011, as seen in Table 1, comprise agricultural products and raw materials. For this second category, the tariff rate of most industrialized economies is always 0%, since they are considered inputs for industrial production, needed at the cheapest possible price, in order to keep up competitiveness. In the case of agro-industrial products, however, the tariff rates in Taiwan are generally high, in

¹⁰ Vincent Siew. “Reviving Taiwan’s Competitiveness: President Ma’s FTA Strategy in East Asia”. First Taiwan-East Asia Conference on Free Trade Agreement, October 2008

most cases over 20%,¹¹ thus establishing enhanced protection for local production, be they direct competitors or not.

Table 1

Chilean Exports to Taiwan (US\$ thousands FOB)			
Description	2010	2011	Competitors
Copper and parts thereof	\$1,746,189	\$1,703,890	Japan, Australia, Peru
Coniferous paste and others	\$43,448	\$56,484	Canada, USA, New Zealand
Crude chemical sosa paste	\$37,161	\$51,591	USA, Russia, New Zealand
Fresh fuji apples	\$54,435	\$50,660	USA, Japan, New Zealand
Chemical eucalyptus paste	\$50,079	\$46,028	New Zealand, Australia
Fresh cherries	\$24,249	\$26,771	USA, Canada, New Zealand, Australia
Iron and steel scraps	\$5,560	\$18,338	Australia
Frozen crab	\$9,541	\$14,640	Vietnam, Mainland China and Thailand
Fish flour	\$4,246	\$13,302	Peru, Australia, New Zealand
Coniferous wood sawn	\$10,444	\$9,848	Australia, New Zealand
Fresh red grapes	\$6,203	\$9,252	USA, South Africa, Argentina
Fresh nectarines	\$8,334	\$8,863	USA, New Zealand
Atlantic salmon frozen	\$3,819	\$8,243	Norway
Other apples	\$3,351	\$7,513	USA , Japan, New Zealand
Moss dried	\$6,934	\$5,600	New Zealand

Source: Central Bank of Chile, *Indicadores de Comercio Exterior 2011*.

¹¹ Directorate general of Customs, Taiwan. “Customs Import Tariff and Import Export Commodity Classification”. Directorate general of Customs, M.O.F and the Bureau of Foreign Trade, M.O.E.A, April 2009

As of now, as can be observed in Table 1, Chile competes with New Zealand in most of its agro-industrial exports. Of these, the top three in which they compete are fresh apples, fresh cherries and fish flour (see Table 2). The other competitors appreciated are always from the northern hemisphere, thus they compete in different seasons (fish flour is an exception to that). As can be observed, on average, Chile's landing costs are lower than those of New Zealand. These are products that do not have a strong range of variation in price ranges, since standardization through international certification of production methods have led to a strong homogenization of production worldwide. In this regard, Chile appears more competitive in its agricultural production on average in terms of price competitiveness.

Given the above information, local importers have been surveyed in order to find out what the main issues were when making a purchasing decision. They can be divided into three areas: Quality, reputation and price.¹² Since quality is generally standard due to the existence of international certification standards in production, the purchasing decision draws down to the other two factors. Regarding reputation, New Zealand rises high above Chile. Numerous studies have looked at how New Zealand has managed to trade at a premium every single one of its products that are covered under the image of a New Zealand national image. Simon Anholt, chief editor of Place Branding and

¹² Prochile, Chile. "Estudios de Mercado". ProChile, 2012.
<http://rc.prochile.gob.cl/oficina/8301>

Public Diplomacy, as well as lead researcher in the Nation Brands Index research group, has generated yearly surveys that rank nations according to their reputational performance in different areas, and New Zealand has been able to retain a top level reputation for the past years, translating into added value for its products.¹³ If we were to scale New Zealand's export reputation into a 1 to 10 scale based on Anholt's research, they would obtain a global reputation of 5.4, while Chile would obtain a 4.5 in 2011. If measured only in East Asia, the difference is larger,¹⁴ since New Zealand has worked up strong campaigns to improve its image in the region.

The final element, pricing, is where Chile's competitiveness stands out. As can be observed in Table 2, Chile's average price for the same product tends to be lower than that of New Zealand. When both countries are faced with the same tariff and non-tariff barriers to trade, Chile edges New Zealand, thus allowing it to take the current leading market shares that it has. The ratio of price/quality, thus favors Chile in the current state of affairs.

¹³ Simon Anholt. "Nation Brands Index 2011". GfK, 2011.
http://www.gfk.com/group/press_information/press_releases/008789/index.en.html accessed on June 5, 2012

¹⁴ Nation Brands Index 2011 for New Zealand, obtained in
<http://www.nzte.govt.nz/explore-export-markets/Export-Markets-Resources/Documents/The%20Anholt-GfK%20Roper%20Nation%20Brands%20Index%20011%20Report.pdf> on June 5, 2012

Table 2

Competition in products - 2011			
Apples (Fresh)	Price (US\$)	KG	Price/Kg
United States	54,393,771	52,424,875	1.04
Chile	39,416,052	46,431,516	0.85
Japan	27,291,124	15,428,838	1.77
New Zealand	18,062,105	17,656,488	1.02

Cherries (Fresh)	Price (US\$)	KG	Price/Kg
United States	45,639,877	6,920,514	6.59
Chile	18,009,163	3,157,253	5.70
Canada	7,618,179	1,050,292	7.25
New Zealand	7,497,487	721,550	10.39

Fish Flour	Price (US\$)	KG	Price/Kg
Peru	65,763,302	44,244,000	1.49
Chile	17,324,364	12,058,000	1.44
India	17,166,827	14,368,000	1.19
Mexico	14,225,303	10,574,000	1.35
New Zealand	4,273,931	3,212,000	1.33

Source: Bureau of Foreign Trade, Taiwan – Trade Statistics

(<http://cus93.trade.gov.tw/ENGLISH/FSCE/>)

If New Zealand and Taiwan were to finalize the ongoing negotiations for an FTA, Chile would be faced with much stronger competition from New Zealand, which would see their tariff and non-tariff barriers reduced as a consequence. Since Taiwan has not signed an FTA with any other non-ally economy yet, this would imply that only one of the competitors of the field will be getting such an advantage. Chile's market share will most probably be reduced in agro-industrial products, even if in

absolute terms the total amounts remain relatively unchanged. Even though these products are still a minority in terms of the total trade figures, Chile's trade policy aims at diversification, and a push away from a commodity – copper – dependence, which could lead into complacency, and eventually damage the competitiveness of the economy as a whole. It should be noted here that there is a similarity in this case with Baldwin's domino theory of regionalism.¹⁵ He argues that the signing of FTAs between third countries can push excluded nations into pursuing FTAs that were not considered in the original position; he uses the term "contagious" to refer to this effect for bilateral FTAs¹⁶. This occurs because a fear of trade diversion sets in.

Chile's past record of raw material dependence – nitrates – during the mid-20th century, led it to a disastrous economic crisis.¹⁷ Even though Mainland China has inflated the market price of copper, returning to a mono-export condition is not on the mind of Chile's policy makers.¹⁸

¹⁵ Richard Baldwin. "A domino theory of regionalism" in Baldwin, Haaparanta and Kiander. *Expanding Membership of the European Union*. Cambridge University Press, 1995.

¹⁶ Richard Baldwin and Jaimovich, Dany. "Are Free Trade Agreements Contagious?". National Bureau of Economic Research, Massachusetts, 2010. <http://www.nber.org/papers/w16084.pdf> accessed on October 21st, 2012.

¹⁷ Tom Azzopardi. "Diversificar Las Exportaciones De Chile." *Business Chile*. Chile, January 2012. <http://www.businesschile.cl/es/content/diversificar-las-exportaciones-de-chile> accessed on August 10th 2012.

¹⁸ Ministry of Foreign Affairs, Chile. "Panorama Economico Actual". Ministry of Foreign Affairs, 2012. <http://chileabroad.gov.cl/sobre-chile/asi-es-chile/panorama-actual/economia/>

Situation – Push and block

Having established the motivational elements behind Chile's push for a possible FTA with Taiwan, it is important to understand the current situation. These negotiations would be carried out under uncommon circumstances, where both countries negotiate in spite of a lack of mutual sovereign recognition. The normal push and block elements that arise in any FTA negotiations, therefore, will add further difficulties into the political sphere.

The push elements are policy-related and market-oriented. Since the 1980s, Chile has had a policy of open regionalism with a world-level commercial integration and unilateral reduction of trade tariffs, according to the very principles of APEC. Its trade development has led it to become an export oriented country that aims to become a platform for Asia Pacific countries wanting to trade with Latin America. A powerful web of FTAs with over 80% of the world's GDP, many of which are in the Asia Pacific region, has been the first building block towards that goal. It is towards this goal that an FTA will be aligned with Chile's trade policy. This Asia Pacific orientation has become an issue of path dependence for Chile's foreign trade policy, with Mainland China, Japan and South Korea being Chile's first, third and fifth main trading partners respectively. "What happened at an earlier point in time will affect the possible outcomes of a sequence of events occurring at a later point in time",¹⁹ thus acknowledging that

¹⁹ William Sewell. "Three Temporalities: Toward an Eventful Sociology." In *Logics of History: Social Theory and Social Transformation*. Michigan, USA:

history matters should lead policy towards further integration of Chile's economy into the Pacific Ocean.

As can be appreciated, there has been a clear policy orientation towards unilateral trade liberalization. This trend has been further strengthened by the announcement made by the Ministry of Public Finance saying that by 2013, all the tariff barriers for product entry will be reduced to 0% unilaterally. As of today, Chile's average tariff payment is 1.5% over F.O.B price. The reduction will only affect Chile's public earnings by US\$ 600 million, which should be recovered by increased competitiveness in trade, and privatization, according to official sources.²⁰ The self-conception of the Chilean state as a platform has moved the government towards trying to become "South America's Hong Kong" in terms of economic liberalization and trade services provider. This self-conception has generated what constructivist authors would call an inter-subjective understanding for the Chilean state whereby liberalization through government lead processes becomes the guiding principle of trade policy.²¹

Alongside a clear state policy, the pursuit of stronger market shares in Taiwan, a "virgin" market for the reduction of tariff

University of Michigan Press, 1996. Page. 262

²⁰ Ministry of Public Finances, Chile. "Ministro anuncia reforma tributaria en Chile". Ministry of Public Finances, 2012.

<http://www.gob.cl/informa/2012/04/27/ministro-de-hacienda-felipe-larrain-esta-es-la-reforma-tributaria-que-chile-necesita.htm>

²¹ Cfr. Alexander Wendt. *Social Theory of International Politics*. (London: Cambridge University Press, 1999). Pag. 170

barriers (considering the above mentioned exceptions of Central American countries and ECFA), raises the prospect and potential gains of pursuing an FTA through First Mover Advantage. The former has been defined as “the generation of asymmetries which allow a firm [or in this case a country] to exploit its position. It is a preemptive move”.²² Even though the authors speak of firms, the principle is applicable to countries. Having tariff reductions in the Taiwanese markets involve relative gains much higher than those expected of an FTA with any other country that has already signed a number of trade agreements with trade partners, and thus offers to many different economies the same advantages that it offers to Chile. In the case of Taiwan, being among the first should mean relative market gains higher than in any other economy for Chile. Besides tariff barriers, further cooperation in the bilateral reduction of non-tariff barriers, currently rather high, would also entail an important relative gain.

At the same time though, there is one big political item blocking a potential FTA: Mainland China. Chile had a bilateral trade exchange of almost US\$ 30.000 million with Mainland China in 2011. Mainland China has become Chile’s main trading partner, with a very positive trade surplus in Chile’s favor. Not only that, as part of Chile’s Asia Pacific policy, the country has chosen Mainland China as one of its main partners, celebrating in 2010 the first forty years of diplomatic relations among both

²² Marvin Lieberman and David Montgomery. “First-Mover Advantages.” *Strategic Management Journal* 9 (1988).

countries, with numerous events for the occasion. In July 2012, Wen Jiabao raised Chile's bilateral relations with Mainland China to that of a Strategic Partnership.²³ Leaders in Santiago take pride in being the first South American country to switch recognition to Mainland China in 1970, and this stands as a pillar of bilateral political relations. Strong adherence to the One-China-Policy alongside a strong “legalized” mentality of Chilean policy makers plays out strongly against a potential Chile-Taiwan FTA, especially among the bureaucrats of the Ministry of Foreign Affairs.

Following with the political risk and looking at it from a Chinese perspective, recent months have been proof that Mainland China has no problems in using trade wars to solve political standoffs, particularly when it feels that its areas of “core interest” are put at risk. The Philippines saw 200 containers of bananas stuck and rotten on the port of Guangzhou due to the Scarborough Shoal issue.²⁴ The alleged infection of the products was ultimately proven false, but the damage was already done. Last year, Japan stopped receiving imports of rare earth metals as a consequence of the arrest of the captain of a Chinese trawler

²³ Library Congress Portal Asia Pacifico, Chile. “Las Oportunidades Que Ofrece La Nueva Relación Estratégica Entre Chile y China.” *Portal Asia Pacifico, Biblioteca Del Congreso*. Chile, July 2012. Accessed on July 10th, 2012. <http://asiapacifico.bcn.cl/noticias/china-chile-relacion-estrategica/>.

²⁴ Edith Regalado. “Chinese Not Buying PH Bananas.” *ABS CBS News.com*, May 25, 2012. Accessed on May 26th 2012. <http://www.abs-cbnnews.com/business/05/24/12/chinese-not-buying-ph-bananas>

that rammed Japanese Coast Guard Ships near the Senkaku/Diaoyu islands.²⁵ Mainland China's expanded economic clout has given it weapons that avoid the need to bring in the army to defend its political interests. In the case of Chile, even though its trade partners are highly diversified, the country is in no position to risk a trade war with its main trading partner. With that being the case, and considering that Mainland China has declared Taiwan to be part of its geographic area of "core interest", if Mainland China does not approve of bilateral negotiations between Chile and Taiwan, it would be almost impossible to achieve an FTA.

The path towards the goal of liberalization

Taiwan has not finalized an FTA apart from those signed with Mainland China and its Central American partners. New Zealand and Singapore are the closest ones to achieving such a stage, but no final date has been given for the conclusion yet. If Chile were to follow this path, it would have to reproduce the same first steps taken by New Zealand and Singapore when they approached the issue of attempting to sign an FTA with Taiwan. Since none of them have been completed yet, no other country has been willing to take the risk yet, taking a wait-and-see attitude towards Mainland China's response for the first-comer. Thus the concept

²⁵ Mao, Feng. "Japan Releases Captain After China Stops Rare Earth Metal Exports." *New American Media*, September 24, 2010. Accessed on May 26th 2012

<http://newamericamedia.org/2010/09/japan-releases-captain-after-china-stops-rare-earth-metal-exports.php>

“tightrope walking” still applies to the situation of FTA negotiations with Taiwan. As the case of Singapore clearly illustrates, “Singapore’s policy toward Taiwan is an example of the tightrope that Southeast Asian countries must walk in the new era of an increasingly powerful China asserting itself. But heavy-handedness by Beijing also bears its share of reputational risk for China, which has thrown its weight around a lot lately, thereby raising concerns among neighbors”.²⁶ With the aforementioned ideas in mind, the future FTA negotiations might follow the following steps:

1st stage – Initial approach

Every FTA responds to the necessities of the market, as they are observed by the different states. Generally, economic representatives or trade officers on the different countries count on first-hand competitiveness information to make such a decision. Thus, in first instance, the Trade Offices positioned in Taipei and Santiago will have to sort out the mechanism to carry out negotiations if economic interest is observed by them. This will depend mainly in the complementarity of both economies vis-à-vis the political and commercial price to pay when opening the market. Strategic trade theory has been a strong defender of protectionism when vulnerability appears in strategic industries. When analyzing the bilateral trade structures of Chile and Taiwan, and economic sector distribution, Taiwan would most probably

²⁶ Ernest Bower and Charles Freeman. “Singapore’s Tightrope Walk on Taiwan.” *CSIS Southeast Asia Program I*, no. 26 (2010)

face further competition in the agricultural sector, which is politically strong, but economically weak. In the case of Chile's economical distribution it is possible to see that Taiwan does not compete in the same production sectors.

Even though the first approach is supposed to be between the aforementioned trade offices, in reality, the first contacts will probably not happen between these offices, due to logical physical reasons – even though a dialogue among them is expected. The approaches taken might more effectively start in an indirect way between the Bureau of Trade Negotiations of the Ministry of Economic Affairs of Taiwan, and the overseas Trade Office of Chile in Taipei, or between Taipei's Economic and Cultural Office in Chile and an institution of the Chilean government of the Ministry of Economics. It is these institutions that are in charge of conducting a preliminary approach to analyze the position of both parties and the potential gains and losses of an FTA. The Representative overseas has the mission of ensuring that communication between both negotiating bodies is efficient and clear, so that the results are explicitly communicated. At this stage, a feasibility study does not necessarily have to be carried out by these organizations, but rather it can be outsourced to the academic sector, or relevant think tanks, to avoid criticisms by Mainland China, as has been done by Taiwan in prior negotiations with Singapore and New Zealand. These are the available communication channels, and it can be expected that professionals in the area of trade negotiations will take over the

process once actual negotiations start.

A second step involves the feasibility study per se. In market terms, there are high compatibilities between Chile and Taiwan, thus both economies should benefit from trade liberalization.²⁷ This study is to be carried out entirely by specialized researchers or think tanks, even though the press claims that the study is done by the Representative Offices for political reasons, thus responding to the need of avoiding official state-to-state contacts. The main obstacle to be expected might be the agricultural dialogue, where highly protected Taiwanese producers will doubt the benefits of opening up this sector to Chilean produce, and most probably will stage demonstrations. Other sector obstacles may not be hard to overcome.

2nd stage – Functional cooperation

In order to build blocks towards an FTA, it is expected that both countries engage in some form of technical cooperation before entering FTA negotiations. The goal of such cooperation is not only to achieve cooperation mechanisms per se, but rather to test the waters towards measuring the reaction of Mainland China, as well as generating Confidence Building Measures between

²⁷ In an analysis conducted by Huang and Su (2012), Taiwan's economy is tested for its complementarity with a set of other economies (through GTAP). Even though Chile is not included in this study, one of the results determined that "the industries with high market share in the USA are agriculture and natural resources" which are complementary to Taiwan. Chile's exports to Taiwan stand along the same lines as the American exports of agricultural products, competing in many of the same products, but in different seasons.

economies that on average have little or no official (government-to-government) contact.

New Zealand and Taiwan signed an investment treaty creating a fund for the development of industrial and agricultural R&D; Japan and Taiwan have signed a number of functional cooperation agreements, with the investment treaty and the aviation agreement being the latest ones; Taiwan and South Korea have started to negotiate an investment treaty that could open the door to further FTA negotiations on a bilateral basis; likewise, other countries working towards an Economic Cooperation Agreement with Taiwan are expected to follow such a path. The same attitude may be expected from Chile and Taiwan, if they were to engage in FTA negotiations.

Thus this cooperation on technical elements represents an initial building block, and it would seem to support neofunctionalist theories; however, it should be noted that these cases are hard to relate to the theory for the simple reason that the functional cooperation will not be achieved per se, but rather as a means towards a pre-defined goal. Neofunctionalism, as proposed by Ernst Haas (1958), considers the notion of positive spillover in integration among different states, where cooperation in one economic sector, if successful, will generate a snowball effect towards an increased number of transactions, and further cooperation. As mentioned above, this does not seem to be the case, since a working route towards FTA negotiations is pre-stated

in the above mentioned countries' functional agreements with Taiwan.

3rd stage – Building political will

The big question that is raised is: how to deal with Mainland China? One chosen strategy could be a two-track dialogue approach, where both Taiwan and Chile approach and engage Chinese authorities in a parallel manner to make sure that the situation does not involve political or economic risk; a rigorous process of consultations may lead to a successful result. If Taiwan has been able to strike over 14 treaties with Mainland China in the past four years, it is to be expected that they count with sensible communication channels to make sure that a potential FTA does not entail a risk for either side. In recent comments, Derek Scissors argued that in the case of a Taiwan-U.S.A. FTA, the “China factor” was not the biggest concern but rather Taiwan’s protectionism and American disinterest.²⁸ In the case of Chile, however, its economic sensitivity towards the market of Mainland China is evidently an issue to be taken into account. Unlike the case of the U.S.A. a plausible increased competition in added value markets and Taiwan’s protectionism in the agricultural sector could be more easily addressed through the FTA itself. A strategy of careful tightrope walking is the key to the development and building of political will on the issue.

²⁸ Scissors, Derek. “Chinese Opposition Not a Concern of U.S.-Taiwan FTA: Scholar.” *Bilaterals - Focus Taiwan News Channel*, August 2011. Accessed on August 2nd 2012. <http://www.bilaterals.org/spip.php?article20024>

For any country that recognizes the People's Republic of China (PRC) as the only government of China, dealing with Taiwan entails a risk that does not disappear through President Ma's political truce. State bureaucracies work under strong limits of path dependence. The bureaucracies of the Mainland China's Ministry of Foreign Affairs, especially in the Divisions dealing with Latin America, are strongly Taiwan-averse due to historical reasons. It is in this region that Taiwan has held up its international political survival, with 12 of its 24 allies coming from the Central and South America. The generation of intersubjective understanding towards a constant political challenge is hard to erase in a period of four years. Thus any deal that a Latin American country forges with Taiwan will be seen by these bureaucrats as a potential threat to the recognition of its sovereignty. It is thus important to generate dialogue mechanisms to reassure Mainland China that an Economic Cooperation Agreement would not entail a threat to its political recognition, but rather a market-based approach to maintaining a competitive stance in Chile's eighth main trading market. Generating such a structure does not happen overnight, and it is here that the functional cooperation approach has to represent a first step in that direction.

Along with that, there could be three other main difficulties to be overcome in terms of achieving political willingness of both sides towards the FTA. The first one is the aforementioned fact that Chile will unilaterally reduce tariffs to 0% by 2015. Given

this fact, it may be thought that there is no gain for Taiwan in signing an FTA. This would entail, however, a narrow-minded comprehension of an FTA, since tariff reduction is not the only point covered by Trade Agreements. Discussions on harmonization of standards, intellectual property rights, non-tariff barriers to trade, trade in services and cooperation in investment are integral parts of a comprehensive trade agreement. The reduction of tariffs, given the current level of tariff barriers for Taiwanese products in Chile – 0% mentioned from 2015 - and Chile's export structure to Taiwan – mostly copper, subject to 0% tariff, and various other raw materials with the same treatment –, would not be the main issue, thus this barrier might probably be easily overcome.

The second point to consider is the fact that Taiwan has established a workable schedule to join the TPP by the year 2020. Given that Chile is already a founding partner of the TPP, what would be the gains of an FTA? To answer such a question is fundamental to proceeding with negotiations from both sides. Since the United States joined the TPP, the nature of the agreement is said to have become more aggressive and imposing, especially in critical issues such as state-owned-enterprises, intellectual property, drug pricing and reimbursement programs and e-commerce, all of which present a picture in which the U.S.A. is looking to impose higher than average standards.²⁹ The

²⁹ Robert Scollay, "REI Development in Asia-Pacific and East Asia: State of Play and Issues for TPP" (paper presented during the 27th Pacific Economic

United States tends to favor comprehensive agreements, with high requirements in market opening, without much room for trade-offs. A bilateral deal will open the door for different working mechanisms that could be implemented in ways that are much more suited to both economies, with a gradual incremental pace – as has been the case for Chile’s FTA’s with South Korea, Japan or Mainland China – and with more flexible quality. Yang Jiang, in her analysis of the constraints towards the FTA between Mainland China and Australia,³⁰ expressed the structural clash that Australia is experiencing in its deals with Mainland China. The previous FTAs signed by Chile with East Asian nations resemble a closer image to Mainland China’s preferred structure for trade agreements than to Australia’s. On the other hand, the United States is said to be trying to push towards a comprehensive and committed structure for the TPP, which would not leave much room for the signing economies to maneuver. With that in mind, a bilateral FTA should open the doors for mechanisms outside the TPP that are much more accommodating to the interests of both parties.

The third issue, especially sensitive for economies in Northeast Asia, would be the agricultural dialogue. The current situation regarding the use of ractopamine in U.S. beef has once again raised the ire of the powerful agricultural sector, calling it to block

Community Seminar, Taipei, Taiwan, 4-5 October, 2012)

³⁰ Yang Jiang. “Australia-China FTA: China’s Domestic Politics and the Roots of Different National Approaches to FTAs.” *Australia Journal of International Affairs* 62, no. 2 (June 2008), pp. 179-195.

potential trade issues. In spite of the negative effect that the ractopamine residues may or may not have on human health, the agricultural organizations of Taiwan may see the trade agreement with the United States as a threat to their survival. Chile and Taiwan do not compete in the same agricultural sectors (with the probable exception of pork and milk among few others), but imports from Chile may be considered as substitutes to local products. It is commonplace in Taiwan, South Korea and Japan to have the agricultural sector blocking trade initiatives. These blockades, however, have not stopped Chile from signing FTAs with South Korea or Japan, thus devising mechanisms to control the pressure. “One clear cost of protection is that the country imposing it forces its consumers to forgo cheap imports. But another important cost of protection may well be the lobbying costs incurred by those seeking protection. These lobbying activities, now extensively studied by economists, are variously described as rent-seeking or directly unproductive profit-seeking activities. They are unproductive because they produce profit or income for those who lobby without creating valuable output for the rest of society”.³¹

4th stage - Negotiations

Once all of the above steps are taken, Chile and Taiwan would proceed to the actual negotiations. These will most probably not

³¹Jagdish Bhagwati. “Protectionism.” In *The Concise Encyclopedia of Economics*. Library of Economics and Liberty., 1993. Accessed on May 27th, 2012. <http://www.econlib.org/library/Enc1/Protectionism.html>

entail many difficulties, since Chile has been influenced by the normative structures playing out in the Asia Pacific,³² and has taken an “ASEAN way” approach to its dealings in trade negotiations with Asian countries. Chile has been very accommodative of its Asian partners’ interests, striking some low quality incremental FTAs that move forward as long as there is consensus and consultation mechanisms. In the case of the Chile-Mainland China FTA, it was negotiated in three stages, according to the Chinese timetable, with investment and services still being negotiated. In the case of South Korea, the FTA left out many agricultural products that are being negotiated on a one-by-one basis. Given Chile’s normative influence received from the East Asian region, its negotiators have been able to achieve different quality FTAs that aim to turn into very similar treaties through a flexible timetable.

Taking ECFA as a basis for negotiations might be the path chosen. Taiwan and Chile could take advantage of the existing framework in order to advance both of their interests through economic cooperation. “The ECFA is not an end in itself. It is a cornerstone for addition agreements to be worked out later in such areas as investment, trade in goods and in services. (...) As a WTO member, Taiwan has the right to negotiate member-to-member FTAs. As cross-strait relations improve, constraints on Taiwan’s international room for maneuver should

³² Juan Salazar. *Chile y la Comunidad del Pacífico*. Santiago de Chile: Universitaria, 1999. 183

continue to be loosened. (...) The situation is now conducive to building positive partnerships for greater regional economic integration. This includes working out FTAs with our trading partners”.³³ As Dent assures, ECFA is the way, not the end, of Taiwan’s trade negotiations with Mainland China.

Conclusions

An FTA between Chile and Taiwan would clearly be beneficial to both parties. For Taiwan, it gives it a chance to use Chile as a platform to reach the rest of South America, and to all the countries with which Chile has already signed FTAs. Chain production cooperation should pose a strong incentive to avoid tariff barriers for Taiwanese companies using Chile’s FTA web. In the case of Chile, the motivation is mainly based on the premise of keeping its top level competitiveness in the market and keeping its edge over New Zealand and other producers of agro-industrial products. It is undeniable that we are in an era of FTAs, and lagging behind in this race means an instant loss of competitiveness in various terms. The questions asked by governments should not be “whether we should” but rather “how can we do it”. Both Chile and Taiwan could reap benefits in their international trade policies with the agreement.

The current Chilean export structure relies strongly on raw materials with little or no added value. In 2011, Taiwan imported

³³ Dent, Christopher M. “Taiwan and the New Regional Political Economy of East Asia.” *The China Quarterly* 182 (June 2005), 182

US\$ 2,178 million worth of products from Chile. Of these, US\$ 1,790 million were copper, US\$ 162 million were wood pulp, and a further amount was other raw materials. A push for greater trade diversification is needed to generate a sustainable trade relationship. Regarding Taiwan, the island reached US\$ 398 million in products exported to Chile during 2011. This reflects a clear and wide trade deficit in its relationship with Chile which might be breached by expanding trade through cooperation of both parties, generating a sustainable trade relationship. This will help the diversification of Taiwanese export markets, providing a global trade bridge into South America and other international markets

The question of how to frame this study relates back to two possible theories. The first one is a clear neorealist perspective where Chile does not move until it sees its relative gains being threatened by a third actor. Thus Chile engages in negotiations to keep these relative gains, more importantly than to achieve cooperation. Secondly, Vincent Cable's "competitive state" theory seems more closely suited to understanding the situation. A loss in market share might mean a loss in competitiveness for Chile's firms in the market, since another country with agro-industrial potential, coming from the southern hemisphere will join the market in better terms of entry and easier market access. To keep up the competitiveness in the market, and maintain a strongly diversified export structure, Chile will have an incentive to look for that FTA.