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An analysis of the American investment environment for Taiwanese business firm

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AN ANALYSIS OF THE AMERICAN INVESTMENT ENVIRONMENT FOR TAIWANESE BUSINESS FIRMS

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CHAPTER I

INTRODUCTION

Taiwan has enjoyed flourishing and rapid economic growth, accompanied by stable prices, successful labor absorption, improved income distribution, and upgraded economic and production structures. The country has shifted successfully from an agricultural base to an industrial base. However, the continuously increasing trade surpluses not only raise a warning signal from trade protectionists, but also exert inflationary pressure on prices causing Taiwanese products to be more expensive and less competitive abroad. This is due in part to a currency appreciation of the New Taiwan Dollar, which has gained more than 25 percent against the U.S. dollar since September 1985.[1]

In the past year, the Taiwanese government has made some concessions to correct the trade imbalance, but the gap is not likely to be closed in the near future. On July 15, 1987, Taiwan's government lifted restrictions on foreign investment. Since that time, with tax and loan incentives, the government has aggressively encouraged businessmen to increase overseas investment in order to lessen the pressure of foreign exchange reserves on prices and to diversify the export market, of which nearly 50 percent has been centralized on the United States market (see table 1-1).

Since the United States has always been the largest outlet for Taiwan's exports and since the policy of Taiwan's

Table 1-1
Taiwan's Major Trading Partners, 1986

Item	Unit	Percentage %	Amount US$
Imports	(Thousand US$)		20,102,049
Country			
Japan		34.2	
U.S.A.		22.4	
Saudi Arabia		3.8	
Kuwait		1.8	
Rep. of Germany		4.7	
Australia		3.6	
Canada		2.0	
Indonesia		1.5	
Hong Kong		1.6	
United Kingdom		1.5	
Singapore		1.4	
Rep. of Korea		1.4	
Philippines		0.6	
Thailand		0.7	
Iran		0.1	
Exports	(Thousand US$)		39,789,198
Country			
U.S.A.		47.7	
Japan		11.4	
Hong Kong		7.3	
Rep. of Germany		3.2	
Saudi Arabia		1.6	
Canada		3.2	
Singapore		2.3	
Australia		2.2	
United Kingdom		2.4	
Indonesia		1.0	
Thailand		0.7	
Philippines		0.8	
Rep. of Korea		0.9	
Kuwait		0.4	
Iran		0.0	

Source: Council for Economic Planning and Development, Taiwan Statistical Data Book, 1987.

government is to spur businessmen to engage in overseas investment, I have chosen to focus on the American investment environment for Taiwan's investors. First, I introduce

Taiwan's economic development strategy from the 1950s to the 1980s and its experience for nearly forty years (1945-1985) in economic development. I also discuss the performance of Taiwan's economy. Then, I examine the problems confronting Taiwan's economy, especially in international trade, and the measures adopted by Taiwan's government to solve existing economic problems.

Throughout the world, direct foreign investment has grown very rapidly in the post-World War II period and has become an increasingly important means of transferring capital, technology, and production capabilities across national boundaries. An increasing volume of direct investment is visible evidence of a growing global economic integration.[2] In order to expand the size of the foreign market, to obtain a larger world market share, and to diversify the export market, it is necessary for Taiwan's businessmen to promote direct investment overseas. This will enable them to bypass such obstacles to trade as the spread of protectionism and the proliferation of non-tariff barriers, and to upgrade the industrial structure and the development of individual national economies. Hence, this paper explores the current status of the American investment climate, the activities of foreign investment in the United States, and the impediments facing foreign investors. It also describes the trend of foreign investment in the United States.

Every country has a particular motive for implementing foreign investment. For this reason, I discuss the factors that may encourage Taiwanese investment in the United States. Similarly, this paper examines the problems associated with investing in the United States. Finally, the future prospects for Taiwanese investment in the United States will center on the Maquiladora Program, which was established by the government of Mexico in 1965. It is designed to encourage the United States and other foreign enterprises to establish facilities in Mexico where they can produce consumer goods from imported parts, taking advantage of relatively low Mexican labor costs, and exporting most of their production.[3] I also examine the Caribbean Basin Initiative (CBI), which went into effect January 1, 1984, and provides for duty-free treatment for twelve years for the majority of products entering the United States from designated Caribbean Basin beneficiary countries (BC's).[4]

CHAPTER II

THE CURRENT STATUS OF TAIWAN'S ECONOMY

A. Taiwan's Economic Development Strategy (1950s-1980s)

1. 1950s

Following the destruction resulting from World War II, the Taiwanese government aggressively reconstructed and developed its island and economy from a disadvantageous position. In 1953 the Taiwanese government introduced the first-four year economic plan since post-war reconstruction was completed the year before. The Taiwanese government also implemented a land reform program to stimulate agricultural production and to improve farmers' living standards. At the same time, labor-intensive import-substituting industries were developed to help conserve foreign exchange and provide additional job opportunities. In other words, The Taiwanese government was working to promote stable economic growth.

2. 1960s

In the late 1960s Taiwan enacted the Statute for the Encouragement of Investment to attract foreign as well as domestic capital to key industries. The investment climate was improved to encourage saving and investment during this period. Export-led industries, designed to take advantage of low-cost labor, moved gradually into world markets and created job opportunities. In the agricultural sector, new farm products were developed, and the export of processed agricultural products was rigorously promoted.

3. 1970s

In the 1970s, the economy entered a new stage of development with government policies calling for a gradual shift to basic and heavy industries. Infrastructural investment was increased to alleviate bottlenecks in transportation, particularly in new ports, airports, and highways. To promote a backward integration, intermediate goods industries were established. Heavy and petrochemical industries were developed to improve the industrial structure. Meanwhile, rural development was accelerated to raise farm income.

4. 1980s

Taiwan undertook to raise energy efficiency, improve energy conservation, and secure stable energy supplies, despite softening oil prices. Although the government continues to restrain energy-intensive industries, it encourages the development of technology-intensive industries. Production technology and management will be upgraded to offset rising labor costs, while labor-intensive industries will be encouraged to automate their production processes and to develop more modern and efficient managerial skills. In the meantime, to provide the highly trained manpower needed for industrial restructuring and upgrading, educational institutions will put an even greater emphasis on science and technology.[5]

B. An Overview of Taiwan's Economic Development Experience (1945-1985)

The following information is based on Economic Development of Republic of China on Taiwan, published by Ministry of Economic Affairs (Taiwan) in April 1987.

1. 1945-1960

Taiwan, like many newly-independent countries, was created from former colonial states and plagued with population pressures, general food shortages, government budget deficits, foreign exchange shortages, and inflationary pressures. By coincidence, Taiwan's government successfully introduced a "land-to-the-tiller" program. It improved food production and also stimulated agricultural exports while building a highly productive agricultural sector during a time of worldwide economic prosperity. This led to an improvement in international trade. Additionally, development of consumer product industries and import substitution policies, including quotas and high tariffs, successfully led to an increased expansion of exports. Also, American military and civilian aid helped to control inflation, rebuild the economy, supply needed commodities, raw materials, and foreign exchange, and generally boosted the confidence of Taiwan's government and people.

2. 1960-1980

Green revolution technology, which included high-yielding varieties and improved water management, was developed in this period which helped to increase productivity in the production of the two major food crops, rice and wheat. During the 1960s and early 1970s, several Export Processing Zones, which imported raw materials and intermediate goods and processed them into finished goods for export, played a critical role in attracting foreign capital and speeding the rate of export expansion.[6]

The Ten Major Development Projects, which included steel, petrochemicals, shipbuilding, nuclear energy, and infrastructure projects, were implemented during the 1970s and helped Taiwan survive two energy crises (1974 and 1979) and still sustain economic growth.

During this period Taiwan experienced dramatic changes in its economic structure, shifting the Taiwanese economy from an agricultural economy to an industrial economy. For instance, agricultural products as a percentage of Gross Domestic Product dropped from 28.7% in 1960 to 15.5% in 1970 and then to 7.7% in 1980. Conversely, industrial products grew from 29.6% in 1960 to 41.3% in 1970 and then to 52.2% in 1980. Similarly, shares of agricultural and industrial products in exports reflected the same results. Agricultural products fell from 67.6% in 1960 to 9.2% in 1980 and industrial products jumped from 32.3% in 1960 to 90.8% in 1980 (see table 2-1). Furthermore, the importance of industry and trade grew appreciably.

3. 1980s and Beyond

Dramatic new developments in technology have continuously focused on the industrial and service sectors. Research and development will become an even more important means of maintaining competitiveness in a highly competitive marketplace. Restructuring the industrial sector and developing the service sector will be the two major priorities for most developing countries. The development of an international marketing network and modern enterprise management techniques will become more and more important for Taiwan in the future.[7]

Table 2-1
Agricultural and Industrial Productions As a Percentage of GDP and Exports in Taiwan, 1951-1980

Sector	Agricultural Products		Industrial Products	
Year	GDP	Exports	GDP	Exports
1951	32.5	91.9	23.9	8.1
1955	29.2	89.6	26.4	10.4
1960	28.7	67.7	29.6	32.3
1970	15.5	21.4	41.3	78.6
1975	12.8	16.4	45.9	83.6
1980	7.7	9.2	52.2	90.8

Source: International Commercial Bank of China (Taiwan), Economic Review, No. 237, May-June 1987.

C. The Performance of Taiwan's Economy

1. Economic Facets

a. Economic growth

From 1953 (when the first four-year plan was launched) to 1986, Taiwan's economy grew at a real annual rate of 8.6%. During the 1953-1960 period, economic growth averaged 7.6% per year while industrialization was established through the development of industries producing substitutes for imported consumer goods. Taiwan was successfully shaped into an export-driven economy and enjoyed economic growth averaging 10.4% from 1961 to 1973.

During the 1974-1980 period, a series of stabilizing but yet stimulative policy measures enabled the economy to maintain an average annual growth rate of 8.3 %, despite the two oil crises. Economic growth slowed down somewhat at the start of the 1980s, in the face of a world-wide economic downturn. However, because of a world-wide recovery begun by the U.S., Taiwan enjoyed a powerful economic rebound during the second half of 1983. Despite the slow-down of the world economy in the latter half of 1984, bringing the Taiwanese average annual growth for 1981-1985 down to 6.4%, the economy once again enjoyed double-digit growth of 10.8% in 1986.

During the past thirty years, per capita GNP has risen at a rate of 4.7% in the 1950s, 6.1% the following decade, and 8% in the 1970s. The growth rate slowed to 3.6% in 1985 because of sluggish international demand and negative growth in domestic investment. It rebounded, however, to 9.5% amid buoyant economic conditions in 1986. Overall, per capita GNP for Taiwan's 19 million people rose 6.1% each year during the 1953-1986 period, reaching $3,751*[1] by 1986, one of the highest levels in Asia. This level was expected to approach $5,000 in 1987.[8]

b. Saving and Investment

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1 $*, which is used in the whole paper, refers to the United States dollar.

The rate of savings in Taiwan has risen from about 7-8% in the early stages of development to 15-20% in the middle stages and to more than 30% in the current decade. In 1986 the national savings ratio -- gross saving as a percentage of GNP -- reached 37.4%, one of the highest savings rates in the world.

Enactment of the Statute for the Encouragement of Investment in 1960 was a great step forward in channelling the flow of domestic and overseas capital into productive investment. The annual inflow of foreign and overseas Chinese capital, expressed in 1986 dollars, has risen sharply -- from $29 million in 1966 to $142 million in 1976 and then to a record high of $770 million in 1986.

Through 1986, overseas Chinese and foreign concerns invested over $5.9 billion in Taiwan. By area of origin, the United States was the source of $1,854 million or 31% of combined foreign and overseas Chinese investment; Japan was in second place with $1,384 million or 23%, followed by Western Europe with $720 million or 12%. Overseas Chinese contributed $1,240 million or 21% of the total.

The electronic and electric products sectors of the economy proved far and away the favorite target of overseas Chinese and foreign investors, accounting for $1,753 million or 20.6% of the total value of all investments. The chemical industry absorbed $1,085 million, followed by service, machinery and instruments, metal products, non-metallic mineral products, banking and insurance, and textile.[9]

Taiwan's external investment has risen from $492,000 in 1962 to $4,124,000 in 1972 to $11,632,000 in 1982 then to $303 million in 1986. In 1987, external investment dropped to $102.8 million because Taiwan's investors reacted cautiously to the continually appreciating local currency and to new reforms by the Taiwanese government, enacted on July 15, 1987, which lifted restrictions on investing abroad. Total external investment stood at over $620 million from 1959 to 1987. By area of origin, the U.S. ranked first with $233.2 million or 37.6%, followed by Indonesia with $28.5 million, Thailand with $20.6 million, Malaysia with $13.1 million, Philippines with $12.8 million, and Singapore with $11 million.

Electronic and electric appliances were the primary targets of external investment. Chemical industries followed. Together these sectors accounted for almost 50% of total external investment. The transportation industry received the least amount of external investment.[10]

c. Inflation Rate

A low rate of inflation is a key factor in sustaining stable economic growth. Taiwan has achieved rapid economic growth with relatively stable prices. The inflation rate dropped from 3000% in 1949 to 1.9% in the 1960s. This rate has been maintained since the first oil crisis of 1974-1975. During the last three years, an inflation rate of less than

1% has been maintained.[11]

d. Sectorial Production and Industrial Structure

In the early 1950s, heavy emphasis was placed on developing the agriculture sector. Expressed in 1986 dollars, industrial output as a percentage of GDP first exceeded agricultural output in 1971. Between 1953 and 1985, agricultural output as a percentage of GDP dropped from 34.6% to 6%, while industrial output steadily climbed from 21.3% to 49.7%. Service output remained almost unchanged, 44.1% in 1953 and 44.3% in 1985.

Intermediate goods manufacturing and capital and durable consumer goods manufacturing still provide the major source of economic growth. The service sector plays the role of stabilizer in Taiwan's economy. Among its subsectors, wholesale and retail trade makes up the major portion of service output, accounting for 15% of GDP. Government services rank second, having maintained approximately a 10% share of GDP.[12]

e. Foreign Trade

Taiwan still is heavily dependent on international trade. During the 1952-1985 period, two-way trade at current prices expanded from $.3 billion to $50.8 billion, a 169-fold increase. In 1986, a boom year for the Taiwanese economy, two-way trade totaled $64.0 billion, $39.8 billion in exports and $24.2 billion in imports. Trade dependence, expressed as the ratio of two-way trade volume to GDP, rose annually from

17% in 1955 to 36% in 1965 to 73% in 1975 then to 86% in 1985. It again rose to 90 % in 1986 (see table 2-2).

Except for the recession years of 1974-1975, Taiwan has enjoyed a trade surplus every year since 1971. Amid robust economic growth in 1986, Taiwan achieved a trade surplus of $15.6 billion (see table 2-2).

Table 2-2
International Trade in Taiwan, 1953-1986
Unit: Millions $

Item / Year	Total Value	Total V/GDP	Exports Value	Exports V/GDP	Imports Value	Imports V/GDP	Balance Value
1952	303	24%	116	9%	187	15%	-71
1955	324	17	123	6	201	11	-78
1960	461	27	164	10	297	17	-133
1965	1,006	36	450	16	556	20	-106
1970	3,005	53	1,481	26	1,524	27	-43
1971	3,904	59	2,060	31	1,844	28	+216
1974	12,605	88	5,639	39	6,966	49	-1,327
1975	11,261	73	5,309	34	5,952	39	-643
1980	39,544	96	19,811	48	19,733	48	+78
1985	50,825	86	30,723	52	20,102	34	+10,621
1986*	63,954	90	39,789	56	24,165	34	+15,624

* Estimate.
Source: C.E.P.D., Taiwan Statistical Data Book, 1987.

Prior to 1960, export goods consisted mostly of processed and unprocessed agricultural products. The proportion of industrial products grew as industrial development expanded. In 1986, industrial products accounted for 94% of total exports, processed agricultural products for 5%, and unprocessed agricultural products for 1%. Major merchandise imports included agricultural and industrial raw materials (64% of total imports in 1986), followed by capital goods and equipment (27%). Consumer goods accounted for a relatively small share at 9%.

Until 1969 Japan was Taiwan's largest export market. The U.S. now holds that position. Since July 1965, when U.S. economic aid was terminated, Japan has provided the greatest share of Taiwan's imports. Combined, Japan and the United States account for about half of Taiwan's trade volume. In 1986, imports from Japan amounted to $8,255 million or 34.2% of total imports; those from the U.S. totalled $5,416 million or 22.4%. Other major sources of imports to Taiwan were West Germany, Saudi Arabia, Australia, Malaysia, and Canada (see table 1-1).

On the export side, the U.S. continued to be the largest market: taking in 1986 $18,995 million or 47.7% of total exports, followed by Japan with $4,545 million or 11.4%. Other important buyers of Taiwan's exports were Hong Kong, Canada, West Germany, the United Kingdom, and Singapore.[13]

2. Social Facets

a. Income distribution

Remarkable economic growth in Taiwan and a rising level of income have been accompanied by a steady improvement in income distribution. In 1952, the income of the wealthiest 20% of Taiwan's households was some 15 times that of the poorest 20%. By 1970 the ratio had narrowed to 4.58 to 1, and since then has remained at about that level. The narrowing of the income gap may be attributed largely to the land reform program, the early emphasis on labor-intensive employment, easy access to education, and a high degree of social mobility.[14]

b. Labor force and employment

Taiwan's labor force has changed in the past two decades. In 1966, 81% of all working-age males and 33% of working-age females were in the labor force. By 1986 the corresponding totals were 75% and 45%. A large increase in the number of women entering the job market, better job opportunities for women, and a desire by males for longer years of formal education have all played a key role in this transformation.

Another major change in the labor force is that joblessness among women decreased to the same level as for men. Unemployment rates twice as high for women than men in 1966 (4.99% to 2.28%), were approximately at the same level in 1986 (2.74% for men and 2.51% for women).

Changes in the economic structure during the period led to a sharp decrease in agricultural employment, from 45% of the workforce in 1966 to only 17% in 1986. Meanwhile, industrial employment rose to 42% in 1986 from 23% in 1966. As the fastest growing sector of the economy, the service sector is expected to increase its share of total employment in the future.[15]

c. Education Development

Taiwan has relied heavily on education and training to develop the skilled workforce on which the desired restructuring of the economy and sustained growth depends. As the first step toward upgrading the quality of Taiwan's manpower, the government launched a vigorous campaign to eradicate illiteracy. By 1986 the illiteracy rate had fallen to only 9.2% of the total population, as compared to 27.6% in 1966.

Over the past three decades, the number of students enrolled in educational institutions has increased dramatically. The percentage of school-aged children enrolled in primary schools was 84% in the 1952-1953 period, and reached 99.9% in the 1986-1987 period. For those respective periods the percentage of primary school graduates enrolled in junior high school was 33.8% and 99.7%. The percentage of junior high school graduates attending senior high school was 62.9% in the 1952-1953 period and 77.2% in the 1986-1987 period. The percentage of senior high school graduates attending schools of higher education between 1952-1953 and 1986-1987 were 46.2% and 82.3%, respectively. Also, higher educational institutions are placing increasing emphases on science and engineering and are strengthening their research and development facilities to meet the needs of economic restructuring and modernization.[16]

d. Improved living standards and social indicators

The phenomenal economic growth in Taiwan in recent years has brought the people a degree of material well-being unprecedented in Chinese history. In 1966, 47.9% of total spending by an average family was on food; by 1986 the figure had dropped to 31.3%. As people spend relatively less on food, they are devoting a larger proportion of their rising incomes to housing, education, and leisure-time activities.

Accompanying a rise in nutritional standards, the daily per capita intake of calories in Taiwan rose from 2,078 in 1952 to 2,874 in 1986, one of the highest in Asia. The average life expectancy at birth, accompanied by advances in medicine and medical service, has increased from 58.6 years in 1952 to 73.6 years in 1986. Also, the number of telephones, television sets, and household appliances owned by the average family has risen rapidly, bringing greater comfort and convenience. Meanwhile, the living space per capita has expanded dramatically from 75 square feet to 210 square feet during this period, approximately a three-fold increase.[17]

D. Problems Facing Taiwan's Economy

1. Intensifying pressure from international competition and trade protectionism

The vigorous growth in GNP and the rising standard of living in Taiwan are undoubtedly responsible for the economic prosperity and affluent quality of life, but they also have promoted the decline of product competitiveness in the world market. Wages paid to laborers are no longer low relative to wages in other developing countries. From 1976 to 1986, the real wage level in Taiwan rose about 22.1% annually on the average in 1981 dollars.[18], while the competitiveness of traditional labor-intensive products began to weaken in the international market. This situation has been exacerbated in more recent years as a result of the slower expansion of world trade, the resurgence of trade protectionism and mounting competition from other newly industrialized countries. Additionally, developing countries which are endowed with abundant natural resources and access to cheaper labor -- such as Thailand and the Philippines -- have already moved into the light-manufactured goods for which the Newly Industrialized Countries (NICs) used to have a clear competitive advantage.[19]

The United States, and some of the nations belonging to the European Economic Community who are major trading partners of Taiwan, have been experiencing serious foreign trade deficits since the late 1970s. As their deficits swell, protectionist pressure mounts among some business and labor leaders and tends to spread to other countries.[20] Taiwan is a target of some of others' pressure. For example, Section 301 of the U.S. 1974 Trade and Tariff Act (used to prevent unfair trade from another country), the recent appreciation of the New Taiwan Dollar, quota systems and self imposed limits on exports, and withdrawing the tariff privileges under the Generalized System of Preferences (GSP), beginning January 1, 1989, all play a role in the ever-increasing tension between Taiwan and the United States, its largest major trading partner.

2. Bottleneck of Science and Technology

If Taiwan is to continue its economic miracle and maintain a consistently high annual growth rate, it is generally agreed that there must be a shift in its industrial structure away from labor-intensive manufacturing industries to technology and capital intensive industries. Research and development expenditures and manpower are the essential elements in promoting scientific and technological development. According to the experience of the advanced countries, there is a direct relationship between the rate of scientific and technological progress and the amount of resources devoted to research and development and cultivation of technical manpower. From 1981 to 1983, national R&D expenditures in Taiwan grew at an annual rate of 22.1%. Although its share of GNP increased from .76% in 1981 to .96% in 1983, this was still too low compared to the 2% average in industrialized countries. During the same period, the government's share of total R&D expenditures rose from 44.2% to 59.5%, while that of the private sector decreased from 55.6% to 40.3%. The private sector undeniably needs to spend more on R&D and to take a more active role in R&D activities.[21]

Total R&D manpower increased at an average annual rate of 9% from 1981 (19,704 full-time equivalents) to 1983 (23,933 full-time equivalents.) The share of researchers as total R&D manpower rose to 51.5% in 1983 from 47.9% in 1981. The number of researchers holding master's and bachelor's degrees decreased between 1982 and 1983, while the number of Ph.D.s and junior college graduates increased. Strictly speaking, cultivating and recruiting upper and mid level research personnel is still the primary focus of Taiwan's science and technology development efforts.[22]

It is very difficult for Taiwan to start a self sustained development of technology, because it lacks a comprehensive and consistent science and technology development system, limited resources, economic scale, and high-tech talent. The country is also dependent on foreign firms to introduce new technology.[23]

3. Trade Surpluses and Foreign Exchange Reserves

Due to its limited natural resources and its export-promoting policy, Taiwan is highly dependent on overseas supplies of raw material and export markets. Beginning in 1954, trade between Taiwan and the United States grew rapidly, jumping from a mere $100 million to $19.5 billion by 1985, and to $24.4 billion in 1986. Bilateral trade favored the United States from 1896 to 1967, but thereafter shifted in favor of Taiwan. During the period 1967-1986, exports from Taiwan to the U.S. increased at an average annual rate of 26.5%, while U.S. exports to Taiwan rose at an average annual rate of 16.7% (see table 2-3).

Table 2-3

Taiwan Commodity Trade With the U.S.

Unit (Millions $)

Year	Exports Amount	%	Imports Amount	%	Amount of Total Trade	Balance
1954	5.01	5.4	98.07	46.4	103.08	-93.06
1955	5.04	4.4	95.54	47.5	100.94	-90.14
1960	13.52	11.5	83.51	38.1	97.03	-94.26
1965	95.68	21.3	176.37	31.7	272.05	-80.69
1966	115.89	21.6	166.34	26.7	282.23	-50.45
1967	167.82	26.2	247.30	30.7	415.12	-79.49
1968	278.19	35.3	239.49	26.5	517.68	+38.70
1969	399.05	38.0	291.75	24.1	690.80	107.30
1970	564.17	38.1	363.84	23.9	928.01	200.34
1971	859.20	41.7	408.16	22.1	1267.36	451.04
1972	1251.32	41.9	543.42	21.6	1794.74	707.89
1973	1677.11	37.4	952.53	25.1	2629.64	724.57
1974	2036.64	36.1	1679.91	24.1	3716.55	356.73
1975	1822.74	34.3	1652.13	27.8	3474.87	170.61
1976	3038.7	37.2	1797.54	23.7	4836.24	1241.16
1977	3636.25	38.8	1963.85	23.1	5600.10	1672.40
1978	5010.38	39.5	2376.06	21.5	7386.44	2634.32
1979	5652.24	35.1	3380.80	22.9	9033.04	2271.45
1980	6760.30	34.1	4673.49	23.7	11433.79	2086.81
1981	8158.39	36.1	4765.67	22.5	12924.06	3392.72
1982	8757.80	39.4	4563.26	24.1	13321.06	4194.54
1983	11333.71	45.1	4646.44	22.9	15980.15	6687.27
1984	14867.71	48.8	5041.64	23.0	19909.35	9826.07
1985	14772.99	48.1	4746.27	23.6	19519.26	10026.72
1986	18994.69	47.7	5415.79	22.4	24410.48	13578.72

Source: C.E.D.P., Taiwan Statistical Data Book 1987, Republic of China.

Taiwan's exports have consistently exceeded its imports since 1976. Taiwan's trade surplus has increased from $567 million in 1976 to more than $15,160 million in 1986, which is roughly 20% of the year's total GNP. This continuous and surging trade surplus not only has triggered talk of trade protectionism in the U.S., but it has also deepened the pressure to appreciate the value of the New Taiwan Dollar, which has already risen more than 25% in the last two years.

Also, the increasing foreign exchange reserves themselves--from $2 billion in 1979 to over $75 billion in 1987 -- have caused a significant imbalance in the money market since foreign exchange reserves earned by exporters have to be converted into local currency. Therefore, M1B, which includes all currency in circulation plus money in checking accounts, passbook savings, and passbook savings deposits, has been boosted at an annual rate of more than 50%, and has heavily undermined price stability.[24]

E. Measures To Solve Existing Economic Problems

In order to solve the problems facing Taiwan's economy, and to reinforce the long-term development of the country, the government has adopted three basic policies: economic liberalization, internationalization, and systematization.

Liberalization aims to reduce governmental assistance, protection, and intervention in private economic activities, to create an equitable and competitive environment, to promote efficiency in the utilization of resources, and to strengthen the potential for economic development. Internationalization focuses on expanding the domain of economic activities outward, opening up the home market to foreign competition, and strengthening substantive ties with foreign countries. Amending, rationalizing and promulgating rules governing economic activities, streamlining economic laws and regulations, and enhancing national interests and the people's well-being play an important role in systematization.[25]

In response to trade protectionism and international competition, Taiwan's government has adopted the following measures:

1. Continuing the Promotion of Trade Liberalization

This measure is to further lower import tariff rates and relax restrictions on imports, simplify customs declarations and clearance procedures, eliminate unnecessary inspections of imports and institute a system of licensed customs inspectors to ensure a high standard of performance in customs inspections. It also would reduce the over-sized imbalance of trade with the United States and promote balanced development of two-way trade with various parts of the world.

2. Improving Trade Structure and Diversifying Export Markets

There are four key points in this measure. The first is to actively promote the production of strategic and high-tech manufactured goods, introduce key technologies, step up the development of new products, and open up new export markets. The second point is to focus on developing precision machinery and specialty products while promoting the export of packaging plants and equipment. The third point is to encourage manufacturers to renovate their machinery and equipment, to step up the importation of capital goods, and to speed up plant automation programs. The fourth and final point in this measure is to encourage local entrepreneurs to make investments overseas, and to diversify sources of agricultural and industrial raw materials with a view to ensuring their adequate supply.

3. Coping With Foreign Protectionism

In an effort to neutralize protectionism, an emphasis is being placed on improving the image of Taiwan's products in international markets, assisting large trading firms in establishing global trade information networks, and stepping up the training of trade negotiators and top and middle level trade promotion personnel. Also emphasis is being placed on strengthening the role of industrial and commercial associations, setting up an agency charged with the responsibility of conducting trade talks and coordinating relevant activities, and inviting trade and economic officials of foreign governments, representatives of foreign industrial and commercial associations, and private businessmen to visit Taiwan.[26]

4. Economic Restructuring

To further the development of agriculture, the objectives are to plan the utilization of agricultural resources, to permanently establish areas reserved for agricultural production and promote specialized regional production, to maintain self-sufficiency in major crops, and to develop products with high economic value.

As for industrial upgrading, the Taiwanese government will focus on four main approaches: adopt preferential tax measures to encourage and improve the domestic investment climate, reduce risks pertaining to investment in venture-capital firms, speed up the transfer of advanced technologies to raise productivity, relax restrictions on overseas investments by domestic concerns, and push forward with the development of multinational companies.

The modernization of the service industry centers on establishing an integrated transportation and communications network and rationalizing their structures. Also operating and managerial techniques in commerce and banking should be adopted from advanced nations to strengthen and upgrade the quality of services. Also, it is necessary to promote the modernization and internationalization of commercial and financial operations to improve their productivity.[27]

The following major measures are intended to eliminate the bottleneck in the area of science and technology:

1. Strengthening the Cultivation and Recruiting of Personnel

This measure emphasizes the continued implementation of the National Plan for Strengthening the Education, Training and Recruiting of High-Level Science and Technology Personnel. Its purpose is to restructure key departments in colleges and universities, improve on the job training of R&D personnel, promote new scientific knowledge and accelerate the cultivation and retraining of technological specialists, assist private enterprises in recruiting specialists in technology, and boost scientific and technical education and teacher training.

2. Reinforcing Tax and Financial Incentives

Tax incentives are used to vigorously implement Measures Governing Tax Credits for Investment in Research and Development by Productive Enterprises. It was promulgated in 1983-1985 to encourage research and development in the private sector by granting certain tax incentives. Financial incentives include improving measures encouraging individual R&D funds for productive enterprises and assigning certain banks to draw up R&D investment programs for public and private enterprises. The banks then would provide preferential grants and loans to such enterprises.

3. Continuing Development of the Hsinchu Science-Based Industrial Park

The Hsinchu Science-Based Industrial Park, similar to the Silicon Valley near San Francisco, is in the final phase of construction. It will encourage private investors to build factories and living accommodations in the park for rent or sale. The objectives of the park are to encourage high-tech industries in the park to contribute to the development of defense technology and new industry. Another objective of the park is to strengthen exchanges and cooperation between the park's high-tech industries and academic research institutes in order to facilitate a more efficient use of resources.[28]

In the past year, Taiwan's government has taken a number of measures to reduce the U.S. trade imbalance with Taiwan. These include:

1. The "Buy American Program"

From early 1978 through 1987, the Taiwanese government annually dispatched thirteen special procurement missions to the United States to make on-the-spot purchases. These purchases have totalled more than $10.5 billion of American agricultural and industrial products. Major agricultural purchases include soybeans, raw cotton, wheat, barley, and corn, while industrial purchases include items such as buses as well as industrial and electronic equipment.

2. Open Market

In December 1986, Taiwan signed an agreement with the U.S. to open up its wine, beer, and cigarette markets and to establish streamlined importing procedures. Recently, Taiwan's government also opened its service sector to foreign investment. This is an area in which the United States is strongly competitive and can hold its own against all competitors.

Taiwan has allowed all the major U.S. fast food companies to open outlets. They have already become a significant challenge to restaurants serving traditional Chinese cuisine. In the banking and insurance industries, Taiwan has agreed to let the U.S. banks join the United Debit Credit System of Taiwan in order to issue credit cards. The U.S. banks also were allowed to establish branch offices in

Kaohsiung, the major port city in southern Taiwan. Insurance licenses have been granted to two U.S. insurance companies, giving them full access to Taiwan's insurance market.

Each year, beginning in August 1987, two American life insurance and two property insurance companies will be allowed to open branches in Taiwan. Taiwan also allows foreign equipment leasing firms to hold up to a 90% equity in Taiwan leasing ventures. The quota system and surcharges imposed on American firms have been abolished. In addition, American motion pictures will receive copyright protection under Taiwan's copyright law.

3. Promotion of American Products

In order to assist the introduction of American products to the local market, Taiwan's government helped the U.S. Department of Commerce set up an American Trade Center by providing free office space in Taipei. In March 1986, a special U.S. product exposition (USPRO) attracted hundreds of American exhibitors. All products entered Taiwan duty-free, and handling and land transportation were provided without charge. In addition to the American products exhibition sponsored by the government, seminars on Taiwan-U.S. trade and investment have also been held several times since 1979.[29]

4. Import Tariffs Reduction

Import tariffs on hundreds of items of particular interest to U.S. exporters have been reduced as a result of continuous trade negotiations. From 1974 to 1985, the tariff reductions on U.S. exports to Taiwan came to a total of 5,027 items; among these, 117 became duty free. At the end of 1986, Taiwan's overall average tariff rate was 28.2%. After cuts on thousands of items, at the end of April 1987, the overall average had dropped by nearly 28% to 20.4%. The average tariff rate for non-agricultural goods went down from 26.4% to 18.2% during that period, while the average rate for agricultural goods fell from 37% to 30.6%. Even more impressive is the more than 50% reduction in the average effective tariff rate for U.S. products in the past decade.[30]

5. The Appreciation of the New Taiwan Dollar

Under pressure from the U.S., the New Taiwan Dollar has appreciated more than 25% against the U.S. dollar since September 1985.[31] This action has made American products more competitive against other rivals, but has also caused Taiwanese products to be more expensive and less competitive abroad.

5. Lifting Foreign Exchange Controls and Encouraging External Investment

To stem the growth in its foreign exchange reserves, Taiwan lifted foreign controls on July 15, 1987. This measure is intended to encourage overseas investment. Taiwan's government hopes that by dismantling long-standing controls on overseas investment, it will be able to trim its foreign reserves, thus relieving the pressure from

Washington, as well as removing an inflationary threat. Previously, under Taiwan's strict foreign exchange controls, the central bank bought all dollars and other currencies earned in foreign trade from exporters, and sold them as local currency. The lifting of this barrier should stimulate the Taiwanese to invest overseas.[32]

CHAPTER III

AN OVERVIEW OF THE AMERICAN INVESTMENT ENVIRONMENT

A. The Current Status of the American Investment Climate

1. Economic Overview

The U.S. market is in close proximity to Canada, Latin America, and the Pacific basin. The diversity of the population and regions of the United States creates a heterogeneous marketplace, which is nevertheless highly integrated, thanks to efficient communications and transportation networks and a common language and legal system.

During the industrialization of the United States, the availability of power and transportation attracted industry primarily to the Northeast and the region around the Great Lakes. In recent years, the South and West with their milder climates, competitive wage rates, advantageous energy and land costs, and lower state and local taxes have become more attractive to investors. Furthermore, improved highways and transportation networks give the South and West competitive access to national markets. The U.S. population, economic activities, and higher personal income have generally shifted away from North and Central regions toward the South and West.

The outlook to the year 2000 suggests that the Southern (Rocky Mountains, Southwest, Far West, and Southeast) as well as the New England regions, are likely to continue to grow.

Other regions are expected to grow at rates below the national average.[33]

The U.S. merchandise trade deficit increased in 1986 as imports rose much more rapidly than exports. On an FAS/CIF basis (see table 3-1), the deficit increased from $148.5 billion in 1985 to $169.8 billion in 1986. During 1982-1986, the U.S. total merchandise trade deficit worsened considerably. The deficit grew from $42.6 billion in 1982 to $169.8 billion in 1986, with much of the increase occurring in 1984. Total U.S. exports, at $217.3 billion in 1986, rose only 2% or $4.2 billion above the 1985 level of $213.1 billion (see table 3-1).

Table 3-1
U.S. Merchandise Trade in 1980-1986
(Billions Dollars)

Item / Year	Exports * (F.A.S.)	Imports ** (C.I.F.)	Balance
1982	212.3	254.9	-42.6
1983	200.3	269.9	-69.4
1984	217.8	341.2	-133.4
1985	213.1	361.6	-148.5
1986	217.3	387.1	-169.8

*F.A.S. (Free Alongside Ship) means that goods are delivered to the vessel which is to be used to transport them, but the buyer is responsible for loading the goods and any subsequent costs.
** C.I.F. (Cost, Insurance, and Freight) means that the buyer is responsible for insurance and freight costs to deliver the goods to the destination.

Source: U.S. Department of Commerce, <u>1986 U.S. Foreign Trade Highlights</u>.

2. Government Policy Toward Direct Investment

The U.S. government conducts an "open door" policy toward foreign investment, treating foreign and domestic companies, in general, equally under the law. Although the United States does not discriminate against foreign investors, there are certain restrictions designed to protect national security and other important interests. Foreign nationals are limited in their ownership share in certain areas of the economy concerned with national defense.

The U.S. government has established the Committee on Foreign Investment in the U.S. (CFIUS) to monitor the impact of foreign investment and to coordinate its implications for U.S. policy. Two pieces of federal legislation have also been enacted: the Foreign Investment Study Act of 1974, which directed the Secretaries of Commerce and Treasury to undertake a large study of foreign investment in the United States, and the Agricultural Foreign Investment Disclosure Act of 1978, which was enacted to require any foreign persons who had acquired land to submit a report to the Secretary of Agriculture. In addition to federal legislation that directly controls foreign investment, there are a number of laws and regulations equally applicable to foreign and domestic investors, especially in the antitrust and securities areas. Also, the Federal Trade Commission has carefully scrutinized activities when foreign companies have attempted to enter the U.S. market by way of the acquisition route. The U.S. government, for example, successfully prevented Fujitsu and Fairchild from mergering by using the antitrust laws because the merger had national security implications.[34]

Many host countries pursue a "carrot and stick" approach to Foreign Direct Investment (FDI), with the carrot being foreign investment incentives and the stick being performance requirements. In the United States, there are no performance requirements, and the federal government offers no incentives to attract new foreign investment. However, many state and local governments do offer various incentives and financial assistance.[35]

3. Labor Force

The U.S. labor force is highly trained and mobile, and is composed of skilled, semiskilled, technical, and professional workers. The labor force is distinguished by its academic education and vocational training in the latest technology. Almost 75% of the workers have a high-school education, and approximately 30% of the adult population continues its education at a college or university after high-school graduation.[36]

Over the latest fourteen year period, the share of the employed labor force in nonagricultural sectors and in agricultural sectors showed almost no change. In 1986 106.2 million people or 96.9% of the employed labor force were in nonagricultural sectors. Only 3.1% or 3.4 million market in the agricultural sector. Also, one-fourth of the employment growth in the United States was found among the professional and technical workers. In addition to managers, administrators, and service workers, clerical workers were one of the broad occupational groups which experienced rapid growth in the last ten plus years. However, significant declines in employment and in their share of total employment were found among operatives and private household workers (see table 3-2).[37]

Table 3-2
Employment By Major Occupational Group, 1972-1986
(Numbers in Thousands)

Occupation	1972	1986	1972-1986 percentage change
Total	82,153	109,59	+33.4
Professional, Technical, & Kindred	11,538	18,532	+60.6
Managers & Administrators	8,081	11,385	+40.9
Sales Workers	5,383	10,935	+103.1
Clerical & Kindred Workers	14,329	20,055	+40.0
Craft & Kindred Workers	10,867	13,405	+23.4
Operative, except Transport	10,388	8,892	-14.4
Transport Operatives	3,223	3,583	+11.2
Labors, except Farm	4,242	4,695	+10.4
Farmers & Farm Laborers	3,077	3,444	+11.9
Service Workers, except Household	9,584	13,699	+42.9
Private Household Workers	1,442	981	-32.0

Source: Monthly Labor Review, January 1987, P.27, Table 1.

The labor force of the future will reflect changes in the industrial structure, with declines in some manufacturing industries and expansion in service industries. The rapidly growing service-producing industries did provide most of the jobs for the large number of youth and women who entered the labor force during the 1970s. Until recently, labor markets have been overwhelmed by record numbers of newly entering workers, reflecting the combination of the baby-boom generation attaining working age and the skyrocketing labor force participation rate among females. The middle-age (25-54) work force will continue to expand during the late 1980s and early 1990s, at an annual rate of 1.8% for men and 2.9% for women. Other age groups, young (16-24) and older (55+) will reflect negative growth in the corresponding period.[38]

4. Foreign Trade Zones

The U.S. Foreign Trade Zones (FTZs) were intended to allow duty-free importation of goods to be processed into finished products for sale outside the country. The Foreign Trade Zone Act, enacted in 1934, calls for the program to "encourage and expedite international commerce." The program grew slowly in the pre- and post-World War II eras, only beginning its rapid expansion in the mid-1970s. Currently, there are 133 FTZs in the United States. In addition, there are 96 subzones of those trade zones, usually located at a manufacturing site. Of the 96, 41 are automotive-related. In 1986, trade zones accounted for nearly $21 billion worth of goods produced, of which about 75% was domestic content. Automotive manufacturing made up nearly $16 billion of that total, using $2.7 billion worth of imported components blended with $13 billion in domestic content. The New U.S. Customs Service Regulations, effective May 12, 1986, are a major step toward streamlining and simplifying the legal requirements of FTZ operations. The U.S. FTZ programs continue to expand rapidly as importing and exporting companies realize the substantial financial advantages offered by FTZs, and as local communities find FTZs an important economic development tool.[39]

5. Tax Reform Act of 1986

Under the tax reform act of 1986, the corporate tax rate will drop from a maximum of 46% in 1986, to 40% in 1987, and to 34% in 1988. These rates will be the lowest in the industrial world and will make the U.S. even more attractive to foreign investors. However, branches of foreign companies will pay an additional 30% tax on any profit made in the U.S., as well as withholding tax. U.S. subsidiaries of foreign companies have always been subject to withholding tax, and the 1986 act does not change this. But subsidiaries do not have to pay a 30% profit tax. The old tax laws required that foreign companies only pay a withholding tax on the stock dividends and any remaining profit could then be repatriated. The new laws will impose a further tax on the appreciated value of properties that were the subject of exchange agreements. Under the old law, certain properties could be exchanged among investors without any tax liability.[40]

B. The Activity of Foreign Investment in the United States

1. The motive of foreign investment

The U.S. Department of Commerce Survey, <u>Foreign Direct</u>

Investment 1973-1987, stated that the motivation behind foreign investment in the United States is: a) accessibility to the largest consumer markets; b) availability of high technology and a skilled labor force; c) the depreciation of the U.S. dollar in relation to some foreign currencies; d) the political stability of the United States; e) fear of increased U.S. protectionism; and f) the cost of production in the United States. Additional factors are such items as securing a better supply and price situation for natural resources; diversifying product lines, political risk, and currency risk; and avoiding fluctuations in earnings.[41]

2. The Current Position of Foreign Investment

a. Foreign direct investment (FDI) flows

During the earlier postwar periods, the United States was the major exporter of direct investment capital. However, since 1981 the United States has become a net importer of foreign direct investment. Foreign direct investment into the United States grew continuously during the last two decades. This growth was particularly pronounced between 1977 and 1984, when the absolute amount of foreign direct investment in the United States grew about 360%, rising from $34.6 billion in 1977 to $159.6 billion in 1984 (see table 3-3). By the end of 1985, foreign participation in U.S. manufacturing, distribution, real estate, and service industries amounted to $183 billion. Total sales of non-bank companies owned wholly or in part by foreigners had reached more than $600 billion by 1985. If recent trends continue, total foreign direct investment could exceed US$350 billion by 1990, more than a four-fold increase over the 1980 level.[42]

Table 3-3
U.S. Foreign Direct Investment Position, 1950-1985
Unit (Millions $)

Year	U.S. Company FDI Position Abroad	Foreign Company FDI Position in U.S.
1950	11,788	3,391
1955	19,396	5,076
1960	31,866	6,910
1965	49,475	8,797
1970	75,480	13,270
1975	124,050	27,662
1976	138,809	30,770
1977	145,990	34,595
1978	162,727	42,471
1979	187,858	54,462
1980	215,858	83,046
1981	228,348	107,590
1982	207,752	123,590
1983	207,203	137,061
1984	212,994	164,583
1985	232,667	182,951

Source: U.S. Department of Commerce, Survey of Current Business, August 1985 and August 1986.

b. Method of investment

Foreign entities have been establishing footholds in the U.S. market through a number of entry strategies. The entry strategies used are acquisitions and mergers, equity increases, joint ventures, new plants and plant expansions, real property (purchase of real estate), branches, agencies, representative offices, stores, outlets, warehouses, and unidentified transactions. The most common strategies adopted by foreign entities are acquisition of all or part of an American company, purchases of real estate, and building new plants.

c. Composition of FDI by investor countries

Traditionally, the United Kingdom, the Netherlands and Canada were the largest investors in the United States, accounting for more than half of total foreign direct investment. However, their dominance will likely be eroded in the near future by Japan, which currently accounts for 10.4%, and West Germany, with 8%. Both countries are benefiting from huge balance of payment surpluses, and foreign direct investment is a natural means of recycling these balances. The United Kingdom with $43.8 billion, or 23.9% of all foreign direct investment in the United States, was the largest single investor in 1985, followed by the Netherlands, with $36.1 billion, or 19.8%, Japan with $19.1 billion, or 10.4%, and Canada, with $16.7 billion, or 9.1% (see table 3-4).

d. Foreign direct investment by industry

Foreign companies in the United States operate in almost all major sectors of the U.S. economy, except defense. In particular, investment is heavily concentrated in manufacturing (33.3% of total FDI in the U.S.), wholesale and retail trade (18.7%), and petroleum (15.4%), which together account for two-thirds of total foreign direct investment (see table 3-5). In recent years, above-average growth rates were experienced in trade, finance, machinery, and chemicals.

The trade and finance sectors are growing at a significantly higher rate than average foreign direct investment in the past decade.

Table 3-4
Foreign Direct Investment In The United States, 1985
By Major Country

Country	Percentage %	Amount (millions)
Total		182,951
United Kingdom	23.1	43,766
Netherlands	19.8	36,124
Japan	10.4	19,116
Canada	9.1	16,678
West Germany	8.0	14,417
Switzerland	6.0	11,040
Netherlands Antilles	5.8	10,603
Other Countries	25.8	31,207

Source: U.S. Department of Commerce, Survey of Current Business, August 1986.

Table 3-5
Foreign Direct Investment In The United States, 1985
By Major Industries

Industries	Percentage %	Amount (millions)
Total		182,951
Mining	2.2	4,070
Petroleum	15.4	28,123
Manufacturing	33.2	60,798
Wholesale Trade	15.0	27,514
Retail Trade	3.7	6,698
Banking	6.3	11,503
Finance	2.6	4,708
Insurance	6.0	11,069
Real Estates	10.1	18,557
Other Industries	5.4	9,912

Source: U.S. Department of Commerce, Survey of Current Business, August 1986.

In 1985 investment in the manufacturing sector accounted for over $60 billion, or 33.2% of total foreign direct investment. The four major sector (chemicals, machinery, food, and primary and fabricated metals) accounted for $47.6 billion, or 26%, of that total. Foreign investment in the manufacturing sector expanded at an annual rate of 26.9% from 1977 to 1985.

Wholesale and retail trade accounted for $34.2 billion, or 18.7% of all FDI. From 1977 to 1985 the average annual nominal increase for this sector was over 40%, the second-fastest growth rate among all sectors. The petroleum sector experienced substantial growth in 1984, and from 1977 to 1985 its growth averaged about 38.5% per annum.[43]

e. Foreign direct investment by location

Foreign direct investment is highly concentrated. About 43% of all foreign firms are located in seven states. Foreign investors generally prefer states located on the east and west coasts and in the South. California, with 2,269 foreign affiliates, or 9.2% of the total, is the leading state in terms of foreign companies. California was followed by Texas, with 2,204 foreign affiliates, or 8.2% of the total. New York had 1,738, or 7%, Florida, 1,438, or 5.8%, Illinois, 1,083, or 4.3%, Georgia, 1,044, or 4.2%, and New Jersey, 905, or 3.7%. Foreign direct investment activities are expected to accelerate further in the southern states (see table 3-6).

In terms of gross book value of property, plant, and equipment of affiliates, Texas ranked first, with $37.9 billion, or 12.9% of the total. California was second, with $34.7 billion, or 11.8% of the total, followed by: New York, with $15.3 billion, or 5.2%; Louisiana with $12.9 billion, or 4.4%; Florida with $9.7 billion, or 3.3%; New Jersey with $9.3 billion, or 3.2%; and Illinois with $9.1 billion, or 3.1% (see table 3-6).

Table 3-6
Foreign Direct Investment In The United States, By Location

Region	Book Value (Millions)	Percentage Of Total Book Value	Number Of Affiliates	Percentage Of Total Affiliates
New England	7,778	2.6	1,539	6.2
Mideast	40,206	13.7	4,111	16.6
Great Lakes	29,923	10.2	2,866	11.6
Plains	12,098	4.1	1,773	7.2
Southeast	69,880	23.8	6,099	24.7
Southwest	48,294	16.5	3,085	12.5
Rocky Mountains	11,873	4.0	1,332	5.4
Far West	41,202	14.0	3,284	13.3
Others	32,307	11.0	647	2.6
Total	293,561		24,735	

Source: U.S. Department of Commerce, Bureau of Economic Analysis, Foreign Direct Investment In The United States, Preliminary 1985 Estimates.

f. The effect of FDI on the Taiwanese businessmen

Based on The 6th Annual Study of General Manufacturing Climate of the 48 Contiguous States of America and an analysis of the American investment environment conducted by the Taiwanese government, the following locations and industry are suitable for Taiwan's businessmen to invest in the United States (see table 3-7).[44]

Table 3-7
Suitable Locations And Industry For Taiwan's Investors

Area	State	Industry
New England	Massachusetts	Electrical and electronic equipment;
Mideast	New Jersey	Drugs, Chemicals and allied product, Food and kindred products, Transportation services;
	Maryland	Electrical equipment, Distribution services, Industrial components and equipment;
Southeast	Virginia	Computer equipment, Telecommunications services;
	North Carolina	Electrical and electronic equipment, Biotechnology;
	Georgia	Electrical and electronic equipment, Ferrous metals, Textiles, Rubber and plastic products;
	Florida	Laser industry;
Great Lakes	Indiana	Medical and dental instruments and supplies, Metalworking equipment;
South Central	Arkansas	Ferrous metals, Electrical power generating equipment, Telecommunications services;
	Texas	Rubber and plastic products, Textiles;
West	California	Electrical and electronic equipment, Biotechnology.

Source: The Report of American Investment Environment, Industrial Development and Investment Center (Taiwan), December 1986.

C. Impediments to Foreign Direct Investment in the U.S.

1. Legal Restrictions

Under federal law, aliens and foreign-owned corporations are prohibited form holding and operating such businesses as communications, defense contracting, air transport, coastal and fresh water shipping, fishing, atomic energy, hydroelectric power, and mining on government property. Also, regulations prohibit interstate branch banking, although statewide branch banking is permitted in some states. Moreover, strict federal antitrust laws limit bank mergers within a state.

Various states' laws place restrictions on foreign investment. Most states prohibit foreign control of insurance companies. Some states do not grant charters to foreign banks. The most common concern is the ownership of land, particularly agricultural land, and restrictions limit the size of foreign land holdings or the duration of ownership.

2. Administration Restrictions

Securities offered publicly in the United States must be registered with the U.S. Securities and Exchange Commission (SEC). They must conform with state security laws, known as "blue-sky" laws, unless the securities are listed on the New York or American Stock Exchange. Also, foreign companies doing business in and trading with the U.S. are subject to antitrust laws.[45]

3. The effect of restrictions on the Taiwanese investors

Foreign investment and its operations in the United States has become increasingly affected by litigation and complex laws. Taiwan's investors should be aware of and understand the requirements and prohibitions of related laws before investing in the U.S. Also, they can hire a consulting firm to help them solve the problem in order to smooth the process of investment.

D. The Trend of Foreign Direct Investment in the U.S.

1. The U.S. policy toward FDI

The United States lacks a coherent and well-oriented FDI policy because of a tradition of laissez-faire by which government planning or intervention in the working of free market processes is considered undesirable. However, the United States will continue to pursue policies designed to maximize the flow of international direct investment motivated by private market forces. But it will also continue its monitoring to ensure that investment transactions are consistent with national security and other interests.[46]

2. The attitude of foreign investors

Even faced with complicated legal and administrative barriers and a widespread outbreak of antiforeign sentiment like the "Fujitsu/Fairchild" merger and "Buy Hawaii," foreign investors will still increase their rates of U.S. investment as they get to know the U.S. market better. Moreover, if the U.S. continues to run huge trade deficits, countries such as

West Germany and Japan, which have huge trade surpluses, will send their export earnings back to the U.S. As for Taiwan's investors, they should undoubtedly send the money back to the U.S. in an effort to neutralize protectionism.

3. The future development of foreign direct investment

The United States has entered a period in which global competition for industries has intensified and will continue to intensify. The competition is between all nations, and the investment inflows mirror the changing nature of the international economy and the increased competitive ability of foreign-based multinational corporations. At the same time, they suggest that foreign firms believe that the U.S. economy is a good long-term investment. The combination of its large market and its political stability, buttressed by the fact that the U.S. is one of the world's superpowers, will continue to attract a flood of foreign investment to the United States.[47]

CHAPTER IV

WHY TAIWAN INVESTS IN THE UNITED STATES

A. Factors Encouraging Investment In The U.S.

1. Lessening the pressure of huge foreign exchange reserves and currency appreciation

Rapidly accumulating foreign exchange reserves have aroused intensified warning signals from protectionists and have exerted inflationary pressures on prices. Also, the revaluation of the New Taiwan Dollar has tended to make Taiwan's products less price competitive abroad. Encouraging investment in the U.S. may lessen this protectionist pressure from Washington.

2. Sustaining economic growth and upgrading industrial structure

Taiwan's economy is facing accelerated structural transformation from labor-intensive manufacturing industries into technology and capital intensive industries, and is heavily dependent on foreign technology to support its economic development. Taiwan also lacks a comprehensive and consistent science and technology development system. It is necessary for Taiwan to absorb and introduce new technology from the United States because the American manufacturing sector is experiencing an R&D-oriented metamorphosis brought on by competitive needs and the fact that U.S. companies are adopting strategies designed to renew or enlarge their technological leadership relative to the rest of the world.[48]

3. U.S. state and local incentives

State and local governments competitively provide different tax incentives and/or financial aid to lure foreign investors in order to create employment opportunities, to increase tax revenues, and to enhance economic prosperity.[49]

4. Financial reforms and tax incentives by Taiwan's government

After 38 years of restricting foreign investment, Taiwan's government lifted foreign exchange controls on July 15, 1987 and allowed individuals and companies to freely convert local currency into foreign currencies. These measures are, on the one hand, intended to encourage overseas investments and to reduce foreign exchange reserves. On the other hand, the government is trying to encourage the introduction of high-technology to upgrade the industrial infrastructure.[50]

In addition, on January 26, 1987, Taiwan's government promulgated an amendment to its Statute for Encouragement of Investment (SEI) that reflected the general trend toward liberalizing the country's economy through more flexible government policies on investment. Under the SEI, when a productive enterprise makes an investment abroad and satisfies certain conditions, it is entitled to either a five year tax holiday or accelerated depreciation, and a deferment of the start of the tax holiday for up to four years. This amendment encourages the public and private sectors to invest in American Venture Capital Enterprises. It also enables them to engage in high-tech investment thus accomplishing the primary object of enhancing the transfer of advanced technology to Taiwan.[51]

B. Problems Of Investing In The United States

The problems of investing in the United States can be divided into two types: those faced by Taiwanese investors and those confronting investors who have branches and/or subsidiaries in the United States.

1. Investors in Taiwan

a. Unstable exchange rates

Under pressure from the United States, the New Taiwan Dollar (NT$) has appreciated over 25% against the U.S. dollar since September 1985. Although the appreciation of currency may reduce investment costs and encourage Taiwanese investors to bring money into the United States, an unstable exchange rate makes investors delay doing so to wait for the next wave of appreciation or a more stable currency.[52]

b. Statutory restrictions

According to Regulations Governing the Screening and Handling of Outward Investment and Outward Technical Corporation Projects, outward investment made by domestic companies face the following restrictions:

(1) Paid-in capital at the time of application: more than NT$20 million (US$.5 million); and

(2) Current debt ratio (debt/capital) at the time of

application: less than 300%.[53]

Most companies in Taiwan are small; fewer than 80 industrial corporations have annual revenues of more than US$60 million. Most are highly leveraged. On the average, manufacturing enterprises have more than twice as much debt as equity.[54] Therefore, many investors in Taiwan have trouble complying with statutory financial criteria. Additionally, Taiwan's corporate law stipulates that a company may not reinvest more than 40% of its paid-in capital. This restriction also prevents investors from engaging in large-scale investment.[55]

c. Discrepancies of cultural backgrounds and marketing systems and strategies

Cultural background has an immense influence on human beings, and people with different cultural backgrounds form different corporate cultures. Corporate managerial and operating philosophies vary with corporate culture and thus influence corporate operating performance.[56]

There are four differences between Taiwanese and American marketing systems and strategies. First, most of Taiwan's industrialists follow a motto of "experience rules" while conducting marketing research, relying on the experience of others. American industrialists are most subject to "expert rules", hiring consultants to conduct research. Second, Taiwan's market segments are less specialized than the American's because of a smaller consumer market. Third, referring to product strategy, most Taiwanese industrialists adopt an individual brand, or combine a family brand with an individual brand in consumer goods. The majority of American products only use a family brand. For example, the Nike brand appears on running shoes, clothing, etc., Coca Cola brand on soft drinks and clothing. Also, Taiwan's entrepreneurs usually don't pay much attention to the packaging of either industrial products or consumer products as compared to American entrepreneurs. Finally, Taiwan's companies favor a mark-down strategy designed to rapidly increase sales volume, whereas American companies like to create one or two high-price "star" products, or use a mark-up pricing strategy to upgrade the value of products in consumers' minds and then promote them. They also concentrate on long-term effects of promotion compared to short-term effects concentrated on by Taiwanese companies.[57] Therefore, discrepancies in cultural backgrounds and marketing systems and strategies between Taiwan and the United States constitute another obstacle to Taiwanese investors in the U.S.

2. Investors in the United States

Taiwanese investors, who have established a foothold in the United States, have faced the following difficulties:

a. Taiwanese conception about management is considerably different from American ideas. Whereas the U.S. uses a consultative style of management, placing a high degree of trust in the workers, the Taiwanese management style is paternalistic and autocratic, with managers having very little trust or confidence in their workers. Without copious managerial experience, entrepreneurs usually need a period of time to adjust to new management;

b. Companies are unaccustomed to dealing with unions and to marketing in the United States;

c. The proportion of American labor costs, medical, and insurance expenses to total costs is considerably higher than such expenses in Taiwan; and

d. Expatriates sometimes have trouble getting visas from the United States' authorities to stay in the country.[58]

C. The Future Prospects For Investment In The United States

Taiwan will lose its Generalized System of Preference (GSP) privileges, effective on January 2, 1989. But this may help push Taiwan to complete its industrial transformation earlier.

The GSP program was established in 1976 to provide temporary tariff incentives to help developing countries enter the United States market and diversify their treatment of some 3000 products from 141 countries. The program was extended until 1993 after it expired in 1984. Taiwan was one of the three leading beneficiaries of GSP privileges in 1986. Taiwan's GSP exports for 1986 amounted to $3.76 billion, or about 20% of its total exports to the United States that year. Over 1000 Taiwan exports are covered by GSP. The withdrawal of GSP privileges will cost domestic exporters about $75 million in annual tariffs. On the average, the GSP provides a 5% tariff reduction on the products covered.[59]

Indeed, the effect of the graduation from duty free GSP benefits could be to accelerate the pace of product diversification and the upgrading of Taiwan's exports to higher value added goods. Larger manufacturers in Taiwan who reap profits from their export operations should be able to absorb the extra cost. However, the majority of family-styled or small and medium sized manufacturers must look for an overseas manufacturing base where labor costs are lower than in Taiwan and in countries that remain eligible for GSP privileges, or they must improve their overall productivity.[60]

2. The presence of Maquiladoras and its effect on Taiwan's businessmen

Begun in 1965 by the Mexican government to alleviate the severe unemployment along the Mexico-Texas border, the Maquiladora program is described as an alternative to the Far East for firms seeking low cost labor to assemble and package products "in bond." A manufacturer can ship parts and components into Mexico for final assembly without paying Mexican duties on raw materials, parts, or machinery, thus avoiding the "red tape" normally involved in such imports and exports.[61]

Following the 1982 Mexican economic crisis, the four governors of the United States border states (California, Texas, Arizona, and New Mexico) petitioned the U.S. government for federal assistance to alleviate the unprecedented regional recession resulting from the economic repercussions from across the border. Also, in order to help American firms reduce their costs and become more competitive with intensified multinational competitors, the U.S. government encouraged maquilas "in bond" plants by limiting import duties to the extent of the value added to a product assembled in Mexico.[62]

Maquiladoras, also called "in bond" plants, are factories to which materials are imported, but still held in bond by customs. When contract work is completed, the materials are then shipped back out of the country in their new state. These plants process imported materials and components into exportable products that are destined primarily for U.S. markets. Bilateral treaties permit the imported materials and components to enter Mexico duty-free because the reworked or finished product will not be sold in the Mexican market. Likewise, reciprocal U.S. tariff provisions (Custom codes 806 and 807) levy custom duties only on the value added in Mexico, primarily the cost of labor.

In recent years, the maquiladora industry has attracted foreign investment from labor intensive manufacturing industries because Mexican wage rates are among the lowest in the world, even lower than in Far Eastern countries (see table 4-1). At the end of 1986, there were 1,035 such maquiladora plants in Mexico which employed about 300,000 people. Maquiladoras generated $1.6 billion in 1986 value-added earnings up from $1.30 billion in 1985. U.S. multinationals contributed 85% of 1986 value added earnings, as well as 80% of the manufacturing industry's employment. Currently, Mexico's value-added exports are weighted heavily toward electronics (46%) and automotive products (25%). But future industry percentage are expected to be fueled by increasing foreign investment from Japan, the United Kingdom, Finland, Spain, Holland, Belgium, and France.[63]

Table 4-1
Maquiladora Hourly Wages Versus Average Manufacturing Hourly Wages In Other Countries

Unit (US$)

	1986	1985	1984	1983	1982	1981
Mexico/Maquiladora						
5 days week	1.07	1.45	1.24	1.17	2.69	2.18
6 days week	0.88	1.20	1.03	0.96	2.22	1.90
United States		13.09	12.59	12.04	11.52	10.79
Brazil		1.27	1.23	1.46	2.16	1.90
Hong Kong		1.78	1.60	1.52	1.67	1.55
Japan		6.64	6.35	6.13	5.70	6.18
South Korea		1.38	1.36	1.30	1.25	1.17
Taiwan		1.68	1.70	1.46	1.40	1.35
Singapore			2.43	2.19	1.94	1.79
United Kingdom		6.06	5.85	6.26	6.76	7.13
France		7.69	7.42	7.92	8.01	8.15
West Germany		9.75	9.55	10.33	10.38	10.53
Spain		4.87	4.68	4.64	5.35	5.60
Italy		7.67	7.46	7.73	7.36	7.39

Source: Multinational Monitor, February 1987.

A report from the Taiwanese government's Construction Investment Commission said one half of the new investment in the U.S. was in construction projects, 32% was in electronic products, 15% in chemical and plastic products, and the rest in the service sector.[64] Taiwan's electronics industry already accounts for 50% of the island's GNP. It is now extending its operations to major overseas markets, especially the United States, in an effort to keep pace with rapid technological developments, and to capture a larger market share.[65]

In addition to the inexpensive labor, the Maquiladora program has one enormous advantage over similar operation in the Far East -- proximity to U.S. markets. Proximity for electronic companies means easy access from the United States to Mexican plant cites, reduced travel time and greatly reduced transportation costs. In other words, Mexico's proximity to the United States permits relatively quick and inexpensive shipments within the United States, as well as close supervision by company officials who might be U.S. based.[66] Therefore, by investing in the Mexican border, Taiwan's investors cannot only take advantage of the lower labor costs and proximity to U.S. markets, but can also alleviate the harm to Taiwan's exporters from the loss of GSP privileges. Mexico joined the General Agreement of Tariffs and Trade (GATT) in 1986 and has a new bilateral trade agreement with the U.S. Therefore, Taiwanese firms in Mexico would enjoy the same GSP privileges Mexican firms receive. There is a lot of potential for Taiwan's investors at the Mexican border.

3. The background of the Caribbean Basin Initiative and its effect on Taiwan's businessmen

Problems of the Caribbean Basin region and its political and social instability can be attributed to the deteriorating economic conditions. The United States government began in the spring of 1981 to develop an economic program that would provide the necessary short term economic relief to those countries and, most importantly, ensure long term economic development in the region. On February 24, 1982, President Reagan announced the Administration's plan for an innovative, multifaceted program to support the long term economic development of the Caribbean Basin. Then, on August 15, 1983, President Reagan signed into law the most important part of his Caribbean Basin Initiative (CBI), the Caribbean Basin Economy Recovery Act (CBERA). Finally, the CBI was implemented in January 1984 and will be in effect for 12 years until September 30, 1995.[67] The CBI has extended economic benefits to approximately two dozen countries in the Caribbean, in Central America, and in northern South America, which have been plagued in the past decade by serious inflation, high unemployment, and balance-of-payments deficits. Because of the special relationship between the United States and the Virgin Islands and Puerto Rico, the CBI includes measures that ensure the healthy economic development of these countries.

The Caribbean Basin Initiative is an integrated program of trade, aid, and investment measures. The measures are designed to stimulate new productive capacity and open new markets for trade by combining foreign and indigenous private sector investment with the impressive human and natural resource endowments of the Caribbean Basin.[68]

The centerpiece of the CBI is the innovative one way free trade arrangement that grants duty-free access to the United States markets for 12 years for all exports from the Caribbean Basin countries (except textiles and apparel, canned tuna, petroleum and petroleum products, footwear, and certain leather products). The eligible products must meet certain rule-of-origin requirements (35% local content) to ensure that the economic benefits accrue to the Caribbean Basin countries.[69]

Implemented in January 1984 and slated to end September 30, 1995, the CBI is not performing as well as first expected. The CBI countries' exports to the United States dropped by some $2.8 billion (from $9.49 to $6.71) in real terms between 1984 and 1986. However, if oil items are removed (which do not enter duty-free under CBI but account for almost $3 billion of the loss of export dollars to the Caribbean due to sharply declining world oil prices), the CBI shows a little success in the first three years of the 12 years U.S. trade promotion program. The economic development envisioned under the CBI will require some patience over the long haul.

The CBI not only provides duty-free access to the United States market, but also provides a lower transportation cost as compared to costs from Far East ports. Additionally, the program can take advantage of twin plants, similar to the Maquiladoras, and management control, especially for U.S. based firms.[70]

Initially, the most interesting impact was a shift of electronic assembly operations from the Far East, where wages are rising, to relatively low wage Caribbean nations. Item 807 of the Tariff Schedule of the United States (TSUS) permits reduced duty treatment for the value of components manufactured in the U.S. and abroad. TSUS item 807A, which was announced by President Reagan in 1986, went beyond reducing duty treatment to provide higher access levels to the U.S. market for Caribbean-produced clothing made from cloth formed and cut in the United States. Most recently, based on the benefits provided by items 807 and 807A, private investors and manufacturers from the United States, Asia, and the Caribbean have aggressively engaged in the manufacturing and exporting of apparel from Caribbean Basin nations.[71] Furthermore, H.R.3101, a House of Representatives bill introduced in 1987, but not yet passed, is designed to improve the operation of the CBI. If passed, it will extend the CBI until September 30, 2007, eliminate duties and quotas on U.S. imports from Caribbean, remove duties on imports from the Caribbean, and so on.[72] Therefore, the CBI will draw more and more investors from different countries and accelerate the economic development among the Caribbean Basin nations.

For Taiwan's investors, investing in the Caribbean Basin countries may have the following advantages:

(1) Duty-free access to the U.S. market;

(2) Low labor cost in Caribbean Basin countries;

(3) Proximity to the U.S. ports and reduced transportation cost;

(4) Access to the U.S. market through the TSUS 807 program;

(5) Circumventing quota restrictions;

(6) Lessening the harm from the loss of GSP privilege.

In summary, the Caribbean Basin countries are equipped with a potentially attractive overseas location for Taiwan's investors, and such investment is strongly encouraged by Taiwan's government.

CHAPTER V

SUMMARY AND CONCLUSIONS

Following World War II, Taiwan's government successfully introduced a series of economic development strategies to restructure and develop its island economy. During the past four decades, Taiwan has undergone a coherent and well-structured economic transformation. Initially an agricultural-based economy, it has industrialized in several phases. The first phase of industrialization was import-substitution. The second was export-driven, labor-intensive industrialization. And now in its current phase, Taiwan has an economy based on capital-intensive production. At the same time, Taiwan has enjoyed flourishing and rapid economic growth as one of the "Four Asian Tigers". However, the continuous trade imbalance and increasing foreign exchange reserves exert inflationary pressure on prices and jeopardize the island's economic growth. The presence of these reserves also causes concerns that the U.S. may take protectionist measures.

In order to relieve the pressure from continuously accumulating trade surpluses and from Washington's protectionists, to cope with the threat from both developed and other developing countries' competition, to upgrade the industrial structure, and to sustain stable economic growth, Taiwan's government has adopted three basic policies: economic liberalization, internationalization, and systematization. However, the 19 million people in Taiwan are not likely to absorb the entire American market in the near future. Also, Taiwan lacks a comprehensive and consistent science and technology development system and is highly dependent on foreign firms for new technology. It is imperative that Taiwan's government relax its foreign exchange controls and encourage Taiwanese businessmen to invest overseas, because direct foreign investment has become an increasingly important means of transferring capital, technology, and production capacities across national boundaries. Like Germany and Japan, Taiwan has huge trade surpluses with the U.S. and should send some of its export earnings back to the United States in order to keep the accounting book between the countries in balance.

There are four main motivating forces for foreign investors to invest in the United States: large consumer markets, political stability, the recent drop in the value of the dollar, and the open investment opportunities. Nevertheless, for Taiwan's investors, securing the required raw material to support its exports and absorbing and introducing high technology to speed up industry upgrading are especially important. Although investing in the United States may undoubtedly benefit Taiwan's investors, there are some difficulties. For example, the Taiwanese are unfamiliar with U.S. unions, environmental laws, and the marketing and managerial systems and strategies used in the U.S.

Additionally, a lack of effective investment channels, conservative banking practices, underdeveloped capital markets, unstable exchange rates and statutory restrictions all undermine the willingness of investors to enter the U.S. market.

In the future, global competition will take place within the United States, as more and more foreign firms invest here. The incessant influx of investment into the U.S. mirrors the ability of more and more foreign-based MNCs to compete in the world market. The flood of foreign investment is also drawn by the United States' suitable and profitable investment environment.

For the present, in order to increase the willingness of Taiwanese firms to invest overseas and improve its economic performance, Taiwan's government must address the following issues:

1. How to provide effective investment channels for investors to undertake external investment;

2. How to improve capital markets in assisting investors' efforts to raise money for overseas investment;

3. How to assist large trading firms to establish global trade information networks, to avoid missing out on business opportunities;

4. How to assist investors in the cultivation and recruiting of skilled personnel to improve overseas operations;

5. How to encourage investors to take advantage of the

Maquiladora program and the Caribbean Basin Initiative to lessen the impacts from the loss of GSP privileges and growing protectionism; and

6. How to assist investors in thoroughly understanding the overseas investment climate in order to reduce the obstacles they will be facing.

In summary, Taiwan's government should hasten overseas investment, particularly in the United States. Taiwan's businessmen should understand that there are complex laws regulating investment in the U.S. and interpretation of these laws changes in the process of litigation. Indeed, how to effectively utilize huge foreign exchange reserves to upgrade the industrial structure and sustain stable economic growth is the big challenge facing Taiwan's government.

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