



Directorate of
Intelligence

~~Confidential~~

25X1

Taiwan-United States: Addressing the Trade Imbalance

25X1

An Intelligence Assessment

~~Confidential~~

EA 85-10059
April 1985

Copy 288

Page Denied



**Directorate of
Intelligence**

Confidential

25X1

Taiwan–United States: Addressing the Trade Imbalance

25X1

An Intelligence Assessment

This paper was prepared by [redacted]
Office of East Asian Analysis. Comments and queries
are welcome and may be addressed to the Chief,
China Division, OEA, [redacted]

25X1

25X1

Confidential
EA 85-10059
April 1985

Confidential

25X1

**Taiwan-United States:
Addressing the
Trade Imbalance**

25X1

Key Judgments

*Information available
as of 15 February 1985
was used in this report.*

Taiwan has had a trade surplus with the United States for 16 years and, barring uncharacteristically effective measures by Taipei, the situation will continue:

- The United States is Taiwan's largest market and absorbs nearly half of Taiwan's total exports.
- Taipei's limited efforts to diversify to other markets have been hampered by world recession and diplomatic isolation.
- Attempts to increase imports from the United States also have been ineffective, in part because sluggish investment has reduced the need for capital goods.
- In addition, US firms have not been competitive with firms from Japan, Taiwan's largest supplier, and from other Asian and European countries.

Taiwan's restrictions on imports and foreign investment also stifle growth in US exports. Tariffs and fees can nearly quadruple the cost of imports, and administrative restrictions hinder efficient product distribution. Moreover, Taiwan's current imports are already high relative to the size of its economy.

Taiwan's economic plans for the 1980s call for export-led growth, development of high-technology industries, and liberalization of trade. Potentially, many of the planned programs could offer opportunities for US and other foreign firms to sell plants, equipment, and technologies or to invest in Taiwan production facilities. However, Taiwan officials have promised several of these projects to US firms, only to later open the bidding to all competitors, alleging that US costs are too high.

We believe that proposed trade liberalization will move slowly. Similar efforts in 1973, 1979, and 1982 had no lasting effect, and Taipei is concerned that rapid change will undermine its very successful economy. For example, customs duties and commodity taxes account for more than one-third of total tax revenues, and elimination of even part of those revenue sources would cause budget problems. Furthermore, authorities are worried that measures to reduce the trade imbalance with the United States will benefit other trading partners as well and, for example, add to Taiwan's own deficit problems with Japan. It is possible that Taipei is holding out for Washington to approve its requests to buy advanced US weapon systems and Alaskan oil, an unrealistic goal because arms sales are constrained by US agreements with China, and Alaskan oil exports are prohibited by law.

Confidential

EA 85-10059
April 1985

Confidential

25X1

We believe the combined effects of several measures could alleviate the trade imbalance:

- Liberalization of Taiwan's import policies—however slow and contentious—will permit US exports to Taiwan to increase.
- Diversification of Taiwan's export markets will take some of the pressure off Taiwan to rely on US markets.
- Vigorous marketing by US firms and greater competitiveness may win large-scale construction and equipment contracts.
- Unlinking the New Taiwan dollar from the US dollar and letting the US dollar fluctuate freely against the Taiwan currency will make US exporters more price competitive with Asian and European suppliers.
- Threatening US restrictions against Taiwan goods will spur greater cooperation. Taipei has shown sensitivity toward US measures that may hurt its exports, such as the loss this year of duty-free status on some products.

25X1

Confidential

Confidential

25X1

Contents

	<i>Page</i>
Key Judgments	iii
Scope of the Problem	1
Exports	1
GSP	2
Imports	2
The Strength of the Dollar	2
Bilateral Investment	3
Factors Underlying the Trade Imbalance	3
Taiwan's Policies for the 1980s	4
The 10-Year Economic Development Plan	5
Moderate Growth Targets	5
Self-Sufficiency in Major Grain Crops	6
Improved Forestry Practices	6
Energy Conservation and Diversification	6
Industrial Structure Modification	6
Manpower Development	6
Trade and Finance Liberalization	7
General Ad Hoc Decisions	7
Taiwan's Measures Aimed at the Taiwan-US Trade Imbalance	8
Buy-American Missions	9
Big Ticket Projects	9
Arms and Oil	9
Obstacles to Change	9
Prospects	10

Confidential

25X1

Taiwan-United States: Addressing the Trade Imbalance

25X1

Scope of the Problem

Taiwan has maintained a chronic trade surplus with the United States since 1968. The surpluses have caused officials in Taipei both embarrassment and concern that the United States may take corrective measures that could cripple the island's economy. But this concern is offset by official relief that surpluses in trade with the United States more than offset deficits in trade with Japan, leaving Taiwan with a positive balance (see table 1). By the end of 1984, Taiwan's annual surplus with the United States reached a record \$9 billion according to US trade statistics—the third-largest deficit for the United States behind Japan (\$33 billion) and Canada (\$19 billion).

Exports

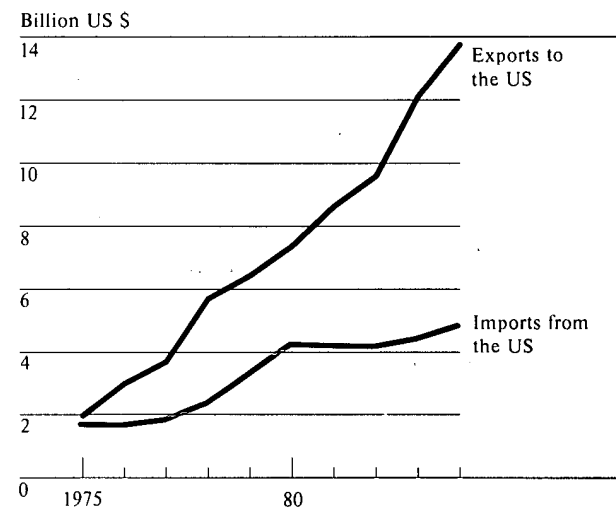
Taiwan's exports to the United States have long been dominated by textiles, apparel, footwear, and, more recently, consumer electronics.¹ US trade barriers, particularly against textiles and apparel, have forced Taiwan to diversify its product mix to maintain a rapid rate of growth in exports. As a result, Taiwan is now among this country's leading suppliers of toys, plywood, furniture, yachts, luggage and handbags, bicycles, hand tools, and industrial fasteners.

The United States is Taiwan's largest export market, accounting for more than 45 percent of sales in 1984. Furthermore, our analysis shows that Taiwan has become increasingly dependent on the US market, especially since 1975. We believe Taiwan focuses on the United States because:

- Long-term diplomatic ties—terminated in 1979—set an early precedent for reliance on the United States for export markets that is sustained by a continuing, close commercial relationship.
- The US economic recovery provided expanding markets while other potential buyers were still suffering from the world recession.

¹ These four categories accounted for 49 percent of Taiwan's exports to the United States in 1975. By 1984 the share had dropped to 40 percent.

Taiwan: Trade With the United States, 1975-84



25X1

305050 3-85

25X1

- Diplomatic isolation hinders export diversification. Many countries with buying potential eschew Taiwan's goods, partly because they have no diplomatic relations with Taiwan that would facilitate trade and partly because they fear that trade ties with Taiwan might jeopardize profitable relations with China.

25X1

- Debt-ridden countries in Central and South America restrict imports for financial reasons and therefore cannot expand acquisitions from Taiwan. The high value of the New Taiwan (NT) dollar² also makes Taiwan goods relatively more expensive than goods from many other Asian nations.

25X1

² The NT dollar is pegged to the US dollar, and currently is worth about \$0.025. Unless noted, all dollar figures in this paper are US dollars.

25X1

25X1

Confidential

Confidential

Table 1
Taiwan Trade, 1975-84^a

Million US \$

	Total Trade			Trade With the United States			Trade With Japan		
	Imports	Exports	Balance	Imports	Exports	Balance	Imports	Exports	Balance
1975	5,952	5,309	-643	1,660	1,946	286	1,823	812	-1,011
1976	7,599	8,166	567	1,635	2,999	1,364	2,279	1,190	-1,089
1977	8,511	9,361	850	1,798	3,686	1,888	2,552	1,289	-1,263
1978	11,027	12,687	1,660	2,333	5,694	3,361	3,584	1,750	-1,833
1979	14,773	16,103	1,330	3,272	6,427	3,155	4,365	2,476	-1,889
1980	19,733	19,811	77	4,217	7,362	3,146	5,141	2,293	-2,848
1981	21,200	22,611	1,412	4,178	8,631	4,453	5,400	2,523	-2,878
1982	18,888	22,204	3,316	4,152	9,587	5,435	4,252	2,443	-1,809
1983	20,287	25,123	4,836	4,401	12,109	7,709	5,081	2,622	-2,458
1984	21,960	30,460	8,490	4,823	13,760	8,937	5,965 ^b	3,205 ^b	-2,760 ^b

^a Because of rounding, components may not add to totals shown.

^b Estimated.

GSP. Taiwan's exports to the United States benefit tremendously from the Generalized System of Preferences (GSP), which reduces or removes US import duties on certain products. Of all Taiwan exports to the United States in 1983, nearly one-fourth (about \$3 billion) were duty free under GSP rules. This year, about 150 Taiwan products with an annual export value of nearly \$1 billion lost at least part of their duty-free status because of the large share they represented of US imports in 1984. Although Taiwan lobbied vigorously to defeat it, US trade legislation in 1984 set new GSP criteria that will eliminate or restrict the duty-free status of additional Taiwan products beginning in 1987. A proposal to bar Taiwan and other primary beneficiaries (South Korea and Hong Kong) from GSP eligibility entirely failed, but Taiwan is nonetheless painfully aware that failure to manage the trade balance may bring further punitive actions by the United States: [redacted]

Imports

Taiwan's imports in the 1980s have diversified in terms of both product mix and suppliers. Increased self-sufficiency and alternative suppliers have cut into US sales of the industrial supplies and machinery that dominated US exports to Taiwan in the 1960s and

1970s. Taiwan is rebuffing US suppliers now because firms in other countries are more competitive in terms of price, financing, and other factors. [redacted]

The Strength of the Dollar. The strength of the US dollar is frequently blamed for slower growth in imports from US firms. However, the US share of total imports has remained fairly constant (about 22 percent) since 1975, which would not be the case if the dollar's strength were the primary factor. Moreover, calculations of the exchange rate elasticity of imports indicate no clear relationship between the NT dollar-US dollar exchange rate and Taiwan's imports from the United States. A sharp drop in the rate of increase in imports in 1981-83 affected all suppliers, not just the United States, and primarily reflects the world recession and a lack of investment in Taiwan. However, if the US dollar were free to fluctuate against the NT dollar as do other currencies, the NT dollar might strengthen, making US goods less expensive relative to those from other suppliers. [redacted]

25X1

25X1

25X1

25X1

Confidential

Japan, Taiwan's largest supplier, has provided the strongest competition for US firms and leads in sales of most machinery and equipment categories. Our analysis of trade data shows that in those categories in which US exports are preeminent, such as turbine generators, Japanese efforts to export more high-quality manufactured goods clearly have eroded the US share of the Taiwan market. [redacted]

Other Pacific Basin countries are also increasingly active in Taiwan, resulting in a shrinking role for US exports. For example, in 1975, the United States accounted for 67 percent of Taiwan's imports of integrated circuits; five Asian exporters (Hong Kong, Singapore, the Philippines, Malaysia, and South Korea) together accounted for only 7.5 percent and Japan for 16 percent. By 1983, the US share was cut by half, Japan led with 37 percent, and the five other Asian nations held more than 23 percent of the sales. Similarly, Brazil, Spain, Sweden, and Singapore have become increasingly important as suppliers of computer equipment and peripherals, though the United States still dominates those products. US suppliers have held their market share in agricultural goods such as corn, wheat, and oilseeds. [redacted]

Bilateral Investment

The United States accounts for about 30 percent of all investment approvals³ for the period of 1952-83. Hundreds of US firms have sales representatives, branch offices, and subsidiaries in Taiwan. In fact, some Taiwan officials assert that many of the firms that manufacture export goods in Taiwan are owned by US-based multinational corporations. The United States benefits, Taipei points out, because US citizens are employed in the plants (especially as high-salaried managers) and profits are remitted to the US home offices. These officials neglect to point out that Taiwan businessmen similarly have invested in production facilities in the United States (see table 2) and are receiving from those investments some of the same benefits that Taiwan authorities imply accrue only to US multinationals. According to an early 1985 press report, 78 percent of Taiwan's \$39.3 million in investments abroad in 1984 was in the United States. [redacted]

³ Approvals are investment proposals that have been reviewed and approved by the host country government. Generally, investors follow through on only about one-third of approvals. [redacted]

Factors Underlying the Trade Imbalance

Taiwan has, by design, enjoyed export-led growth for nearly 30 years. In the mid-1950s, the government recognized that agriculture alone could not support sustained expansion of the economy and undertook financial and trade reforms to encourage the development of export and import-substitution industries. Many of these policies persist, including low-interest loans for export industries, preferential tariff treatment of imports used to manufacture export goods, foreign exchange controls, and high tariffs on imports that compete with Taiwan-made goods. In 1965, Taiwan established the first of three Export Processing Zones, where export industries are provided cheap, government-built infrastructure and financial and trade benefits. By the 1970s, Taiwan had successfully established a dual trade structure, exporting labor-intensive manufactures to developed countries and more capital-intensive intermediate goods to less developed countries. [redacted]

Taiwan continues to be highly competitive in export markets. Low labor costs have contributed greatly to the price competitiveness of Taiwan goods.⁴ In addition, the Central Bank has closely monitored the money supply to control inflation. Because Taiwan imports from 80 to 90 percent of its energy requirements, lower energy prices also have contributed to low inflation; in addition, wholesale prices in general have increased more slowly—2 percent annually in 1981-83 after average yearly increases of more than 8.6 percent in 1976-80—removing some inflationary pressure. The practice of manufacturing and selling cheap counterfeit products that undercut sales by legitimate manufacturers, both domestic and foreign, also helps boost exports. [redacted]

Taiwan's import picture has been less buoyant. Capital equipment imports, generally a major category, slipped somewhat in the 1980s because of a lack of

⁴ A 1984 labor law set minimum wages at \$154 monthly. Average monthly wages for mining and manufacturing workers in Taiwan were about \$344 in 1983, compared to \$299 in South Korea. [redacted]

25X1

25X1

25X1

25X1

25X1

25X1

25X1

Confidential

Table 2
Selected Taiwan Investments in the United States

Taiwan Firm	Product	Comments
Formosa Plastics Group	Polyvinyl chloride	New plant in Texas
Formosa Plastics Group	Polyvinyl chloride	Purchased plant in Delaware from Stauffer
Formosa Plastics Group	Plastic pipe	Purchased plant from Johns Manville
Ching Fong Investment	Computer components	Purchased plant from Exxon
Asian Polymer Corp.	Low-density polyethylene	Purchased plant from Occidental
Tatung Co.	Electric fans, TVs	New subsidiary in Los Angeles
Taiwan Power	Uranium exploration	Joint venture with Rocky Mtn. Energy Corp. & Mono Co.

25X1

investment. High tariffs curb imports and shelter Taiwan manufacturers from foreign competition. Some items are subject to tariffs that could double their price; an additional "commodity tax" on 31 specific items can bring the total tax to as high as 287 percent of the good's value. The highest tariffs are on consumer goods, products US manufacturers want to sell in Taiwan. []

economy is export driven, GNP growth will, in turn, depend on an expansion of exports—an expansion that would widen the trade gap even further, because the United States is Taiwan's major export market. []

25X1

Taiwan also has formidable nontariff barriers restricting many imports. For example, one law sets a minimum volume for wine imports that discourages sample shipments designed to test marketability. US exporters complain that a lack of bonded warehouses also precludes safe storage of unsold products, necessitating small shipments in response to individual orders, which entails both delays and extra shipping costs. On occasion, Taiwan has also restricted imports from firms that trade with China; in September 1983, trade authorities even urged importers to spurn goods from Washington state, apparently in retaliation for its ties with China. []

Attempts to expand total imports have been disappointing. Imports last year, in fact, did not meet Taipei's publicly announced expectations; however, we suspect that authorities privately had more conservative import goals, but issued optimistic targets to sidestep US demands for action to narrow the trade surplus. Authorities have again set a high target for 1985—about 16 percent above 1984 levels—which we believe will not be attainable. []

25X1

25X1

Taiwan's Policies for the 1980s

Furthermore, Taiwan's economy may simply be unable to absorb additional large-scale imports. The island's import ratio (total imports as a share of GNP) is very high, exceeding 50 percent in 1983.⁵ This suggests a paradox for bilateral trade: the rate of increase in imports from the United States will fall short of Taiwan's GNP growth rate; because the

Two general approaches that the economic leadership is taking during this decade will affect the trade imbalance. The 10-year plan, issued in March 1980 to cover the 1980-89 period, includes several programs that are intended to change the structure of the economy and the nature of trade. On a less grand scale, ad hoc decisions detail the administrative practices to be used to implement the plan's more general goals. []

25X1

25X1

⁵ The average import ratio for 12 other island economies in the most recent years for which data are available is 33.1 percent. []

25X1

Confidential

Confidential

Counterfeiting—An International Scandal

Trade in counterfeit products—those that violate international patent, copyright, or trademark protection agreements—have bolstered Taiwan's exports while undermining the favorable reputation of Taiwan's business environment. [redacted]

According to a 1984 study by the US International Trade Commission, counterfeit products cost US firms \$6-8 billion in lost sales worldwide in 1982, and Taiwan was the most egregious offender. [redacted]

Many countries now scrutinize imports of certain Taiwan products for violations—notably popular and high-fashion apparel, auto parts, recordings, and electronics hardware and software. Saudi Arabia has prohibited imports of Taiwan-made auto parts because of the hazard posed by their inferior quality. [redacted]

Taiwan authorities are making very slow progress eliminating commercial counterfeiting; new laws and study commissions have had little effect because of lax enforcement. Pressure from foreign governments and from domestic firms that fear repercussions against their legitimate products is beginning to push Taipei into prosecution of offenders. According to Taiwan press reports, the Board of Foreign Trade (BOFT) and police departments investigated more than 850 counterfeiting cases in 1984, up from 612 in 1983; BOFT plans to expand its enforcement staff this year. [redacted]

The 10-Year Economic Development Plan

Nearly the entire development plan for the 1980s affects trade, either directly or indirectly. Concerns about continued economic growth, increased self-sufficiency in certain products, energy availability, technological enhancements in industry, and manpower development run through the entire document. Some of the basic assumptions of the plan have been overtaken by events, but the general direction and most of the specific targets are still valid. [redacted]

Moderate Growth Targets. The plan calls for overall real economic growth in this decade of 7.9 percent annually. Expansion of foreign trade is to remain the primary means of economic growth and stability.

The Economic Decision Making Process

The American Institute in Taiwan has characterized the economic decision making process in Taiwan as simple on paper but, in practice, an arduous and complex consensus process that usually results in watered-down decisions. Dominated by President Chiang Ching-kuo and Premier Yu Kuo-hua, the process is "top down" and very conservative. The Ministers of Economic Affairs (Hsu Li-teh), Finance (Lu Jen-k'ang), and Communications (Lien Chan), the Governor of the Central Bank (C. C. Chang) and the Chairman of the Council for Economic Planning and Development (Chao Yao-tung) participate in the implementation of general guidelines issued by Chiang and Yu. Under the pervasive influence of the Kuomintang and business interests, these civil servants oversee day-to-day economic management. Much of their activity is reactive—attempts to maintain the status quo in the face of either domestic or foreign pressures—rather than innovative. [redacted]

Under Yu Kuo-hua's guiding hand, Taiwan could slow the minor advancements made to date in liberalization. Yu, initially as the Minister of Finance and later as the governor of the Central Bank, took a leading role in the introduction of many of the restrictive policies now under attack. It remains to be seen if his broader responsibilities as Premier give him a more liberal viewpoint. Hsu Li-teh, on the other hand, as Minister of Finance, was in favor of greater liberalization and apparently continues to advocate that view as Minister of Economic Affairs. Chao Yao-tung also has favored liberalization and, together with Hsu, may continue to create friction that could impede economic decision making. [redacted]

Exports of goods and services in real terms are to grow 12.4 percent yearly and imports 12.5 percent. Except for imports, actual accomplishments in 1981-84 have been impressive: in real terms, both GNP and exports have increased about 10 percent yearly, but imports only 4.4 percent. [redacted]

Confidential

Confidential

Taiwan's Central Bank also has successfully controlled inflation despite huge foreign exchange holdings (more than \$15 billion at yearend 1984). The 10-year plan calls for maximum annual price increases of 6 percent, but wholesale prices through 1984 rose only 1.4 percent yearly. Consumer prices jumped 5.2 percent yearly, still well within the plan guidelines. But Central Bank governor Chang disclosed in February that the bank was forced to buy large amounts of US dollars in January to ease pressure on the NT dollar (also thereby maintaining a stable exchange rate), so inflation may become more worrisome. [redacted]

Self-Sufficiency in Major Grain Crops. Taipei wants farmers to switch from government-subsidized rice, which is in surplus, to other small grains. Progress has been slow, however; corn output has increased rapidly since 1980, but wheat and millet production has dropped considerably. Moreover, reliance on imports has actually increased in the 1980s, with imports as a share of grain supplies rising from 65 percent in 1980 to 71 percent in 1983. We believe Taiwan will not be able to achieve self-sufficiency; increased domestic production may reduce import requirements for some small grains, but not by an amount sufficient to affect US exports seriously. [redacted]

Improved Forestry Practices. Taiwan plans to cut less timber to improve soil conservation, which may increase the need for timber imports. The United States is Taiwan's third-largest supplier of timber and could supply more. Strong competition, especially for hardwoods, will continue to come from Malaysia and the Philippines, the two largest suppliers, as well as from other Southeast Asian nations. [redacted]

Energy Conservation and Diversification. The plan was written at a time of increasing concern about energy pricing and availability, so conservation and diversification are prominent goals. Although energy concerns of the 1970s have diminished, energy efficiency has improved, with energy use per dollar of GNP dropping 7.7 percent yearly since 1980. [redacted]

To reduce dependence on Middle Eastern oil, Taiwan is trying to diversify its energy suppliers. In January, authorities approved a joint effort with a US firm to explore for oil and natural gas in Indonesia; Taipei also is negotiating to buy Indonesian liquefied natural gas and is building new port facilities to handle it.

Taiwan has increased the volume of coal imports 17 percent each year since 1980 while slightly reducing oil purchases. Imports of US-origin coal have soared nearly 50 percent a year since 1980.⁶ Additional nuclear power plants (Taiwan Power Corporation's plants 7 and 8)—for which US firms are competing—have been under discussion for years and may be contracted in 1985. Plans to improve energy efficiency in transportation by building mass transit systems promise further opportunities for US firms. [redacted]

Industrial Structure Modification. Taipei plans to direct the economy away from labor- and energy-intensive industries, with emphasis on high technology. Structural modifications have several implications, including increased investment, enhanced energy efficiency, and new demands for manpower development. Purchases of capital goods for new industry may boost imports of US manufactures and technologies; however, Japan will maintain the competitive edge. Taiwan plans to move labor-intensive industries out of the export-processing zones and replace them with firms that manufacture goods such as precision instruments and computer products, thereby enhancing the export competitiveness of Taiwan-made high-technology products. We expect the affected firms to resist any such moves because they stand to lose many of the conditions that contribute to their profitability. [redacted]

Manpower Development. A declining population growth rate has left Taiwan with shortages of both unskilled labor (for such traditional industries as textiles) and highly skilled labor (for the planned high-technology industries). One result has been nearly 15-percent annual increases in average nonagricultural wages, driving up production costs and weakening the price competitiveness of Taiwan's exports. Already having one of the more highly educated labor forces in the Pacific Basin—Taiwan requires nine years of formal schooling—Taipei plans more extended academic and technical training in support of the move to

⁶ Still, the United States accounts for only about one-fourth of Taiwan's coal purchases. Australia is Taiwan's leading supplier; South Africa and Canada also sell sizable volumes of coal to Taiwan. All three sell coal at prices 5 to 20 percent lower than US coal prices. [redacted]

25X1

25X1

25X1

25X1

25X1

25X1

25X1

Confidential

6

Investment: Not Meeting Expectations

Investment has been sluggish despite Taipei's efforts to encourage industrial expansion and modernization. Many industrialists cite the uncertainty they feel because of the plan to focus on high technology. Traditionally involved in more basic sectors, conservative investors are hesitant to commit funds to operations for which Taiwan may have neither adequate skilled manpower nor sufficient research and development capacity to be competitive. Moreover, they see US expansion leveling off in 1985, which would reduce demands for Taiwan products of any sort and dictate against capital investment now. Through the third quarter of 1984, idle capital in Taiwan increased to 12.1 percent of GNP from only 1.2 percent in 1980. [redacted]

In 1984, the government acknowledged the continuing need for basic industries such as textiles and apparel, but encouraged them to move up scale and to modernize equipment to be more competitive in international markets. US recovery in 1984 induced some investment to expand Taiwan industries that export to US markets. Approvals of foreign investments have increased as well, but Taiwan applies widely varying restrictions on foreign investors on a case-by-case basis and the lack of clear-cut regulations is discouraging to investors; since 1976, direct foreign investment from all sources totaled \$761 million, about 31 percent of all approvals. [redacted]

Moreover, Taipei is encouraging Taiwan businessmen to invest abroad, especially if foreign investment helps develop new markets for Taiwan products. Authorities stress ties with the Caribbean Basin in particular. Taiwan hopes to take advantage of the Caribbean Basin Initiative to expand business by investing in Caribbean firms that will increase exports to the United States. [redacted]

more technology-intensive industry. Minister of Education Li Huan is promoting academic and vocational training in Taiwan to stem intellectual flight and is trying to bring back to Taiwan those young professionals who have chosen to remain abroad after training, mostly in the United States. [redacted]

Trade and Finance Liberalization. The plan also addresses taxation, trade restrictions, and foreign exchange controls, with an eye toward loosening constraints on imports and investment. While calling for "stimulating the growth of trade by promoting more effective fiscal and monetary measures," it spells out few details on how this would be done. The plan calls for reducing average customs duties from 39 percent to 20 percent by 1990, and for merging commodity and stamp taxes. [redacted]

25X1

It also lays out plans for a value-added tax (VAT). Nominally a 5-percent tax, the compounding effect as items work through the production-wholesale-retail chain would increase the effective rate substantially. The potential for negative impact on imports is high. The VAT will be applied not to the declared value of an imported good, but to the c.i.f. value of the import (thus taxing the transportation and insurance costs)⁷ plus import valuation uplift,⁸ customs duties, harbor fees, and any applicable commodity taxes. Hence, importers would be paying the VAT on top of the existing taxes. For example, an import costing \$100 c.i.f. with a 10-percent valuation uplift, a 40-percent tariff, the 2-percent harbor fee, and no commodity tax now costs \$156; under the VAT, it will cost \$163.80, for an additional 7.8 percent of the item's original value. If valuation uplift is eliminated, the delivered cost would be \$142 without the VAT and \$149.10 with the VAT, for an extra 7.1 percent of the original value. Supporters of the measure say that authorities will reduce tariff levels to offset the VAT, but there is no guarantee that would be done. Authorities expected the VAT to be implemented in 1984, but it met considerable legislative and business resistance and they now hope to introduce it this year. [redacted]

25X1

25X1

General Ad Hoc Decisions

25X1

The various decisionmaking entities on Taiwan also issue aperiodic regulations and decisions affecting trade and investment policy. These decisions may be

25X1

⁷ Taiwan already assesses customs duties on the c.i.f. value of imports, a practice which the United States and other trading countries have objected to without result. [redacted]

25X1

⁸ Taiwan assumes that exporters understate the value of goods they ship, so the Taiwan customs authorities automatically add a percentage to the stated value. [redacted]

25X1

25X1

Confidential

in response to investment proposals, domestic business influences, trade problems, requests from foreign governments, or other outside pressures. Because they are in response to specific situations, they are not always consistent and often provide mixed signals. Consequently, they cannot be interpreted as general policy and in many ways can confuse the regulatory arena even further.

Highlights of recent ad hoc decisions include:

- *Reduction of valuation uplift.* The uplift has dropped to 10 percent from 15 percent and is eventually to be eliminated entirely.
- *Reduction of import duties.* Since September 1983, Taiwan has cut import duties on several hundred items. In August 1984, tariffs were reduced on 59 items that represented nearly 4 percent of 1983 imports from the United States. In September, the Ministry of Finance announced plans to trim maximum tariffs on about 1,000 items to 65 percent; these items account for only about 5 percent of Taiwan's total imports. Tariffs on several textile and apparel categories were reduced in October (see table 3 for sample tariffs).
- *Relaxation of import restrictions.* At least 11,000 items are subject to import restrictions other than tariffs. Most imports require a permit, which is generally freely granted; but, in early 1985, Taiwan announced that about 5,500 items—mostly textiles and apparel—would no longer require import permits. Taiwan also has loosened import bans and relaxed rules that disallowed entry of certain products from specific countries.
- *Reduction of the harbor tax.* The tax paid by vessels using Taiwan maritime facilities was cut from 4 to 2 percent.
- *Changing domestic-content requirements.* The 10-year plan called for increased local content requirements for certain "important" industrial products. On the other hand, the 1984 automotive industry development plan indicated that lower domestic-content requirements would be initiated to encourage greater foreign participation. In late 1983, authorities ordered that 40 percent of all whole-plant purchases by state enterprises be domestically

produced, but that too may be only loosely applied. Apparently, the actual requirement will vary by industry and, very likely, by the amount of pressure foreign investors apply on Taipei for lower domestic-content levels. On a similar note, some potential investors have found that requirements vary by industry on the degree to which investments show Taiwan ownership; a recent ruling, for example, requires 50 percent Taiwan ownership of leasing firms. Yet AT&T will be permitted to hold 70 percent of a joint venture to produce electronic devices.

25X1

- *Changing export performance requirements.* Taiwan requires that many partly or wholly foreign-owned firms export a share of their production. The share increases as needed to reserve domestic markets for Taiwan firms. Toyota late last year canceled plans to build automobiles in Taiwan partly on the basis of export requirements. A US firm negotiated for months before reaching a market-sharing arrangement without explicit export requirements. Though the change is minor, it demonstrates the possibility of greater flexibility on export performance.

25X1

Taiwan's Measures Aimed at the Taiwan-US Trade Imbalance

In December 1983, President Chiang issued guidelines for the economy that included a call for reduction of the trade imbalance. An ad hoc ministerial-level committee and a lower level task force were formed to formulate specific proposals to offer relief. Most of the suggestions made public have been simply iterations of the ad hoc decisions listed above, but with US goods receiving preferential treatment. If Taipei takes such narrow actions, protests and perhaps retaliation will probably follow from Taiwan's other trade partners. Broader proposals that date back to the late 1970s have, for the most part, been palliatives, and are either unrealistic or have only a marginal effect.

25X1

Confidential

Confidential

Table 3
Sample Tariff Levels
on Taiwan's Imports

Percent of c.i.f. value

	Tariff
Wool carpet	40 (reduced from 100)
Synthetic carpet	40 (reduced from 75)
Bedsheets, tablecloths	40 (reduced from 50)
Selected paper products	40 (reduced from 50)
Chocolate	50 (reduced from 75)
Household metal products	35 (reduced from 40)
Electric irons, juice squeezers	40 (reduced from 45)
Golf clubs	35 (reduced from 40)
Tobacco products, accessories	75 (reduced from 100)
Silk products	75 (maximum)
Finished leather	31
Apples	75

Buy-American Missions. Taiwan has sent nine formal buying missions to the United States since 1978, with purchases totaling more than \$7 billion. A 10th mission is scheduled for April this year and plans about \$200 million in purchases. These missions are primarily publicity for Taiwan's effort to address the trade imbalance and buy goods that Taiwan would probably have purchased in any case, predominantly agricultural products and coal. On the ninth mission (fall 1984), for example, \$510 million of the total \$572 million in purchases went for agricultural products that probably would have been imported through normal channels. [redacted]

Big Ticket Projects. Leading government authorities also have promised that US firms would have exclusive bidding rights on many major capital projects included in the 10-year economic development plan (see table 4). For example, Chiang Ching-kuo in early 1984 announced that US firms would be "key suppliers" for such major construction projects as nuclear power plants 7 and 8, Taipei's subway system, and three planned hospitals. However, several of the promised projects have been opened to bids by firms from other countries. The responsible officials claim that US costs exceed those of other suppliers by too much to ignore. Nonetheless, Taipei has hurt its credibility by not complying with its own stated business commitments. [redacted]

Table 4
Selected Projects in 10-Year Plan
of Interest to US Firms

Billion US \$

	Value
Total	40.32
Thermal power plants (17 projects)	10.03
Nuclear power plants (8 projects)	8.04
Telephone networks (expansion)	6.19
China Steel Corporation (expansion)	5.02
Highway construction	2.96
Agricultural mechanization (equipment procurement)	1.93
Hydroelectric power plants (8 projects)	1.83
Taipei and Kaohsiung rapid transit systems	1.50
Civil aircraft (procurement)	1.25
Harbor coal-handling capacities (expansion)	1.00
Rolling stock for island railroad (procurement)	0.57

Arms and Oil. Trade and other government officials have offered to reduce the surplus by increasing imports of US weapon systems and Alaskan oil. These options are obviously unrealistic because arms sales are constrained by US agreements with China and Alaskan oil exports are prohibited by law. Alaskan natural gas can be exported, but Taipei has shown little interest, preferring to tap Indonesian and other, closer supplies. We believe Taiwan expects that US concern about the trade imbalance will finally be enough to force Washington to approve Taipei's requests. [redacted]

Obstacles to Change

It is difficult to be optimistic about the potential impact of the current liberalization campaign. Similar efforts—mostly tariff adjustments in 1973, 1979, and 1982—had no lasting effect. Yu Kuo-hua himself said in late 1984, "Taiwan has been relaxing trade controls and revising tariffs for years but without the desired effect . . . perhaps the range is not broad enough."

Confidential

Confidential

Attempts now to change a wider spectrum of regulations may suggest a more sincere effort; however, we believe that the restrictions will be relatively easy to reimpose if the government is pressured by domestic business or revenue requirements to balance the budget. Indirect taxes now account for three-fourths of total tax revenues, with customs duties and the commodity taxes alone providing more than one-third. Taipei estimates that just the reduction of valuation uplift by 5 percent would reduce revenues by NT \$3 billion, nearly 1 percent of total tax revenues. [redacted]

Trade authorities have expressed cautious interest in a "free trade zone pact" with the United States that would allow a strictly bilateral reduction of trade barriers. However, they have considered and scrapped plans for a free trade zone four times in the past three years, and now intend to defer judgment of such arrangements until they have "carefully studied the impact of a US-Israel pact"; but that pact was proposed in 1981 and is still not operational, suggesting that a comparable Taiwan-US arrangement lies only in the distant future. [redacted]

25X1

25X1

Taiwan's economic leadership is understandably concerned that rapid change will undermine its very successful economy. It is, however, moving so slowly that the adjustments have had little impact on the trade imbalance. For example, the commodities for which import duties have been cut are largely items not exported to Taiwan by the United States—or any other major trade partner, for that matter. The political influence of domestic producers is too great for the authorities to be able to initiate measures that may enhance the competitiveness of foreign goods on domestic markets. Yet, the government orchestrates such massive press attention to accompany the introduction of these measures that US observers are left with the impression that massive progress is under way in trade liberalization and that considerable sacrifice was required to gain the support of Taiwan industry. [redacted]

Prospects

There are several actions that can alleviate the trade imbalance problem with Taiwan. Individually, none can eliminate the imbalance, but, collectively, they could make significant progress toward better management of bilateral trade:

- Liberalization of Taiwan's import policies.
- Marked diversification of Taiwan's export markets.
- Vigorous marketing efforts in Taiwan by US firms.
- Unpegging the NT dollar from the US dollar.
- US imposition of trade restrictions directed against Taiwan goods. [redacted]

25X1

We believe that Taiwan will continue to liberalize import restrictions only slowly because of the pressures of vested interests on the island and chronic difficulty in reaching agreement on policies. For the next few years, expansion of imports because of liberalization will be slow as Taipei gradually reduces the array of restricted products. Nevertheless, we expect trade liberalization to help reduce the trade imbalance in the long run. [redacted]

25X1

Taiwan's security services are a powerful obstacle to further opening of the domestic economy. Intent upon excluding potential threats to the political stability of the island—particularly from the mainland—the security services restrict the flows of people and data that are necessary for modern international business. Taiwan has been unable to participate fully in international banking practices, for example, in part because the security services will not permit the necessary telex and information-sharing processes. [redacted]

25X1

Taiwan officials also recognize that measures they take to liberalize trade and investment would benefit all partners, not just the United States. Former Minister of Economic Affairs Chao explained in 1983 that one reason for the slow course is that Japan might benefit most from liberalization because of its existing competitive advantages, which would simply add to Taipei's own trade deficit woes with Tokyo.

25X1

Confidential

Confidential

improve the island's export record, but would not affect shipments of textiles, electronics, or other products to the United States. The potential benefit to Taipei might be that Taiwan would no longer be as dependent on the United States for export revenues and thus would be more willing to accept reductions of exports of certain products to the United States. As with trade liberalization, however, we believe this is a long-term benefit, with no near-term effect.

25X1

If the Taiwan authorities were to eliminate the link between the NT dollar and the US dollar, the NT dollar could appreciate against the US dollar and US exporters would benefit.

25X1

Despite Taipei's protestations that it is acting as quickly as feasible to liberalize trade, little has happened. Consequently, we believe the most persuasive measure the United States has to encourage liberalization of Taiwan's trade structure is the threat of restricting Taiwan's exports to US markets. Indeed, some officials are extremely alarmed at that possibility. In December 1984 and again this past February, Yu Kuo-hua reassured traders that Taiwan intends to work toward free trade; we suspect that the increasing frequency of such statements reflects rising anxiety created in Taipei following the passage of the US Trade and Tariff Act of 1984 and the threat to eliminate Taiwan's GSP eligibility. This suggests that a clear understanding that additional restrictive measures are in the offing may spur Taiwan into more effective action. In the absence of such an understanding, we believe the United States will see only slow progress in resolving the trade deficit problem.

25X1

Confidential

Confidential

Confidential