Deep-pocketed Taiwan spreads the wealth

A cashed-up Taiwan will remain a major supplier of capital to the ASEAN region for many years, according to DANNY CHAN, of Alpha Asset Management.

Taiwan’s economic achievement over the past four decades has been acclaimed as one of the modern economic success stories. During that period, Taiwan managed to achieve consistently high economic growth rates. Thanks to the relentless export drive by local manufacturers, Taiwan’s exports grew exponentially in the 1970s and 1980s. In 1971 Taiwan recorded its first trade surplus and in 1987 its annual trade surplus soared to a peak of US$18.7 billion. As a result of the rapid growth in trade surpluses Taiwan has accumulated a huge amount of foreign-exchange reserves and it has emerged as a major supplier of capital since the mid-1980s.

At the end of September 1997, Taiwan had the third-largest foreign-exchange reserves in the world, behind Japan and China, and was estimated to have about US$28 billion invested in the ASEAN region. There is a considerable discrepancy between the official and unofficial figures for outward investment because many of the investment projects have not been registered or have been done through a third country.

From the mid-1980s, Taiwan’s economy went through a rapid structural change and local manufacturers were forced to reallocate their low-tech, high-labour-content products to low-cost ASEAN countries in order to remain competitive. The current objectives of the government’s outward investment policies are securing supply of raw materials and natural resources, acquisition of needed technology, establishment of sales channels and industrial sites, reduction of production costs and strengthening of economic and trade relations with friendly nations.

Because of strict controls on capital movements prior to 1987, the bulk of the foreign-exchange reserves accumulated before then were deposited by the Taiwan Central bank in banks overseas or invested in securities issued by foreign governments. However, following a significant relaxation of foreign exchange controls in 1987, long-term capital outflows in the form of foreign direct investment by the private sector increased markedly.

INVESTMENT BY REGION
A labour shortage, rising land prices and an appreciating currency have since 1988 made investment abroad an increasingly attractive alternative to domestic expansion. As a result, a growing proportion of the huge volume of savings accumulated by the private sector has been moving into direct investment overseas.

Although the official outward investment figure grossly understates the actual amount of investment, it nevertheless gives an idea of where Taiwan invests its capital surplus. The official figure (excluding mainland China) shows that America and Asia are the two most popular regions for Taiwan investment. Between them they have captured 94% of the total approved outward investment.

America accounts for more than 50%
of Taiwan's outward investment. This is due to the fact that the US was the number-one trading partner for Taiwan until 10 years ago. The long business association and close personal relationships between Taiwan and America have certainly made the US a desirable place to invest in. A number of small and medium Taiwanese businesses have also chosen to invest in Caribbean and Latin-American countries to take advantage of the free entry into the US market.

Asia (excluding mainland China) is the second most popular destination for Taiwan's outward investment. Given their proximity and low cost structures, it is not surprising that the ASEAN countries have attracted a significant percentage of Taiwan's investment in recent years. Over the past 10 years Taiwan has been ranked as the second-largest investor in the ASEAN region.

INVESTMENT BY COUNTRY
Taiwan's investment in the ASEAN countries is fairly well spread, with the exception of Japan and Korea, where there are restrictive foreign-investment policies and limited investment opportunities.

Malaysia is the main investment destination for Taiwan in the region, capturing 27.5% of Taiwan's investment in the ASEAN region through taxation and other investment incentives.

Hong Kong is the second most popular country for Taiwanese investors. However, it is common knowledge that a significant proportion of the investment made by Taiwan in Hong Kong is, in fact, headed directly into mainland China. This is a method by which Taiwanese investors can bypass the government's ban on direct investment in mainland China.

With cheap labour and low-cost industrial sites, Thailand attracted 14.6% of Taiwanese investment in the ASEAN region. Taiwan investment in Vietnam began only in 1991, but rose rapidly from 1993 as a result of a concerted effort by the Taiwanese government to push investment in that country. Vietnam is now ranked fourth in Taiwan's investment in ASEAN countries.

It is common knowledge that a significant proportion of the investment made by Taiwan in Hong Kong is, in fact, headed into mainland China, bypassing the Taiwanese government's ban on direct investment.

INVESTMENT BY INDUSTRY
Investment by industry in the ASEAN region is dominated by four industries:
- chemical, rubber and plastic products;
- electronics and electrical;
- wholesale, retail and trade; and
- banking and insurance.

These four industries account for almost 70% of the outward investment in Asia.

Banking and insurance is the leading industry, accounting for nearly one-third of the total outward investment in the ASEAN region. However, it should be noted that investment holding companies are officially classified in the banking and insurance industry. These investment holding companies are the vehicles for manufacturing investments in other ASEAN countries.

It is not surprising that the electronics and electrical industry is the second most popular for outward investment, given that Taiwan is the world's third-largest producer of electronics and information-related products. Rising labour costs in Taiwan have forced many local electronic and electrical firms to move their production offshore.

INVESTMENT IN CHINA
Many Taiwanese manufacturers needing cost-effective labour and cheaper production sources have chosen to invest heavily in mainland China since the late-1980s. At the same time, preferential treatments offered to Taiwanese manufacturers by mainland China have created a very attractive investment environment.

Until 1991, there were no official records of Taiwan's investment in mainland China due to a ban on direct investment in China. In July 1997, the Taiwan government issued an amnesty, allowing local companies to register their illegal mainland China investment projects without penalty. As at the end of September 1997, the total amount of registered direct investment projects in mainland China was $US3.7 billion. However, the true figure is estimated to be as much as eight times more. Currently, Taiwan is the second-largest investor in mainland China, behind Hong Kong.

For economic, geographical, ethnic, historical, cultural and language reasons, mainland China has become a desirable destination for Taiwan investments. Many Taiwanese firms have invested in mainland China through their branches or affiliates in third countries, such as Hong Kong and Singapore, which, technically, do not have to be registered. It is estimated that 70% of Hong Kong investment in mainland China is from Taiwan.

Given that Taiwan is expected to continue to generate trade surpluses, foreign exchange reserves will continue to grow. With current reserves in excess of $US80 billion and estimated foreign assets held by the private sector in the region of $US70 billion, it seems that Taiwan will continue to be a major supplier of capital for the ASEAN region for many years.