

Attracting Investors from Taiwan

by

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1. Global FDI

After reaching an all-time peak in 2000, global FDI flows plunged by nearly 40% in 2001 and dropped still further in the next two years. It was the longest and deepest downturn on record. 2004 marked the start of a recovery, now in its third year, during which global FDI flows have grown by over 20% annually. According to EIU report, global FDI inflows are set to continue to grow by about 20% in 2006.

After three years of dramatic contraction followed by three years of rapid recovery, global flows of foreign direct investment (FDI) will grow relatively slowly but steadily for the rest of this decade. As a result, by 2010 global FDI will return, in nominal US dollar terms, to its 2000 peak of US\$1.4trn—mainly because of activity in the developed world, rather than the emerging markets which led the recovery in 2004-05 from the deep FDI slump in 2001-03.

2. Emerging markets lead the recovery

In both 2004 and 2005, emerging markets accounted for the bulk of the increase in FDI inflows. After recovering by 57% in US dollar terms in 2004, FDI inflows into emerging markets grew by 26% in 2005 to reach a record high of almost US\$400bn (more than 40% of the global total). FDI inflows increased to all emerging-market regions, and reached record levels in every single region except Latin America and the Caribbean. Recent FDI trends have been underpinned by rising corporate profits and improved balance sheets, as well as buoyant economic growth. Higher prices for many commodities also stimulated FDI in countries that are rich in natural resources.

China was far and away the main FDI recipient among emerging markets. With a record inflow of US\$79bn, China accounted for one-fifth of all inflows into emerging markets in 2005 (a large part of the increase in China was accounted for by financial sector investments worth some US\$12bn).

..,but are likely to fall away

The pattern of 2004-05, when emerging markets drove the recovery, will be reversed this year—inflows into emerging markets are expected to increase by only about 3% in US dollar terms, whereas inflows into the developed world are projected to rise by some 36%. In part this is because of the delay in the recovery in intra-developed country flows, whereas the bounce back in flows to the emerging markets occurred about two years earlier.

Contrary to the experience of the past two years and to widespread expectations about the concentration of new FDI in the emerging world, almost the entire increase in global FDI in 2006-10 from 2005 is expected to take place in the developed countries, in large part because of pattern of cross-border mergers and acquisitions (M&A).

The value of completed cross-border deals worldwide surged to US\$435bn in the first half of 2006, a 48% increase over the same period in 2005. The increase was heavily concentrated in the developed world, with a much more modest increase for deals in emerging markets.

Although FDI flows to the emerging markets are expected to remain buoyant, averaging more than US\$400bn per year in 2006-10, there will be only modest further growth in inflows from the record highs achieved in 2004-05.

Emerging markets prospects will be adversely affected by a slowdown in growth after 2007. The fact that privatisation revenue will tail off in many leading emerging markets will dampen inflows, as will increased risk perceptions about some emerging markets among many investors. In a few countries populism and nationalism are on the rise, culminating in some cases in the repudiation of existing contracts with foreign firms. Protectionism, structural weaknesses and financial and corporate vulnerabilities in emerging countries in some regions could hinder FDI. External imbalances and the possibility of sharp exchange-rate fluctuations, as well as volatile commodity prices, pose risks that could also hamper investment activity.

3. Global FDI in 2006-10

Forecast global FDI inflows in 2006 of some US\$1.16tn, which represent a

22% increase over 2005. After 2006, global FDI flows will continue to rise, but the rate of growth is expected to slow. Between 2006 and 2010 global FDI inflows are projected to grow at an annual average rate of 8%. Growth in global FDI flows will exceed the rate of growth in world output. EU-US investment flows will grow strongly over the forecast period, particularly from Europe to the US. Economic growth, further deregulation, supportive public policy and a continued trend among MNCs to internationalise a greater range of functions, such as R&D, will underpin this trend. FDI inflows into the US are set to rise particularly strongly in 2006-10, and the US is forecast to be far and away the main FDI recipient in the world (with some 23% of the global inflows). Investors will continue to be drawn to its wealth of market opportunities and its investor-friendly entrepreneurial culture, trading environment and infrastructure.

4. Outward Investments

The advent of globalisation served as a catalyst for Taiwanese businesses' internationalisation and outward investments. According to the Investment Commission, Ministry of Economic Affairs, Taiwan, by September 2006, some USD 100 billion of direct investments have been invested by Taiwanese businesses abroad. More importantly, the real figure is even higher than this estimate since many of the Taiwanese business investments were made by their overseas' subsidiary companies, and are not recorded in Taiwan. For the choice of investments, the Taiwanese businesses seem to prefer to keep their investments in Asia, concentrating in China, followed by the Americas and Europe.

In 2005, Taiwanese businesses have invested some USD 8.45 billions in Asia along (79.6%), of which some USD 6 billions of investments went to China (67.2%). Investments made to the Americas and Europe were USD 1.6 billions and USD 0.3 billion respectively. This indicates that there is a clear geographical preference when it comes to making investment decisions for Taiwanese businesses. The high Asian concentration can be more than geographical, but also industry characteristics, overseas market spread as well as a global investment pattern. This also indicates that Taiwanese business is not doing enough to develop its American and European market as well as the recent 'China Factor' phenomenon.

The internationalisation of the manufacturing sector has also opened up opportunities for its supporting service sector, enhancing the sector's international competitiveness. Taiwanese investments abroad include both the manufacturing and service sector. Major items for outward investment in the past five years include: electronics and electric product manufacturing, finance and insurance, services industry, chemical production as well as wholesale and retails.

In 2005, some 57.1% of Taiwanese investment overseas was in financial industry, followed by electronics and electric product manufacturing (15.5%), services, wholesales and retail and chemical production, making up 5.9%, 3.6% and 1.5% respectively. Investments made to China focused on the manufacturing sector whereas investments made outside of China concentrate on the service sector.

According to the statistics of the Investment Commission of the Ministry of Economic Affairs, the amount of Outward Investment approved from January to August 2006 to all regions but Mainland China was US\$2.4 billion, an increase of 40.98% compared with the same period of the previous year. The amount of Investment to Mainland China from January to August 2006 was US\$4.6 billion, an increase of 27.82% compared with the same period of the previous year.

5. Taiwanese Investments to China

1) Cross-strait trade relation

Despite their political differences, trade and investments between Taiwan and China have been on the increase. Under globalisation, China has been actively engaging in entering the international community. The dynamics of East Asia has shift drastically since Deng's opening up policy for China in 1978. The economic reform and opening up policy has made China a centre for both foreign direct investments and global manufacturing centre. The growth momentum in China was so strong that during the 1997 Asian Financial Crisis, China was the only major economy in the region that managed to maintain a high national growth rate. China's cost advantage and its abundance

domestic market has made itself the centre of investments not just for Asia, but worldwide.

The economic incentives to invest in China combined with its historical links with Taiwan, in terms of language and culture, has made trade and investment relations between China and Taiwan closer than any other country. As the Taiwanese Government opens up its trade and investment policy to China, China soon became the largest trading partner as well as investment destination for Taiwanese businesses.

2) Taiwanese Investments to China

Among Taiwanese investments to China, some 90.5% were made in the manufacturing sector (figure 1). Since investments to China concentrate on electric and electronic products, it is hardly surprising that as electronic industry takes off in China in recent years competes head-on with the Taiwanese exports.

According to the official statistics in Taiwan, Taiwan has invested some USD 47.23 billions. But according to China's official statistics, Taiwanese businesses have invested just over USD 42 billions (actual). The agreed contract investment figure however, was more than double the amount, at USD 90.49 billions.

3) Overseas Manufacturing Model for Taiwan

Early Taiwanese investments to China have reaped the benefits of China's labour cost advantage. This has added benefits of increase productivity and increased base of manufacturing. The early investors were mostly small and medium enterprises investing in the labour intensive industries. Input components were typically exports from Taiwan. This model has changed in recent years however. According to Ministry of Economic Affairs' "2005 survey of the manufacturing sector investments abroad", the model of production has shift to placing order in Taiwan and filling the manufacturing needs in China. Some 40% of the orders in Taiwan were filled in China. This indicates that the Taiwanese investment model to China include not only capital and equipment requirements, but also China's competitive labour force

to produce for the world.

6. Reasons Behind Taiwanese Manufacturing Sector Investing Abroad

According to the “2005 survey of the manufacturing sector investments abroad”, Taiwanese businesses’ choice of investments has seen a decline from the 5 ASEAN countries (Singapore, Malaysia, Thailand, Indonesia and the Philippines) to other places. In terms of the industry choice, electric and electronics made up 41.3% of the total investments, metal and plastic products made up 10.4% and 8.5% respectively. For the most investment in term of both industry and places, China tops the chart with electronics and electric products (40.4%) where as investors to the US has the same preference, with electronics and electric products made up 55% of the investments. Investors to Vietnam tend to focus on clothing and metal products.

63% of the investors took the plunge to invest abroad mainly due to the local market potential; 55% were taking the advantage of cheaper local labour cost and 28.6% of the investments were following their Taiwanese clients. Another key reason for behind investing abroad was the deteriorating Taiwanese business environment.

The biggest challenge facing Taiwanese businesses investing abroad is the fierce market competition (58.1%), followed by difficulties in capitalisation (26.3%) and increasing in local labour costs (25.8%). Markets where fierce market competition was a concern include: Japan, Western Europe, Hong Kong, the US and China. 78% of the investors to Indonesia find local political instability as most critical and 38% of the investor to Vietnam find language gap as the biggest barrier.

Some 64% of the businesses surveyed think that it is important for the Taiwanese Government to offer some support for businesses investing abroad including investment agreements and clauses to avoid double taxation. 51% want to see the Taiwanese Government offer the investors’ financial package and insurance and 24.2% want the family education and healthcare be dealt with. The survey showed investors to Indonesia need government’s help in capitalisation and insurance; investors to Hong Kong and Vietnam see insurance and double taxation as the most immediate issue. Investor to

Hong Kong, China and Thailand also see family healthcare and education as the prime concern for their investment decision.

7. Compare with China and India in attracting FDI

China scores higher than India on many of the key ingredients of growth: it is more open to trade and foreign investment, has a better record of macroeconomic stability and has put more effort into education and infrastructure. It is perhaps 10-15 years ahead of India in its economic reforms.

China and India have invested heavily in education in recent years, allowing them to start competing in more skill-intensive markets. Every year, 1.2m engineers and scientists graduate from Chinese and Indian universities.

China's growth is not based simply on cheap labor: wages are lower in India and Vietnam. It also has the advantages of good infrastructure, an educated workforce, a high rate of saving available to finance investment and, most important of all, an extremely open economy.

China's GDP is more than twice the size of India's, and its share of the growth in global GDP since 2000 has been three times larger. More importantly, it is much more integrated into the world economy. India's population is almost as big as China's (the two together account for 38% of the world total), however, in the long run India might pull ahead because its population will continue to grow long after China's has leveled off.

But the main difference is that China's exports of goods and services are about six times bigger than India's, and growing faster. China's economy is much more open: by 2005 its average tariff on manufactured products will be 9%, compared with 30% for India. Foreign direct investment in China is 13 times bigger than that in India. India is far less integrated into the global supply chain.

Over the past 20 years, China's real GDP growth has averaged 9.5% a year, compared with India's 5.7%, and it is likely to outpace India's for at least another decade. It is true that India has better-developed institutions than China, with less corruption, an established rule of law and protection of

property, but it lags badly in education and infrastructure, which along with openness to trade are key ingredients for rapid growth. Its adult illiteracy rate is 39%, compared with 9% in China. Another impediment to rapid growth is India's saving rate of 24%, only half China's rate and too low to finance the required investment in industry and infrastructure.

However, India has been able to exploit its great comparative advantage in an era of broadband communications and globalisation: its wealth of technically adept, English-speaking talent. According to EIU report, further reforms are needed.

First is more liberalisation, continuing to opening India's markets even wider to competition and reducing the role of the state in the economy. Second is the improvement of India's woeful infrastructure, the biggest bottleneck in the race for growth. Third is a change in India's labor laws, which act as a serious obstacle to labor-intensive manufacturing. Fourth is education, which is not only failing to prepare the rural poor for work off the land, but is also no longer equipping enough talented young graduates with the skills that have fuelled the services boom.

In short, China and India both offer immense opportunities, as long as they continue on their path of reform, there is an excellent chance that their rapid expansion can be sustained for several more decades.