

**Taiwan, Mainland China, and the United States:
Another Golden Triangle in Global Supply Chain**

**Presented to
Committee of 100
11th Annual Conference**

**May 2-4, 2002
San Jose, California**

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Background

On 1 January 2002, Taiwan became a member of the World Trade Organization ("WTO"), thus marking a happy ending to a decade's effort in WTO accession.

All the laws and regulations needed to implement Taiwan's concessions on accession have been put into effect. Now what the government must face is the ever more challenging task of boosting Taiwan's economic growth within the framework of the WTO regime, in the wake of the global and local economic downturns, bearing in mind that in 2001, Taiwan encountered its very first recession, with a GDP growth rate at an unprecedented minus 1.91% and the unemployment rate at a record high of 4.57%.

Government Policy in Response to WTO Membership

In response, the Taiwan government has recently announced its policy as follows:

Active Participation in the International Arena

Taiwan will actively participate in a new round of multilateral trade negotiations and the international rule-making process to expand Taiwan's networking with other WTO

members. Furthermore, while past trade disputes with Taiwan's major trading partners have been resolved through bilateral trade negotiations, mostly under the threat of unilateral sanctions and retaliations, the government will now resort to the WTO dispute resolution mechanism for fair and equitable settlement of future trade disputes.

Providing Adequate Relief Against Trade Impacts

The government will, within the WTO framework, adopt adequate measures to mitigate the impacts of increased imports on domestic industries. According to governmental evaluation and certain studies by private think tanks, the industries hardest hit by Taiwan's WTO concessions are the agricultural industry, the automobile industry, the wine and tobacco industry, and the consumer electrical appliances industry.

Measures that are to be adopted include safeguards, anti-dumping investigation, and countervailing measures against foreign subsidies as available under the WTO framework.

Enhancing Competitiveness of Domestic Industries

In addition to defensive trade relief measures, the government will assist domestic industries in their restructuring and upgrading so as to maintain their niche and competitiveness.

Taiwan has traditionally focused on manufacturing activities and gained worldwide recognition for its competitive advantage in efficient production. However, with the increasing competition from a number of developing countries led by Mainland China, Taiwan can no longer take such advantage for granted.

To cope with the challenges ahead, the government has put forth various programs to encourage investment in R&D, acquisition of new technologies, and the upgrading of human resources. Furthermore, emphasis is equally placed on the service industry and the agricultural sector. For the service industry, the government will continue

with financial reform and come up with other measures to facilitate the introduction of new ideas and technologies to improve the quality of the service sector. Meanwhile, the government is also actively promoting e-commerce and the development of the distribution and the logistic service industry. In a sense, tremendous new business opportunities become available in a new environment created by Taiwan's WTO accession, only to be enhanced by creativity, strong entrepreneurship and sound government policy.

In the agricultural sector, the government will assist farmers in upgrading their operations, improving the distribution system of agricultural products, and increasing the added value by integrating environmental protection, recreation, and tourism with agriculture. As Taiwan does not claim special advantages of its natural resources, emphasis needs to be directed to the improvement and commercialization of its agricultural technologies.

Recently, many thoughts have been given to exploring the great business potential to be generated by means of packaging Taiwan's agricultural technologies for license to other areas where the cost of production is lower and more competitive. Such new business model will not only increase the welfare of Taiwan's farmers, but also benefit huge populations in less developed countries that suffer from poverty and food shortage, not to mention the emergence of abundant business opportunities. More active participation in international organizations aiming to address the food shortage problem also fulfills Taiwan's responsibility as a member of the world community.

New Prospect for Cross-Strait Trade Relations

Many view cross-strait relations as an important factor affecting the future of Taiwan, both politically and economically.

In this regard, the WTO provides an ideal framework for the improvement of cross-strait trade relations. Previously, cross-strait trade in goods could only take place in an indirect manner, but direct trading will soon be possible. In anticipation of increased imports from Mainland China, adequate import relief systems will be established to mitigate the adverse impact on local industries.

With respect to trade in services, the government will, phase by phase, allow two-way investment in the service industries. Most notably, banks can soon expect to be allowed to open offices in Mainland China, not only serving the needs of Taiwanese invested business there, but also competing in the financial sector of the gargantuan Chinese market. Telecommunication is another sector for which we can soon anticipate a green light for investment in Mainland China.

As for regulation for overall investment in Mainland China, the policy of "active opening, with effective management" has just replaced the previous policy of "no haste, with patience." The current debate on whether the semiconductor industry should be allowed to build foundries in Mainland China serves as the best test as to how this policy will be put into practice.

Some Thoughts Beyond WTO

The WTO rules only set forth the minimum code of conducts for member countries. Compliance with the WTO rules does not necessarily guarantee a member a more prosperous economy or a higher social welfare. To tackle the current challenges, a vision for Taiwan's continuous prosperity as inspired by its WTO accession is being formed on the part of both the private and the public sector, though its breadth and depth may vary slightly between the two. The relation with Mainland China could be a part of such vision.

In this post WTO accession period, Taiwan and Mainland China will endeavor to increase their competitiveness. However, many in the United States are unaware of Taiwan's significant contribution to Mainland China's economic development in recent years and that understanding the dynamics of the US-Taiwan-Mainland China economic triangle is critical for United States economic policy making towards Greater China.

Division of Labor and the Characteristics of the US-Taiwan-Mainland China Economic Triangle

Over the past twenty-five years, since Mainland China opened economically to the West, a supply chain has developed between the US, Mainland China, and Taiwan companies. In this supply chain, US companies are the center for research and development (R&D), brand management and marketing; Mainland China companies provide a manufacturing powerhouse for the production of goods with low labor and operating costs; and Taiwan is a bridge that economically links the US and Mainland China as a manufacturing network integrator. This trend of division of labor between the three is beyond doubt.

Statistics evidence this economic triangle as Taiwan's trading volume with Mainland China is estimated to have reached US\$29.9 billion in 2001, which accounted for 13% of the total trading volume of the same year, up 1.8% from 2000. Taiwan's export volume to Mainland China is estimated to have reached US\$24 billion, which accounted for 19.6% of Taiwan's total export volume, up 2% from 2000. Taiwan's imports from Mainland China were US\$5.9 billion, which accounted for 5.5% of the total import volume, up 1.1% from 2000. The trade surplus stood at US\$18.1 billion, down 8.8% from 2000 and thus, Taiwan enjoyed the largest trade surplus against Mainland China.

The trade performance vis-à-vis Mainland China in 2001 was mostly the result of the cross-strait division of labor. Mainland China is now Taiwan's third largest trading partner, second largest export market, and the fourth largest source of imports.

In 2001, according to US statistics, China had the largest trade surplus against the US, at around US\$83 billion. Its exports to the US reached around US\$102.2 billion and imports, US\$19.2 billion. However, according to the Mainland China statistics, its exports to the US amounted to only around US\$54.2 billion and imports around US\$26.2 billion. At the same time, Taiwan's exports to the US were around US\$27.6 billion according to its own customs statistics, while the US statistics show US\$33.3 billion. Given the huge differences between the statistics on the value of exports to the US, one may well wonder what role the cross-strait division of labor plays in it.

In addition to trade, Taiwan's outbound investment to Mainland China has been growing steadily, covering a wide range of business sectors, and investment in the

manufacturing industry has gradually shifted from the traditional labor-intensive industries to the information and electrical industry. In 2001, approved investment projects amounted to US\$2.78 billion, representing more than 100% growth from US\$1.23 million in 1996. Other official figures apparently do not reflect the true picture of Taiwan-based companies' investments into Mainland China. From 1991 to October 2000, the estimated value of Taiwan-based companies' cumulative approved equity investments into Mainland China ranges from the most conservative figure of US\$15.6 billion to US\$50 billion, according to different official announcements. Some reports suggest that the figure could be well beyond US\$ 100 billion, representing more than 50,000 investment projects and covering all provinces in Mainland China.

As a result of this gross investment in Mainland China, Taiwanese entrepreneurs have built up remarkable networks there for manufacturing, initially for export purposes, and more recently, for distribution, marketing, and logistic support for the purpose of domestic sales. One example is United Stones Industry Company, Ltd., that produces agglomerate marble by transferring Italian manufacturing technology to Taiwan and Mainland China, and has successfully built a distribution network of 1300 employees and more than 60 warehouses/branch offices countrywide, which would be an ideal partner that some US company may find desirable for forming a strategic business alliance.

The WTO accession of both Taiwan and Mainland China will only fuel further expansion of such networks. Businesses from other countries can tap into such networks through their strategic alliance with Taiwanese partners, while Mainland China's businesses can also benefit from their access to the global networks of supply chain through their Taiwanese partners.

Role of Taiwanese Entrepreneurs as Integrator in Supply Chain

Since Mainland China and Taiwan both joined the WTO, Taiwanese entrepreneurs have become more eager to explore new business opportunities in Mainland China, either on their own or through joint venture with other international investors. In addition, US companies are becoming increasingly aware of Taiwan's importance in

the supply chain as the manufacturing network integrator. Because of the common language and background with Mainland China, coupled with the Taiwanese's entrepreneurial expertise in management, operations, technology and marketing, Taiwanese businesspeople uniquely understand the nuances of business practices in both the East and the West. This places Taiwan businesses in a position to help US companies access Mainland China's low-cost labor, resources, and vast domestic market.

Interestingly, as 70% of Mainland China's IT business is Taiwan-owned, Quanta Computer Company is another case of Taiwan's unparalleled role in the global supply chain. In the year 2000, Quanta was the world's second largest producer of notebook computers, producing for the familiar US and Japanese brands, Apple, Hewlett Packard, Dell, IBM, Fujitsu-Siemens, Sharp, Gateway, Compaq and Sony. Quanta's example demonstrates how marketing driven US companies piggyback on Taiwanese business networks to manufacture in both Taiwan and Mainland China.

Many industrial leaders even take the view that the west march to Mainland China is not merely a choice but a necessity. However, many have also raised the concern about the hallowing out of Taiwan's manufacture-based economy. The migration of Taiwan's manufacturing industry to Mainland China is further perceived as fueling the growth and prosperity of a dreadful opponent at the expense of Taiwan's own future. Such doubts and debates may linger for the years to come. Both sides across the Taiwan Strait need to exercise their wisdom to eliminate such concerns for achievement of mutual benefits.

However, from a practical viewpoint, what is critical for Taiwan's future is to ensure that businesses will conduct their core operation and retain the key value in the supply chain within Taiwan. In a knowledge-based economy, the majority of value generated in the supply chain is usually related to R&D, design, manufacturing capability, component sourcing capability, the ability to invest in, build, and operate manufacturing facilities, and marketing and distribution. Many Taiwan companies are focusing their strategies on how to expand their capabilities so as to acquire a constantly increasing role in the supply chain. Furthermore, knowledge intensive business services also provide tremendous business opportunities and are crucial for

the development of a knowledge-based economy. Great efforts, therefore, have been and will continue to be made to create an environment conducive to these high-value-added operations and the development of the supporting business services beyond the WTO requirements.

To prevent Taiwan from being bypassed in the wake of industrial globalization, the government has also announced a series of measures specifically to attract multinational as well as domestic companies to keep or move their (global or regional, as the case may be) R&D, managing and marketing operations in or to Taiwan. These measures include tax incentives and subsidies for certain encouraged activities.

The next step the government may need to take is to release capability and resources currently held by various public and private research organizations and academic institutions so that the research fellows and teaching faculty can more actively participate in industrial activities and the fruits of their intellectual pursuits can be readily made available for commercialization.

Encouraging Strong Entrepreneurship

A good indication of the strength of entrepreneurship is the growth in start-up companies. Thus, the continuous promotion of start-up companies is also an imperative for reinvigorating Taiwan's economy. Through start-up companies, new dynamics and momentum can be injected into the economy and continued growth can be sustained. With support from all members, in particular Mainland China, the Eleventh APEC Ministerial Meeting Joint Statement publicly endorsed the proposal on "Economic Revitalization Through Start-up Companies and Venture Capital" in the wake of the Asian financial crisis.

In the case of Taiwan, start-up companies have greatly contributed to Taiwan's economy. However, in 2001, there appears to be a decline in the number of newly found companies, down 13.03%, while the total initial capital invested in these companies has also dropped by 13.69%. With the economic upturn in view, we

expect a new surge in the numbers. In addition to the growth of start-up companies, we are also trying to create in Taiwan an environment in which entrepreneurs can thrive, as recommended in the *APEC Best Practices Guidelines for Entrepreneurship and Start-up Companies* as endorsed by the Thirteenth APEC Ministerial Meeting's Joint Statement. (Please see the attachment)

Furthermore, as highlighted in the *APEC Best Practices Guidelines for Entrepreneurship and Start-up Companies*, Taiwan needs to continue its efforts in facilitating access to efficient capital markets, both public and private, to ensure that capital will be available for all stages of its corporate growth.

Venture capital (VC) has long been an important source of capital needed by start-up companies. In 2000, Taiwan had 184 VC companies, with a total paid-in capital of US\$3.65 billion. From 1996 to 2000, they have invested in 6,343 projects with a total investment of US\$3.58 billion. However, during the period from 2001 to March 2002, there appeared to be a reduction in the number of VC companies in operation, and their total paid-in capital had merely increased by US\$ 171 million. This may be a sign that more efforts are needed to promote the establishment of VC companies and their funding for start-up companies.

In addition, while VC companies used to focus on investment in the manufacturing industry, we hope their future investment will also flow to start-up companies in the knowledge-based services sector. This will then ideally fit in with the plan of Taiwan's role as an integrator in the global supply chain.

Our vision for Taiwan's future, as inspired by its WTO accession, goes beyond mere compliance with the WTO rules and requirements. Such vision is illuminated by the *APEC Best Practices Guidelines for Entrepreneurship and Start-up Companies*, which state in the preamble that to enhance the APEC region's economic growth and prosperity, APEC must continue to develop global competitive advantages, based on

constant innovation, daring entrepreneurship, and dynamic start-up companies. This is our mission!

Guiding US Policy towards the Asia Pacific Region—APEC Best Practices Guidelines for Entrepreneurship and Start-up Companies

In the past, US policy toward the Asia Pacific region has focused on imbalances in trade that often resulted in embittered trade negotiations and confrontations. While I do not suggest an entire change in US policy, I propose that the US consider balancing these policies with constructive efforts to economically enhance other countries through “Structure Issues”.

Structure issues examine how to stimulate sustainable economic growth in a country through building a sound legal, economic, political, and social framework. It involves facilitating an environment that supports thriving entrepreneurialism for economies to grow themselves and witness increased standards of living. Structure issues are also characterized by developing a highly educated, innovative, and creative populace that can apply those traits to businesses and continued economic growth.

The *APEC Best Practices Guidelines for Entrepreneurship and Start-up Companies* is a fine example of how Structure Issues can be incorporated into international policy. At the Thirteenth Annual APEC Ministerial Meeting last October in Shanghai, the Guidelines were welcomed into the meeting's official Joint Statement and the Ministers, "encouraged relevant APEC fora to apply the Guidelines to their future work." This document also created common ground for Mainland China and Taiwan to work together for their mutual economic benefit.

According to the Guidelines, "to enhance APEC region's economic growth and prosperity, APEC must continue to develop global competitive advantages, based on

constant innovation, daring entrepreneurship, and dynamic start-up companies." The *APEC Best Practices Guidelines for Entrepreneurship and Start-up Companies* is an all inclusive proposal that focuses on developing policies that would stimulate the private sector's growth through the development of start-up companies and venture capital in a knowledge-based economy. The document also addresses developing structures for countries to efficiently harness e-commerce; to develop high quality educational systems that lead to social advancement; to facilitate an environment where sound corporate governance and a healthy business culture are observed; and, to create a fair and reasonable environment for competition that protects the operation of the market while building a new economic model for a knowledge based economy.

Because Taiwan's example proves that democracy and capitalism can successfully engage Asian culture, these APEC Guidelines can be a model for the US to assist the future development of all Asian member economies. Adopting policy toward the Asia Pacific region that promotes greater economic liberalization, and the creation of legal, economic, and social structures for more robust economies, may potentially have political ramifications.

One of the great aspects of *APEC Best Practices Guidelines for Entrepreneurship and Start-up Companies* is that it does not mandate policy, but it encourages its adaptation. I encourage the US to examine this document and adopt these policies towards the Asia Pacific region. While these concepts of innovation and entrepreneurship may seem very familiar, it is because the US has the world's best entrepreneurial system. At this moment, the US has an opportunity to lead the Asia Pacific region towards structuring its own entrepreneurial environment. By following the *APEC Best Practices Guidelines for Entrepreneurship and Start-up Companies*, as evidenced by Taiwan's small success, and by following the US' successful example, the US may export these American economic values to the Asia Pacific region.

I would like to encourage all of us to facilitate structure issues by creating an environment that is consistent with the *APEC Best Practices Guidelines for Entrepreneurship and Start-up Companies*.

