U.S. Exports to Taiwan – Machinery Leads the Way

In the 10th largest market for American products, the new growth areas include financial and other services, health and beauty items, and natural foods.

BY MICHAEL H. COGNATO

Taiwan is best known as a world-class exporter. But with its increasingly affluent population and a shortage of natural resources, it also depends heavily on imports to supply its industry and satisfy its consumers' growing demands. A substantial amount of these imports – nearly 11% in the first half of this year – come from the United States. One reason, explains Citigroup economist Cheng-Mount Cheng, is that the United States is an "upstream supplier" for much of Taiwan's export industry. Electronics manufacturers here frequently incorporate American-made circuitry in their products, for instance, and semiconductor foundries rely on precision measuring devices and equipment from the United States.

"Basically, Taiwan's economy is heavily dependent on trade," says Cheng. "When exports grow, that will also increase imports." In addition, because Taiwan has a relatively low tariff structure – the average rate will fall to 5.5% by 2007 – economic growth tends to translate directly into increased imports, he notes. With continued growth of around 4% annually projected in Taiwan for the next several years, market analysts, trade officials, and importers all express cautious optimism about future prospects for U.S. exports here.

In 2005, the U.S. exported more than US$22 billion in goods to Taiwan, according to statistics from the U.S. Commerce Department – enough for the United States traditionally to rank as Taiwan's second largest source of imports after Japan (although China appears poised to move past the United States for 2006). The value of the American products consumed by the island's 23 million people exceeded that of all but nine other U.S. markets in 2005 – in fact, the amount represented more than half the value of U.S. exports to the entire continent of South America. Moreover, U.S. exports to the island have been increasing steadily; a slight rise of 1.5% in 2005 followed a spike of 25% the year before.

Machinery accounts for more than half the value of total imports from the United States. Though a great deal of Taiwan's manufacturing base has moved across the Strait, the industries that remain rely heavily on large, complex equipment and advanced technologies in which the United States has long enjoyed a competitive advantage. The American suppliers of this kind of equipment, meanwhile, are unlikely to relocate from the United States to overseas production sites. As William Tzou, vice president for operations in the machinery division at Fu Sheng Industrial Co., puts it while tapping his forehead: "Not all of the technology can be moved. A lot of it exists up here."

Tzou is in a position to know – Fu Sheng is a leading manufacturer of air compressors in Taiwan that in 2003 acquired a plant outside of Pittsburgh that it now runs as a fully owned subsidiary, FS-Elliot. Simpler compressor types are manufactured in Taiwan and, increasingly, China. But centrifugal compressors, the biggest and most complex sort, are still made almost exclusively in the United States or Europe. Fu Sheng's Elliot plant ranks first worldwide, with a global market share at around 80%, according to Tzou. While the technology is an important factor in the plant's success, more important to Fu Sheng is its workers' experience. "It's what's in the people's brains, their manufacturing processes and cumulative knowledge," that produces their competitiveness, Tzou says.

Demand in Taiwan for the large compressors remains strong. Tzou describes the Taiwan market for capital equipment as "zigzagging," with shortfalls in one sector quickly followed by increases in others. Textile manufacturers used to be the biggest source of demand for FS-Elliot's machinery, but most of those plants have long since moved on to China. Electronics firms took their place. Now, flat-panel display makers need the company's centrifugal compressors to clean and dry their products, and semiconductor firms rely on them for clean and steady air supplies in their manufacturing process.

According to industry observers, these types of operations are likely to stay in Taiwan for some time to come – in fact, several large manufacturers have recently invested in expensive new plants here. Analysts point to the stronger protection of intellectual property rights and well-trained workforce in Taiwan as other reasons why companies with advanced technology are not likely to transplant production lines to the mainland in the near future.

Compressors, of course, are just one of a host of capital goods where the United States maintains a strong market presence. Nuclear equipment and aircraft figure heavily in the trade figures, as do advanced electronics and industrial chemicals that are used to turn silicon into semiconductors. Citigroup's Cheng points to aircraft in particular as a likely sector for growth, as Taiwanese airlines will find a new market in cross-Strait flights, as those become a reality. Nuclear equipment, meanwhile, will continue to be important through the end of construction on Taiwan's fourth nuclear plant in 2010, and beyond this for replacement components for all four plants.

Agricultural exports are also highly important, with Taiwan ranking is the sixth largest export market for U.S. farm products. The United States is good at producing many types of food that are popular here, such as soybeans and beef, and U.S. suppliers have relationships in Taiwan stretching back decades. Demand for U.S. farm products is continuing to increase – the value came to US$2.3 billion in 2005, an increase of more than 11% over 2004. Smaller increases were registered in both 2003 and 2004.

Vincent Tseng, general manager of Amanda and Vincent Resource Co., predicts that "the share of U.S. goods in the market will increase" further. His firm has been importing white peaches, cherries, and plums from the United States for three generations, selling primarily to wet markets and wholesale chains. Tseng points to the competitive cost of U.S. fruits compared to other countries' produce as a reason for its popularity in the market, as well as the consistent quality in packaging and freshness. Additionally, for certain goods, such as white peaches, the United States is the only major supplier in summer months. A cut in tariffs on farm imports from 20% to 5% in 2008, Tseng says, should lead to even bigger increases in sales.

For other items, U.S. farm products are competitive for reasons purely of quality. According to Hank Lee, purchasing division manager at importer Mayfull Foods Corp., American beef is still perceived in Taiwan as superior in quality to supplies from Australia, New Zealand, and other countries. From what Lee sees in the market, prior concerns about mad-cow disease have all but disappeared in Taiwan. (U.S. beef imports had been banned until early this year, and still are blocked from several other Asian countries.) “Quite a lot of customers have now switched from Aussie beef back to American,” Lee explains. “For us it’s no problem to sell right now.”

Lee says that hotels and high-end restaurants are willing to pay a premium for higher-quality steaks and burgers. As a result, although about 30% of his company’s meat shipments by volume come from the United States, they are responsible for more than 50% of the total by value. New products and concepts are also beginning to take root in the growingly affluent Taiwan market. Kobe-style beef from Idaho, for instance, fetches at least three times as much as meat from lesser cattle – around US$30 a pound. “Fifteen years ago, no one wanted beef at that price here,” Lee observes. In the last few years, Mayfull has also expanded its offerings to include American wine.

Another important trend in bilateral trade is the increasing role of services. Already, they account for a large and growing proportion of both countries’ economies – over 75% of U.S. GDP and nearly as much of Taiwan’s. U.S. government estimates put private-sector service exports to Taiwan at US$5.5 billion in 2004 (the latest year for which figures are available), an increase of 12.6% from the previous year.

Certain major sectors stand out. In financial services, limited choices in fixed-income investment instruments force many institutional investors to turn to the United States and other well-developed markets for more varied products. According to Jane Hwang, vice president at State Street Bank’s Taipei branch, the United States is recognized as the most “sophisticated” market globally, and provides a wide range of fixed-income and related derivative products not available here. One example she points to is the debt market, where insurance companies need these long-term investment instruments to match their liabilities, and will buy them abroad if they are not available here. As the institutional assets market continues to grow, demand for those sorts of investment products will increase apace.

Education is also a prominent part of the trade in services. Despite stiffening competition from schools with lower tuition in Australia and Canada, as well as increasing local options, American colleges and universities continue to draw high numbers of Taiwanese students. The Institute for International Education, in an annual report released last year, put the number of Taiwanese students in the United States at nearly 26,000. Though that figure is 1% off the 2004 total, it represents a marked recovery from the dip that occurred in 2001-2002. The American Institute in Taiwan’s Commercial Section estimates that the United States has now reclaimed its longstanding position of holding more than 50% of the Taiwanese study-abroad market.

Various other sectors are also frequently mentioned as likely sources of strong future demand for U.S. goods and services. Taiwan’s push into biotechnology and nanotechnology, for example, will require the support of research institutions and equipment manufacturers in the United States, where the infrastructure and technologies for both industries are already further developed. Irene Tsai, director of the Commonwealth of Pennsylvania’s Trade Office, notes that Taiwanese companies frequently contract with research and development centers in the Philadelphia region. “Research centers [in Taiwan] are thinking about cooperation with foreign countries and labs right now,” she explains. The Taiwanese firms are essentially paying to license the patents or obtain other technological results of the programs. Moreover, because of the government’s emphasis on these two sectors, imports into Taiwan of necessary equipment and materials – precision measuring devices, for instance – will be tariff-free or even subsidized.

Niche consumer markets are also developing in the health and beauty sectors. Numerous market observers mentioned organic and all-natural foods as gaining in popularity, and described American standards for this sort of produce as particularly well-respected. Oliver Rust, executive director of retail measurement service for ACNielsen, cites the aftermath of 2003's SARS outbreak, a general global trend towards greater health awareness, and Taiwan's aging population as contributing to greater consumer willingness to pay a premium for benefits to health. He points to figures showing double-digit growth in Taiwan in the past year for skincare products as evidence of this trend.

Of course, the outlook is not entirely without challenges for American firms selling into the Taiwanese market. Macroeconomic risks are very real – Citigroup's Cheng points to increasing domestic political instability as a possible brake on both spending and investment. Rust mentions the very high savings rate here – 60% of income after spending on basic necessities – as curbing consumption, along with a related reluctance by consumers to pay more for extra value in sectors other than healthcare. In some sectors, such as automobiles, the United States has simply lost its competitive edge to cheaper Asian or more stylish European products.

Trade barriers also still exist. A report from the Office of the U.S. Trade Representative mentions Taiwanese policies that inhibit shipments of rice, alcohol and tobacco, wood, and some pharmaceuticals, among others. Complicated and opaque government procurement practices also continue to make life difficult for U.S. construction and engineering firms.

Perhaps most damaging in the areas where the United States should be competitive are regulatory hurdles in the services sector. As an example, State Street's Hwang explains that financial regulators, by insisting on reviewing and approving each new product, greatly limit the investment options open to Taiwanese investors. In other countries, it is much more common for regulators to ban certain practices but allow anything else not specifically proscribed. Here, Hwang says, "Each new product has to be reviewed and approved." This creates big delays and added costs that undercut the advantages of speed and flexibility that underlie U.S. competitiveness. Given the rapid growth in the importance of services to both economies, such tendencies threaten to become bigger impediments as time goes on.

The overall trends, however, are towards greater openness and increased trade. As these trends progress, Taiwan should continue to grow in importance as a market for so much of what the United States now sells overseas.