



Executive Summary

Semiconductor Quarterly Report Second Quarter, 2005

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INTRODUCTION

The US-Taiwan Business Council is committed to providing our members with tactical and strategic advice on how to succeed in the Taiwan market. As part of a suite of information products distributed to our members, the Council publishes several analysis reports each year. These reports are published each quarter, with an expanded report in the fourth quarter that covers the entire previous year.

The Semiconductor report focuses on the semiconductor industry as it relates to Taiwan, China, and the U.S., and provides up-to-date analysis of developments during each quarter. Each report also contains contact information valuable in initiating and maintaining a relationship with Taiwan private and government entities, as well as other useful information including organization charts and a glossary.

The US-Taiwan Business Council's Semiconductor Report has been published since the first quarter of 2002. Although these reports are distributed exclusively to members and to U.S. government employees, this executive summary provides some insight into the focus and contents of the report.

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QUARTERLY SEMICONDUCTOR ANALYSIS

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A growing number of Taiwan trade groups and politicians have been going to China to negotiate trade deals with Beijing, despite warnings from officials in Taipei that their actions could be illegal. Taiwan remains in a politically sensitive period with China, as the series of proposed trade initiatives has eroded the Taiwan government's authority and further emboldened the Pan-Blue opposition already encouraged by the perceived success of their leaders' trips to China in the spring.

The latest incident appeared innocent enough: a farmers association traveled to China in June for discussions, and Beijing responded by allowing more fruits in duty-free. This "mango diplomacy" may seem harmless, but it strikes at a key political constituency for Taiwan President Chen Shui-bian in southern Taiwan, while also undermining his authority as Taiwan's elected leader. Moreover, flush with success, Beijing is pushing forward with more attempts to isolate the ruling party.

There had been some reason for cautious optimism at the turn of this year over the potential for relaxing certain cross-Strait investment criteria. However, through developments during the spring and early summer it has become increasingly clear that the Chen administration does not feel confident enough to loosen significant areas of potential investment. The downside for Taiwan chipmakers is that they will probably not see any further relaxation of China investment restrictions anytime soon.

U.S. chipmakers face their own regulatory troubles; plenty of government concern over the exodus of semiconductor manufacturing abroad, but little in the way of concrete initiatives to keep chip fabs at home. The latest in-depth review came in the form of a report by a Department of Defense task force.¹ Its main thesis is that chip factories are exiting the U.S. at such a pace that the U.S. military will soon not have access to a reliable domestic supply for its hardware needs. At the same time, China's capacity to design and manufacture high-caliber chips is on the rise, and its military technology is improving all the time.

While reports like this one often contain valuable information and insight, so many such warnings have been given that some perspective is needed. Increased chip manufacturing overseas has been a boon to the U.S., increasing its research and development and ensuring it will remain at the cutting edge of manufacturing technology. America's semiconductor design firms and production equipment makers have benefited the most from this migration, as a majority of their sales is overseas.

This quarterly report will focus on the recent developments between Taipei and Beijing, and what they might mean for future technology cooperation and integration across the Taiwan Strait. It will also bring readers up to date on the case against United Microelectronics Corporation (UMC), the second largest foundry chipmaker in the world, and how that has impacted perceptions of the government's inability to effectively manage cross-Strait investment and trade.

This report will also address the notion that growing chip manufacturing overseas is a zero sum game for the semiconductor industry as well as how it affects the national security interests of the U.S. Both government and industry attention on these issues should ensure that sound policies are pursued, thereby supporting continued global competitiveness by U.S. companies.

¹ Report of the Defense Science Board Task Force on High Performance Microchip Supply, www.acq.osd.mil/dsb, February 2005

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