



Executive Summary

Semiconductor Quarterly Report Annual Review, 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
JANUARY 1, 2006**

It has taken a full year of investigations, but prosecutors have indicted the second most powerful semiconductor industry executive on the island, alleging he conspired to help build a semiconductor factory in political rival China. It was the defining moment of the year for Taiwan's semiconductor industry, and it shows very clearly that Taipei is in no mood to relax China investment regulations anytime soon – nor will prestige save any of the executives already being scrutinized for alleged illegal chip investment activity.

The government has already called for a slow-down on investment to China as it revamps the way it manages money and technology flows. Part of the stoppage (there has not been a single advance in chip investment policy since last year anyway, but now the stoppage is official) is due to the case against Robert Tsao, the chairman of the world's second biggest chip foundry, United Microelectronics Corp. (UMC). The other main reason for the stoppage has nothing to do with the chip industry at all – it is about internal Taiwan politics.

The action taken by Taiwan prosecutors to indict Tsao appears justified, given the clear legal status of Taiwan semiconductor investment to China. However, Taipei is using the UMC situation as a pretext to continue to drag its heels on further loosening of China chip investment regulations, a policy harmful to its own chipmakers. The ruling party views warily the exodus of electronics manufacturing and jobs to China for a variety of reasons – economic, military and political. Taiwan needs a coherent loosening policy due to the special situation that exists between Taiwan and China, but the current administration of President Chen Shui-bian is seemingly not interested in developing such a policy.

It is important to understand that the discussion regarding chip investments in China is only part of a passionate domestic debate over the future of Taiwan and over what role economic integration with the Mainland will play in that future. This report will examine in detail the politics surrounding chip industry investment in China, with the recent indictment of Robert Tsao and other UMC executives as a key element. It will also discuss the impact of the DPP defeat in important city and county elections in December, 2005, and how that loss means that Taiwan chip sector investment will remain in a deep freeze for the foreseeable future.

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