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Taiwan Academy of Banking and Finance



The Impact of American Political Trends on Taiwan's Banks, and Possible Countermeasures

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Principal Investigator : Tien-Wang Tsao

Co-Principal Investigator : Show-Ling Jang

Sub-Investigator : Wei-Jen Lai / Shu-Hwa Chih

Researcher : Pei-Shan Tung / Chia-Ching Lin / Pei-Shan Wu

Assistant : Yu-Ru Peng

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Abstract

American growth has remained stable in recent years, and various stock market indices have reached new highs. Despite the good economy, labor demand from traditional manufacturing has remained sluggish. Thus, in the hopes of further boosting American companies' role in local economic development, US President Donald J. Trump has issued major policies on foreign investment, tax reform, free trade, infrastructure, and energy. After these policies come into effect, all sectors must pay attention to fiscal balance, which will maintain the stability of the dollar against other currencies.

Geopolitically, Trump is friendly to Canada, but remains wary of illegal Mexican immigrants. The wall between the US and Mexico, which had been mentioned in previous elections, and border adjustment taxes, will be difficult to truly implement, but other policies including immigration and taxation are still expected to limit American companies' reliance on Mexican imports. The hope is that they will bring manufacturing back home to create jobs and broad-based economic opportunities. In Asia, North Korea's nuclear and ballistic missile policies have not improved, but the US and UN have gradually cut its aid through diplomatic, economic, and anti-money laundering/counter financing of terrorism (AML/CFT) channels, helping open up dialogues between the North and South, and even multilaterally. For the Middle East, the situation with Syrian rebels and the Islamic State (ISIS) has gradually eased, but after the US recently recognized Jerusalem as the Israeli capital, the Palestinian situation heated up somewhat.

On the economy, the US has proposed new trade and industrial policies. Taiwan can consider integration with its existing "5+2" industrial policy. These main industries include manufacturing (the Great Lakes region and Midwest), biotechnology and medicine (Northeast and Silicon Valley), oil refining and natural gas (South), and venture capital (Silicon Valley and the Northeast). Taiwan's banking industry can also consider whether these areas hold business opportunities for new strategies and even business bases.



Research Findings

1. The US economy is continuing to improve, and the Trump administration should move towards reducing the budget deficit.

The United States, the world's largest economy, has a total area of about 9.82 million square kilometers, total population of 320 million, a 2016 economic growth rate of 1.6%, per capita production of US\$ 57,000, and US\$ 18.6 trillion in GDP. In its October 2017 World Economic Outlook, the International Monetary Fund (IMF) predicted that its GDP will reach US\$ 19.4 trillion in 2017, and break past US\$ 20 trillion in 2018. Its July 2017 forecasts for GDP growth were 2.1% in both 2017 and 2018, which were revised slightly upwards to 2.2% and 2.3%, respectively, at the end of 2017. Although recent US economic data have shown expansion, the IMF is still worried about the progress of the tax policies advocated by Trump and the execution of his financial policies. After the tax plan is settled, though, provided no major events occur in 2018, economic growth should remain on a growth track.

Previous presidential candidates have all been required to put forward views on deficit reduction. US Treasury Department data show that the fiscal deficit declined from 9.8% of the gross domestic product (GDP) in 2009, during the start of Obama administration (US\$ 2.1 trillion in income; US\$ 3.52 trillion in expenditures), to 3.3% in 2016, at the end of the Obama administration (US\$ 2.99 trillion in income; US\$ 3.54 trillion in expenditures). In 2016, expenditures on social security, unemployment, and labor were US\$ 1.31 trillion, at 36% of total government spending, followed by Medicare/Medicaid at 28%. Defense spending, interest payments, and other expenditures¹ made up 15%, 6%, and 7% respectively. Trump, who advocates the use of tax cuts to boost the economy, hopes that economic growth can be increased to 3.5%, and also advocates increasing spending on infrastructure, veterans' benefits, education, childcare, and defense. In the future, while opening up and increasing tax receipts, the government is also expected to reduce spending on social security, Medicare/Medicaid, and national defense.

¹Other expenditures include veterans' benefits, education, training, & social services, infrastructure, legal administration, international affairs, natural resources & environment, aerospace, and other.



[Table 1] America's Fiscal Situation 2007-2017

Year	President	Fiscal receipts (trillion US\$)	Fiscal expenditures (trillion US\$)	Fiscal surplus/ deficit (10 trillion US\$)	Fiscal surplus/ deficit to GDP
2007	Bush Jr.	2.65	2.82	-166	-1.1%
2008	Bush Jr.	2.55	3.02	-646	-3.1%
2009	Obama	2.1	3.52	-1410	-9.8%
2010	Obama	2.14	3.43	-1280	-8.7%
2011	Obama	2.24	3.5	-1260	-8.5%
2012	Obama	2.34	3.37	-1040	-6.8
2013	Obama	2.60	3.24	-637	-4.1%
2014	Obama	2.79	3.23	-447	-2.8%
2015	Obama	2.96	3.36	-399	-2.5%
2016	Obama	2.99	3.54	-552	-3.3%
2017 (projected)	Trump	3.21	3.65	-443	-2.6%

Source: insideGov, TABF

2. The US, China, and Russia are geopolitically dominant. American geopolitical interaction in North America, Asia, and the Middle East warrants continuing attention.

After World War II, the international order was divided into several camps, including democracies (led by the US), and communism (led by the USSR). Among the latter, after mainland China broke with the USSR in the 1960s, it began developing relations with emerging countries in Africa and Asia, forming a “third world” camp. To this day, although the USSR has dissolved, Russia still exists, China has undergone 30 years of economic development, gradually going down the road of socialism with Chinese characteristics. The US, China, and Russia remain the world's most important geopolitical players. In terms of America's geopolitical interaction with other countries, the renegotiation of NAFTA with Canada and Mexico is the most important issue in North America; the resolution of the North Korea issue and consensus on resource development in the South China Sea are the most important issues in Asia; and support for US sanctions on Afghanistan and Pakistan from other countries, as well as interactions between Israel, Syria, and other neighboring countries, remain the most important issues in the Middle East.



3. The core of Trump's policies is "America first," involving job creation, climate change denial, fair trade, and balanced budgets

"America first," referring largely to economic benefits, is the ideological core of Trump's policies. The source of these benefits includes higher incomes, lower expenditures, jobs, and subsidy reductions. Associated policies involve diplomacy, trade, and energy.

The second-level implications of "America first" include job creation, climate change denial, and fair trade, with policy implications that would broaden American growth. Trump's two main directions for job creation are incentives for manufacturers which had previously gone overseas to return, and those for foreign multinationals to invest in America. On the second point, Trump believes that climate change issues are a major factor hindering the development of advanced countries, and that it is not caused by human activity. Thus, on June 1, 2017, at the White House, he announced withdrawal from the Paris Agreement, which had been signed in 2015. Although the withdrawal has been criticized by various countries and some leading domestic technology industries, Trump believes that America has many natural resources yet to be exploited, and that improvements in extraction, refining, and environmental technologies can even reduce pollution from these traditional sources. Meanwhile, subsidies for green and renewable energy count as government expenditures. Finally, for trade, Trump believes in "fair trade, not fool trade," that huge trade imbalances between countries is an anomaly which must be corrected through renegotiation, and that such multilateral patterns may cause some free-trading countries to "free ride" through the terms and regulations of trade. Thus the US should separately negotiate with other countries in response to each individual situation.

Trump's economic policies involve rethinking expenditure and revenue. For the former, the administration projects that tax reductions will reach US\$ 2.6 trillion, mainly including personal and corporate tax reductions, and infrastructure investment. For revenue, they estimate that US\$ 1.74 trillion can be made up from trade, US\$ 0.487 trillion from deregulation, and US\$ 0.147 trillion from energy policies, for a total of US\$ 2.374 trillion. In fact, as the administration has reduced the scale of its previous tax reform policy, total expenditures may not reach US\$ 2.6 trillion, so the budget may balance. Even if not, there will not be excessive financial deficits.

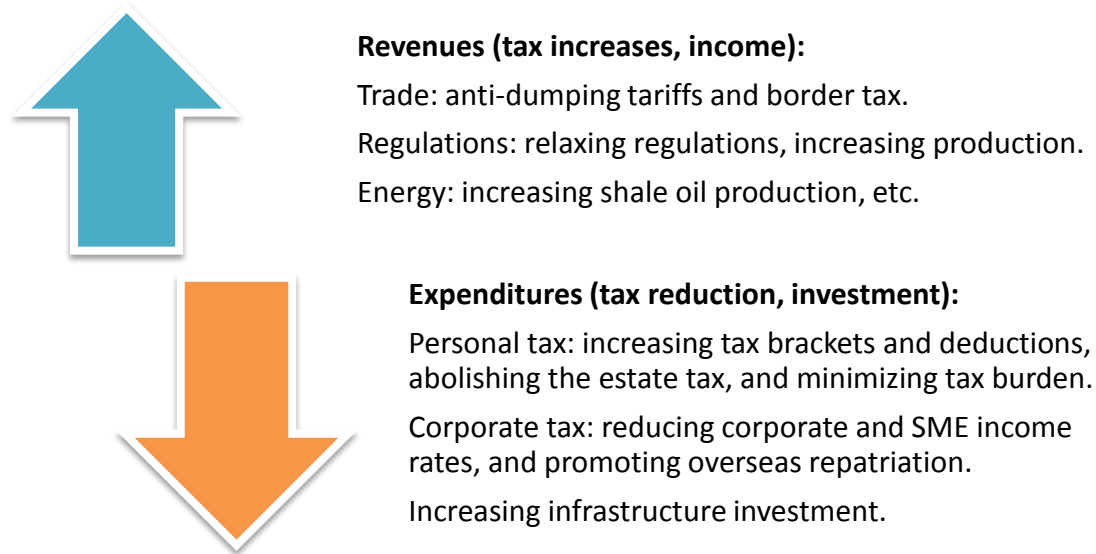


Fig. 1: Revenues and expenditures proposed by the Trump administration

Source: TABF

[Table 2] Trump's Tax Reforms

Policy		Current system	New system
Corporate Tax	Maximum rate	35%	21%
	Repatriation of overseas profits	One time overseas and domestically, 35% rate	Reduced to 15.5% of current assets and 8% of non-current assets. American affiliates of foreign companies may be subject to a 20% excise tax in the future.
	SME income tax	Maximum rate 39.6%	1. Reduced to 21%, with 20% operating income deduction; the cost of new equipment may be deducted immediately; the federal alternative minimum tax for companies is eliminated. 2. Applicable to pass-through entities including small partnerships and wholly-owned companies
Personal Income tax	Maximum rate	39.6%	37%
	Progressive rate brackets	Seven progressive brackets: 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%	Keeps the seven brackets, but changed to 10%, 12%, 22%, 24%, 32%, 35%, and 37%.



Policy		Current system	New system
	Standard deduction	Individual: US\$ 6,350 Joint declaration: US\$ 12,700	1. Standard deduction combined with tax allowance. 2. Individual: about US\$ 12,000. 3. Joint declaration: US\$ 24,000.
	Itemized deduction	Personal allowance: US\$ 4,050	1. Most listed deductions eliminated. 2. Child tax credit doubled to US\$ 2,000, of which US\$ 1,400 is refundable. 3. Mortgage interest deduction retained, raised to US\$ 750,000, only applied to main residences.
	Inheritance and gift taxes	12%-40%	1. Keeps the current annually adjusted allowance. 2. The threshold for inheritance and gift taxes increases from US\$ 5 million to US\$ 10 million. 3. Gift tax reduced to 35%
	Net investment income surtax	3.8%	Eliminated

Source: TABF (signed 2017/12/22, effective 2018/1/1).

Trump's trade protectionism will influence America's economic relationships with other countries, potentially reducing international capital flows, causing immigration restrictions, and also influencing financial markets like exchange rates. The uncertainty of US trade policy will influence foreign investment decisions, and also the trade and investment supplying raw materials and components to Chinese manufacturers. For Mexico, the key decision is border policy. Japan has been greatly impacted by the US leaving the TPP, but TPP member countries may still cooperate through negotiated agreements. For Korea, America withdrew from the US-Korea FTA, and will raise tariffs on Korean exports, but the two countries may still renegotiate a trade and investment agreement.

4. Trump's industrial policy direction is worthy of reference for Taiwan's emerging industries

With Trump's new policies, Taiwan's government and industrial associations should actively provide information on trade and investment to help businesses participate in construction of and investment in American infrastructure, complementing America's main industries, and promoting cooperation, investment, strategic alliances, and mergers between the two countries. In terms of academic research, industry-university



cooperation and joint R&D relations can be established with American universities and research institutions. Taiwan's 5+2 industries (the Asia Silicon Valley, biomedicine, green energy, intelligent devices, and military aerospace, plus new agriculture and the circular economy) can be included in the scope of cooperating with emerging industries in America (the Internet of Things (IoT), cloud technology, big data, and AI, etc.), plus biomedicine, aerospace manufacturing, refining, natural gas, financial insurance, and venture capital. Possibilities for cooperation should be re-evaluated.

Conclusions

1. Focus on the effects of Trump's tax reforms on Taiwanese businesses in the US

If Trump's tax reforms are completed, Taiwanese businesses should pay attention to three points in the draft policies: 1. A shift from personal to territorial taxation; 2. Repatriation of overseas profits; and 3. Tax enforcement and prevention of tax base erosion.

Since few Taiwanese businesses have set up subsidiaries in America, the impact of conversion between personal and territorial taxes remains limited. For overseas profits remittance, Taiwan must pay attention to whether American companies have set up profitable subsidiaries in Taiwan. For tax avoidance, the main points remains the tax impact of companies in America for offsetting import costs after the reform, and foreign subsidiaries repatriating their profits. Meanwhile, Taiwanese banks should note whether Taiwanese companies require more financing services after following their American clients back onshore.

2. Incentivizing clients to use Taiwan's "5+2" industrial policies to link up with American new economy policies, and expanding cooperation

After taking office in 2016, Tsai Ing-Wen has actively promoted the "5+2 industries." Trump's new trade and industrial policies announced in January 2017 may change the direction of cooperation, or create more opportunities for cooperation between the US and Taiwan.

For example, two major axes in Asia's Silicon Valley, "IoT business opportunities" and the creation of an "innovation ecosystem," involve encouraging clients to cooperate with American Silicon Valley companies, schools, and research institutions. Meanwhile, the



Taiwanese biotech industry is cooperating with partners in areas like Boston and San Francisco. The key point involves cooperative development of technology. If one party already has the technology, they can think about commercialization, joint promotion in Europe/US or Greater China, or expanding the size of target markets in order to increase the chances of success.

3. Exploring important business opportunities in new American industry development areas

Emerging industries in the US have been moving in recent years from Silicon Valley to some emerging industry blocks in other areas, such as Boston's biotech industry, assembly of technological products in the Great Lakes region and the Midwest, software production and aircraft manufacturing in Seattle, and petroleum refining and petrochemicals in Texas. Most of Taiwan's financial sector has not yet established footholds to serve these emerging blocks, and should evaluate the opportunities in doing so. Meanwhile, the past advantages of bases in financial centers like New York have gradually been overtaken by the increasing strictness of AML/CFT regulations. Domestic banks should consider moving out of their past business models of financial market transactions, syndicated loans, and cross-border remittances in New York, and gradually build relations with American companies in emerging industries with close ties to Taiwanese industries, or with Taiwan-invested American companies, in search of related business opportunities such as commercial lending and supply chain financing, etc.

4. Investing, supporting, and developing new joint projects between Taiwan and the US

Taiwanese banks have mostly been conservative about new industry investments, but in order to help domestic industry secure the funds necessary for development, and to improve the efficiency of capital utilization, under the premise of risk control, the Financial Supervisory Commission (FSC) plans to relax banks' upper shareholding ratio limit in startups from the current 5% all the way to 100%. Risk control regulations however stipulate that total direct investment in startups should not exceed 3% of banks' net value. Currently, banks' total investable funds are estimated at around NT\$ 1,000 billion. In addition, the FSC has also released a circular explaining banks' investment in the "5+2" sectors, corresponding to the sectors "matching the government's economic development plans" mentioned in Art. 74.2 of the Banking Act. In order to simplify the application process, it is not necessary for the competent authority of the target company to separately issue a certificate of cooperation with the government's economic



development plan – which should encourage investment by domestic banks.²

Based on these plans, Taiwanese banks will gain more space to invest in financial startups and the “5+2 industries,” which can promote the use of investment methods supporting the development of domestic and foreign startups. Together with academic and research cooperation between Taiwan and the US, there will be more investment, support, and development for plans for joint emerging industry cooperation between Taiwan's banking industry and the US. Hopefully these measures will improve banks' willingness to innovate.

² The FSC will relax regulations on banks' investments in startups. FSC news release, October 24, 2017.