Taiwan's spectacular export success and high savings rate translated into mounting foreign exchange reserves and inflationary pressures in the mid 1980s. The U.S. strongly urged Taiwan to revalue its currency and to liberalise outward flows of capital. The ensuing appreciation of the New Taiwan dollar after 1987 and increased wages and land prices gradually eroded the competitiveness of Taiwan's labour-intensive industries relative to those of a number of South-East Asian economies, as well as China. The loss of trading privileges under the U.S. GSP scheme in 1989 accelerated this process. Traditional labour-intensive industries are now being phased out or transferred offshore and are being replaced by more capital- and skill-intensive industries, such as electronics.

Taiwan's pattern of trade reflects its industrial structure. Over 90 per cent of Taiwan's exports are manufactured goods, and trade is concentrated with developed countries, although trade with the Chinese mainland is increasing. The U.S. takes roughly one-third of Taiwan's exports, followed by the EU with 15-20 per cent, and Japan with 12 per cent. Exports to Hong Kong were also sizeable, although a significant portion was re-exported to China. Japan supplies about 30 per cent of Taiwan's imports, followed by the U.S. with 20-25 per cent and Hong Kong with 6-7 per cent. Taiwan's trade with the other Asian NIEs has been relatively modest. Taiwan registered an overall trade surplus of US $9.1 billion in 1992, down from US $11.7 billion in 1991. This surplus included a surplus of almost US $11 billion with the U.S. and a deficit of US $11.8 billion with Japan.[18]

Foreign investment, in a variety of forms and from different sources, has played an important role in Taiwan's economic development. Japanese firms invested in Taiwan during its colonization which ended with WWII. During the 1950s, the chief source of capital inflow was concessional aid from the U.S.. In the 1960s, foreign investment, principally from the U.S. and Japan, played a role in the shift to labour-intensive export manufacturing. Nevertheless, foreign direct investment in the 1950s through the 1970s never amounted to more than ten per cent of total funding of manufacturing. Foreign investment surged during the 1980s, reflecting new investor confidence following the ending of martial law in 1987, expectation of further appreciation of the New Taiwan dollar and the partial lifting of exchange controls.

Overseas Chinese accounted for approximately 30 per cent of foreign direct investment in Taiwan in the 1960s and 1970s, but this dropped to an average of ten per cent during the 1980s. Japan is the leading non-Chinese investor in Taiwan, accounting for approximately 30 per cent of total stock of inward foreign direct investment up to 1990, compared with 28 per cent for the U.S. and nine percent for

[18] IMF, Direction of Trade Statistics Yearbook, Washington, 1993.