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Discussion Paper



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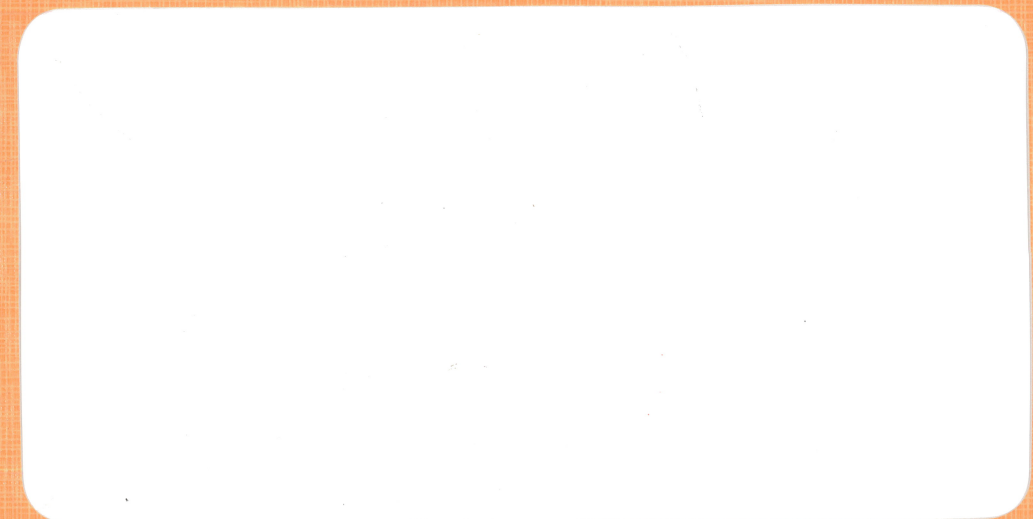
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Economic Development in Transition
-- The Case of Taiwan

by
Dr. Tzong-shian Yu

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Economic Development in Transition

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I. Introduction

From 1984 through 1992, Taiwan, the Republic of China, underwent a dramatic change in its process of economic development, which was different from any economic change experienced before. In nature, it was not cyclical fluctuations but a structural transformation. In conventional business cycles, it is easy to identify the distinctive diagnostics of depression and prosperity, but the economic fluctuation which took place during this period of time in Taiwan was characterized by unusual adjustments. For example, Taiwan achieved high economic growth with very mild inflation and low unemployment despite the sluggishness of the world economy and unfavorable impacts of internal and external challenges.

The main purpose of this paper is not only to explore the signs of Taiwan's economic fluctuations during this transition period, but also to examine how Taiwan has made its self-adjustments so quickly and smoothly. To accomplish this, our analysis

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includes: features of Taiwan's economic transition; the motives behind economic transformation; socioeconomic challenges; the process of self-adjustment; and, implications of Taiwan's economic transition. Finally, we shall make some concluding remarks which include future problems to be addressed and the prospects for the next decade.

II. The Features of Taiwan's Economic Transition

For Taiwan, the 1980s are considered a period of economic transition, and this can be illustrated by the following economic transformations.

1. Taiwan transformed from a poor society to a relatively wealthy society, and this can be expressed in terms of per capita GNP, the level of household appliance ownership and the rate of self-owned housing. In 1990, the per capita GNP was US\$7,954, the level of holding household appliances including a color T.V., refrigerator and telephone was more than 93 percent, the rate of private automobile ownership was over 29 percent and the rate of self-owned housing was more than 80 percent.¹

2. The industrial structure had transformed from labor-intensive industry to technology-intensive and capital-intensive industry. Before the 1970s, labor-intensive industries dominated in the economy, but by the end of the 1980s, most industries had a high technology and capital intensity. At that point, labor-intensive industries had little room for further development.

3. The labor supply had changed from a surplus situation to a shortage, while capital supply had evolved from a shortage to an abundance. When entering the 1980s, industrial sectors started to suffer from the shortage of labor, and guest labor from developing countries became a big issue. The unemployment rate was consequently very

low and it continues to be as such.

4. Income distribution reversed its trend and tended to become more unequal. From 1952 to 1980, year-on-year, income distribution equality improved. However, from 1980 onwards, it has tended to become more unequal because of the enlargement of salary differentials and the sharp rise in real estate prices.

5. The economy underwent liberalization, with protectionist policy measures being eliminated and financial activities starting to depend on market forces rather than on government management. Private banks increased rapidly and tariffs declined sharply². In the process of transformation, people in Taiwan needed to adjust to this new operating environment and this caused social unrest and conflict. Even so, Taiwan's economic growth didn't deviate from its trend and still maintained a high rate of growth.

III. The Motives Behind Economic Transformation

In the 1980s, people were puzzled about the paradoxical phenomenon of Taiwan enjoying rapid economic growth on the one hand, and suffering from financial over-speculation, social disorder and political conflicts on the other. To examine this paradox, it may be necessary for us to explore the motives behind Taiwan's economic transformation.

1. Excess Savings with Limited Access to Investment Opportunities

After 1972, almost each consecutive year saw the gross saving ratio exceed 31 percent, and in 1986, it reached 38.5 percent (the highest saving rate in the world). Excess savings also reflect a trade surplus. From 1975 to 1992, (except for 1980) Taiwan experienced a trade surplus. In 1985, the trade surplus accounted for 15.74

percent of the GNP and in 1986, it accounted for 19.8 percent of GNP with few investment channels for excess savings. Two conditions arose: one was the decline of the interest rate; and the other was the rapid appreciation of the N.T. dollar against the U.S. dollar. From 1986 to 1988, the official interest rate reduced to 3.5 percent, and many banks were reluctant to receive deposits, which then fueled speculative activities in Taiwan. At the same time, the N.T. dollar appreciated against the U.S. dollar by more than 50 percent, and this seriously reduced the competitiveness of Taiwan's commodities in the world market and many small businesses were unable to survive.

2. Social Conflict Arising from the Release of Social and Political Movements

For almost forty years, due to the threat of Chinese Communist forces and the consideration of Taiwan's security and stability, Taiwan was under the shadow of Martial Law. According to the law, any anti-government political movements, and any speeches which were favorable of communist propaganda were prohibited. In 1987, Martial Law was lifted, and dissidents initiated many violent demonstrations and social movements also emerged. In particular, the labor movement and environmental protection movement increased production cost and thus reduced the competitiveness of Taiwan's enterprises.

Thus, the interaction of financial speculation, social disorder and political conflicts forced Taiwan not only to change its industrial structural but also to adjust itself to the new operating environment.

IV. Socioeconomic Challenges

In the 1980s, the apparent challenges included financial over-speculation, social movements and political conflicts, and these conditions deteriorated the investment

climate and constituted a nightmare for the general public.

1. Financial Over-speculation

In 1986, the trade surplus started to increase rapidly, and the money supply (M_{1B}) sharply increased. These constituted a situation where a large level of money had accumulated but had few appropriate investment channels. This resulted in over-speculation, or the so-called "financial high fever" phenomena. The obvious indicators of this were: (1) the spread of underground investment companies, (2) the dizzying rise of the stock market, (3) the sharp rise of real estate prices, (4) the gambling craze, and (5) the rapid appreciation of the N.T. dollar. In fact, these activities were closely related with each other through speculation and windfall profits.

(1) The spread of underground investment firms

Owing to the fact that excess savings were so abundant and the official interest rate was so low, many underground investment companies established themselves, which, in nature were similar to the "rat associations" which occurred in Japan in the 1970s. Such kinds of companies made use of very high interest rates to attract depositors. The depositors often included retired government employees and veterans because their living expenses relied on the interest from their deposits. The interest rate offered by these companies was more than an annual rate of forty percent. These illegal companies then used these deposits to buy land, so the price of land sharply rose; or to buy stocks, so the price of stocks skyrocketed.

(2) The stock market explosion

In the late 1980s, the stock market in Taiwan was no longer considered a place for investment, but had become a place for speculative activities instead. The weighted price index had risen more than fifteen-fold in only three years. During the boom period, the

number of stock brokerages were twice that of the companies whose stocks were trading. More ironically, one-fifth of Taiwan's population engaged in the trading of stocks and the daily value of stock transactions rose as high as N.T.\$200 billion, or five percent of GNP in 1989. Many teachers, college students, government employees and housewives gave up their regular activities and indulged in casino-like stock speculation.

(3) The sharp rise of real estate prices

Many underground investment houses and also a large number of insurance companies became active in the real estate market, and the price of land skyrocketed in urban areas. From 1986 to 1989, the price of land increased by 10 to 100 times and the price of housing increased by 3 to 5 times. Many people made huge windfall profits from the real estate market.

(4) The gambling craze

Because of the huge base of savings accumulated in Taiwan, many people indulged in gambling. From south to north, the island was swept with betting activities and people made use of any possible means to bet. This included everything from traditional lottery tickets to highly illegal motorcycle races, and from mahjong games to Hong Kong's horse races. This led to the unfortunate term of "Republic of Casino" used to describe the ROC.

(5) Rapid appreciation of the N.T. dollar

Owing to the rapid expansion of exports relative to the increase of imports, Taiwan had accumulated a large trade surplus which amounted to US\$15 billion in 1986. Since all foreign-exchange earned from exports must be surrendered to the Central Bank in exchange for N.T. dollars, the Central Bank must purchase the U.S. currency and issue N.T. dollars to the exporters. The successive operations of the Central Bank formed a

psychology of expectation which often induced foreign banks and even individuals to speculate and sell their U.S. currency to the Central Bank of China. Therefore, the excess supply of foreign exchange caused the N.T. dollar to appreciate from a rate of NT\$39.1 : US\$1 in January 1986 to a rate of 26:1 in January 1989. Thus, the N.T. dollar appreciated by fifty-three percent. This rapid appreciation of the N.T. dollar greatly reduced the level of competitiveness of Taiwan's products in the world market and many export-oriented enterprises faced a critical moment in the late 1980s.

Actually, the above speculative activities were closely related to each other and seriously deteriorated Taiwan's investment climate. The spread of "rat associations", the gambling craze, and the stock market madness undermined people's willingness to work. The sharp rise of real estate values worsened income distribution and increased production cost, which, in turn, reduced the competitiveness in the world market. The rapid appreciation of the N.T. dollar against the U.S. dollar raised the prices of exports and reduced their competitiveness.

2. Social Movements

Prior to the ending of Martial Law, Taiwan society was much more stable and safer. When Martial Law was lifted, many social movements took place and key areas of disruption were labor-management disputes, environmental protests, farmer movements and student demonstrations. These movements have without a doubt exercised a profound influence on the investment climate.

(1) Labor-management disputes

Past disputes between labor and management mainly originated from 1986 through 1989, and labor disputes mainly took place in both public and large private firms, but not in small businesses. The disputes were focused on retirement and severance

payments, overtime pay and the distribution of year-end bonuses. The disputes resulted in strikes which, in turn, increased the costs of production without a simultaneous increase in labor productivity.

(2) The environmental protection movement

In the early stages of Taiwan's industrial development, the production of pollution was ignored and was not considered a serious problem. From the 1980s onwards, the people of Taiwan have realized the seriousness of the pollution problem, and government actions to address the problem have been initiated, but the results have been disappointing. Many scholars in Taiwan have joined together, under the encouragement of international environmental groups, and have launched the environmental protection movement. The environmentalist sentiment has grown very strong, and in some cases public work projects could not be finished by their expected completion dates due to local opposition. In the private sector, many plants and factories could not be established as was expected due to local residents' protests. For example, electrical-generation plants and petrochemical operations have been halted temporarily.

(3) Other social movements

During the last decade, in addition to the above movements, there have been farmer protests, consumer movements and student demonstrations. The farmer protests resulted from increasing imports of competitive imports (mostly from the US), and in particular the import of turkey meat from the US resulted in large-scale farmer rallies.

The student movement has often been used by the opposition party for political purposes, and the consumer movement arose from unusual price increases in different commodity imports. Street demonstrations prevailed for a short period of time.

Obviously, the labor-management disputes caused a large capital outflow and many

small businesses were forced to look for investment and production opportunities outside of Taiwan. Environmental protection should be emphasized, but when the interest groups abused this right, many factories could not be built. This is also one of the reasons why many enterprises left Taiwan and made their investments abroad.

3. Political Conflicts

The lifting of Martial Law in 1987 resulted in a difficult time for Taiwan, and society suffered from political instability and social disruption. For about four years, the government seemed to have lost control over the changes occurring in society, and illegal activities such as strikes, street demonstrations, and protests were common. Crime rose dramatically and Taiwan no longer seemed a safe place to live.

In addition to these societal ills, a political movement emerged which threatened the very future of the ROC: the independence movement. This political movement's concept was to completely separate from the Chinese Mainland and establish the Republic of Taiwan instead of the Republic of China. This independence movement was tantamount to the United States Civil War and would have not only divided the people of the island, but would have certainly provoked military actions from Mainland China.

Many people, when faced with political instability and the military threat from the communist Chinese government, sent their children and wives to foreign countries and terminated any long-term investment in Taiwan.

In short, the financial over-speculation, social movements and political conflicts constituted severe challenges for Taiwan's authorities. Among these, the most crucial one was the political conflict, which exerted an extremely unfavorable influence on people's confidence.

V. The Process of Self-adjustment

Even though Taiwan suffered severely from these challenges, a self-adjustment process occurred. In fact, by 1992, these challenges had been overcome. Almost all the underground investment companies were closed without any serious impact on society. The stock market had returned to normal levels, gambling largely disappeared, the foreign exchange rate remained stable, and the price of real estate dropped by 20-30%. However, as compared with other Asian countries, the price of real estate in Taiwan was still very high.

Labor-management disputes were almost entirely resolved, and the environmental protection movement had become more rational and other social movements also disappeared.

At the same time, political conflicts had greatly reduced. The independence movement still exists today but the people who devote themselves to the movement have become more reasonable.

Comparatively speaking, the self-adjustment process in Taiwan was extremely successful. To make further analysis, we would like to explore the adjustment by the government and the adjustment by the private sectors.

1. The Adjustment of the Governmental Policies

In 1989, Taiwan's financial frenzy reached its peak. To cool this down and to eliminate speculative activities in real estate and the stock market, the government adopted a tight-monetary policy which entailed controlling the money supply, raising the reserve ratio and putting constraints on credit to real estate traders.

These policy measures produced their desired effects. For instance, on February

12, 1990, the stock price index reached its peak at 12,680 points and then started to drop sharply. By early October of the same year, it dropped to an index of 2,500 points, which forced many of the stock-trading firms to close. And when the stocks prices dropped, many underground investment companies went bankrupt and gradually disappeared since they had no way to make windfall profits and no ability to pay high interest rates to depositors. More importantly, the government also took effective actions to check their activities.

The tight-monetary policy also had an effective impact on the price of real estate. In early 1990, the prices of real estate started to fall and dropped by 20-30 percent by 1992. From late 1990 to 1992, the stock market remained stable in comparison to the past and the stock traders also became more reasonable and careful in their stock trading.

Due to the urgency of the environmental protection movement, the government was forced to deal with pollution concerns. Firstly, the vast majority of factories located in cities and suburban areas moved to other locations. The pollution by factories located in industrial areas is also being highly regulated in comparison to the past. The Environmental Protection Administration was established in 1987 for these regulation purposes and the government is spending a substantial amount of money in this respect. In the Statute for Upgrading Industrial Structure, promulgated in late 1990, any factory will be encouraged to purchase pollution control equipment. Furthermore, pollution producing industries are restricted from establishing new operations.

As for the improvement of social and political conditions, in May 1990, the new cabinet took office, and adopted a series of effective measures to resume social order and stabilize political conditions. As a result, the social chaos has gradually been diminished. In addition, although the number of crimes is still increasing, its growth rate is substantially reducing. The greatest concern remains the political climate, and this is

largely because of the independence movement which became more active in 1991 than ever before. Fortunately, the vast majority of the Taiwan public do not support it, and recently, the support of Taiwan independence has become even weaker. However, to the majority of the people in Taiwan, the independence movement still remains a nightmare.

On the positive side, in order to raise national income, to plant roots for future industrial potentiality, to equalize regional development, and to improve the quality of life, the government initiated the Six-year National Development Plan in 1991, which is expected to make a significant contribution to Taiwan's economic development. In fact, the implementation of the plan was helpful for accelerating Taiwan's economic growth in 1991 and 1992.

In addition, the government is determined to carry out economic liberalization and internationalization, which is a catalyst for the private sectors to adjust themselves with the new operating environment.

2. The Adjustment of Private Sectors

When the investment climate became worse and the rapid appreciation of N.T. dollar against the U.S. dollar reduced enterprises' competitiveness, the private sectors had to adjust themselves and cope with the new set of conditions. One approach they chose was to look to foreign countries as development sites for their industries. During this critical period of adjustment, some industries found the ASEAN countries desirable investment locations and were offered preferential conditions, and moved their factories to these countries. A little later in time, Mainland China emerged as a desirable investment location with more preferential treatment than the ASEAN countries, and many small businesses moved to the Mainland.

It can not be denied that a great deal of capital moved off the island. Though much of the capital was for overseas investment which has created trade opportunities for Taiwan, some of the capital moved to areas such as the United States, Canada, and Australia only due to risk avoidance and may not help to create any real trade opportunities for Taiwan. This, however, has played a role in reducing foreign exchange reserves and has thus relieved the pressure on the N.T. dollar to appreciate against the U.S. dollar.

As for the labor-management disputes, they lasted for only a short time. From 1990 onwards, labor movements almost disappeared and the numbers of labor-management dispute cases dropped substantially. This can be explained as follows: (1) labor mobility is extremely high in Taiwan and dissatisfied workers easily move to other firms; (2) Taiwan's wage rate is very high and even surpasses Hong Kong or Singapore, even though the per capital GNP in these two countries is higher than Taiwan; (3) workers in large firms do have their own unions, but in many cases, unionization is not successful as many workers are reluctant to pay membership fees; and (4) ninety-eight percent of Taiwan's firms are small businesses and unions thus find it difficult to establish themselves.

By the end of 1991, Taiwan resumed its balanced position in the sense that speculative activities had substantially reduced, no serious social movements bothered the public and political conflicts were mainly confined to congressional disputes. As far as 1992 is concerned, the growth rate of GNP was 6.1 percent, the consumer price index increased by 4.5 percent, the unemployment rate was 1.5 percent, per capita GNP was 10,215 US dollars, and the trade surplus accounted for 3.99 percent of GNP. As compared with East Asia or the whole world, Taiwan's economy performed very well.³ (see Table 1).

Table 1. Economic Performance of Taiwan, 1984-1992

	Rate of change in GNP in % (at 1986 prices)	Rate of change in consumer price index %	Rate of change in wholesale price index %	Unemployment rate %	Income distribution Gini coefficient	Excess savings as % of GNP	Gross saving ratio %	Trade surplus as % of GNP (at 1986 prices)	Per capita GNP in US\$	Exchange rate US\$/NT\$
1984	11.6	-0.02	0.5	2.4	0.287	11.9	33.8	13.55	3,167	39.47
1985	5.6	-0.2	-2.6	2.9	0.290	14.8	33.6	15.49	3,297	39.85
1986	12.6	0.7	-3.3	2.7	0.296	21.4	38.5	19.32	3,993	35.50
1987	11.9	0.5	-3.3	2.0	0.299	18.4	38.5	17.51	5,275	28.55
1988	7.8	1.3	-1.6	1.7	0.303	11.7	34.5	12.01	6,333	28.17
1989	7.3	4.4	-0.4	1.6	0.303	8.5	30.8	9.59	7,512	26.16
1990	5.0	4.1	-0.6	1.7	0.312	7.3	39.2	7.57	7,954	27.11
1991	7.2	3.6	0.2	1.5	0.308	7.5	29.9	6.87	8,788	25.75
1992	6.1	4.5	-3.1	1.5			28.0	3.99	10,215	25.16
Average	8.3	2.1	-1.6	2.0			34.1			

Source: Council for Economic Planning and Development, *Taiwan Statistical Data Book, 1992*.

VI. Implications of Taiwan's Economic Transition

From 1984 to 1990, Taiwan faced many challenges and was reeling from both internal and external impacts. As mentioned above, when Taiwan entered 1992, it had overcome many of its difficulties and adjusted to the new set of conditions. One can now ask for the implications that Taiwan's transformation can provide.

1. People's Affluence

Through the endeavors of the past four decades, Taiwan's society has grown richer and a large middle class has emerged. The level of savings is extremely high and these can be used during difficult times. In particular, income distribution is more equitable and the literacy rate is one of the highest in the world. The availability of education has been a crucial building block in Taiwan and many entrepreneurs, intellectuals and Taiwan "success stories" come from poor families. This indicates that Taiwan's society is a fair one, and the majority of people do not want to have radical political change. Basically, people are happy and preoccupied with today's achievements and wealth, and while they look forward to improvement, it is of a gradual nature and not a radical change.

2. No Unemployment Problem

In many Western countries, although per capita incomes are high, the unemployment problem is a serious social illness. In Taiwan, the unemployment has been extremely low for decades. As far as the period from 1984 to 1992 is concerned, the unemployment rate was 2 percent. In many sectors there is an actual

shortage of labor and the impact of allowing foreign labor is currently a big issue in Taiwan.

3. No Debt Burden

Frugality seems to be an integral part of Chinese culture and perhaps this is a result of the influence of Confucianism. For more than thirty years, the government in Taiwan has not seen a budget deficit⁴. Further, during the last ten years, foreign debt has become insignificant. The successive trade surpluses have accumulated huge levels of foreign exchange which in turn has induced rapid appreciation of the N.T. dollar. This appreciation has made exports more difficult, but has increased people's wealth relative to foreign countries. It would seem that the high savings ratio for individuals in Taiwan (one of the highest ratios in the world) also can be applied to the government as a whole.

4. Internationalization for the People

Since 1978, even under the communist threat from the Beijing government, Taiwan has allowed its citizens to travel abroad. This exposure to foreign cultures and economies has allowed comparisons to be made about which systems are more successful and thus desirable as models for Taiwan's economy and society. For instance, in 1992, 4.21 million people went abroad for sightseeing and businesses, which accounted for 20.5 percent of Taiwan's total population.

5. The Flexibility of Small Businesses

In Taiwan, small businesses not only dominate the industrial sector, but even the service sector. In the process of Taiwan's economic development, as compared with large firms, small businesses have received less assistance and protection from the

government. However, these small businesses have provided a plethora of job opportunities in Taiwan and have no doubt assisted in the low unemployment rate. Further, in tough financial times these firms are extremely resilient and quick to adapt to new conditions. Since 1987, when many of them found that they could not survive in Taiwan by undertaking labor-intensive production, they moved to the ASEAN and the Mainland so as to cope with these difficult times.

VII. Concluding Remarks

The experiences of Taiwan's economic development in the 1980s are very significant not only to Taiwan itself, but also to other countries when they become affluent and have no appropriate ways to digest their excess savings. Though Taiwan has overcome many critical moments and difficult circumstances, it can not be ignored that Taiwan still has several serious problems to solve. The most important are the deepening of technology-intensive industry, the improvement of investment climate and the conflict of political claims.

Obviously, Taiwan has lost its comparative advantage in traditional labor-intensive industrial development. To raise its competitiveness in the world market, Taiwan must upgrade its industrial structure through the introduction of new technology and the enhancement of the R&D program. However, the deepening of technology-intensive industry is closely related with the improvement of the investment climate. In order to improve its investment climate, the best way is to stimulate the willingness to invest, which in turn, is associated with political stability, social order, sufficient infrastructure and reasonable prices for real estate. In particular, political stability is of paramount importance to the people's confidence, and the Taiwan independence

movement is no doubt a nightmare to the majority of the people.

With regard to the prospects for Taiwan's economic development, it is reasonable for us to project that Taiwan will experience moderate growth since the trade competition has become so keen and the sharp rise of wage rates and environmental protection must increase production cost. However, in tandem people in Taiwan will enjoy an increasing quality of life because the government has determined to improve the living circumstances through the implementation of the Six-year Development Plan.

Footnotes

1. General-Directorate of Budget, Accounting and Statistics, Preliminary Report on the Statistics of National Conditions, Feb. 1992.
2. In 1992, 15 new private banks set up in Taiwan, and the effective tariff level reduced to 4.5 percent.
3. The whole world was in recession, and its growth rate was 0.6 percent. The East Asian countries achieved the highest rate of economic growth, and Taiwan had the highest rate of economic growth amongst the four Asian dragons.
4. Only from 1991 did the government start to run a budget deficit because the government launched its Six-year Development Plan and will require heavy financing for implementing it.

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