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Occasional Paper

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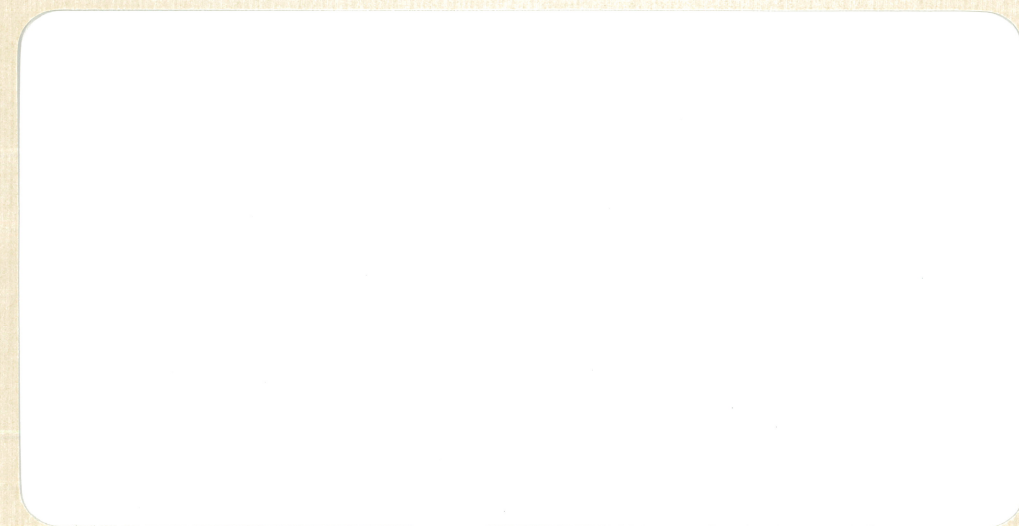
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**A Quick Adjustment of Taiwan to an Enhanced
Economic Position in the World**

by
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No.9205

August 1992

THE UNIVERSITY OF CHICAGO PRESS
CHICAGO, ILLINOIS 60607

A Quick Adjustment of Taiwan to an Enhanced Economic Position in the World*

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Tzong-shian Yu**

I. Introduction

The decade of the 1980s for Taiwan, Republic of China was an unusual one in the process of economic development in the sense that it was still able to achieve high economic growth, mild inflation and low unemployment in spite of the sluggishness of the world economy, and unfavorable impacts of financial "high fever", social disorder and political instability. This seems paradoxical, especially since no other country has been able to maintain this level of economic growth when faced with so many internal and external challenges.

In the early 1980s, in the shadow of the breakdown of the Sino-American diplomatic relationship and the lingering impact of the second oil crisis, the growth rate was rather low. In 1981, the economy grew 6.16 percent, and grew by 3.55 percent in 1982. Inflation was relatively high at 16.3 in 1981 and 3 percent in 1982, and income distribution worsened.

* Delivered at the 1992 East Asia Petrochemical Industry Conference, May 21-22, 1992, Taipei, R.O.C.

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After a short period of adjustment, Taiwan's economic development resumed its consistent growth trend. The salient point here is that during this period, Taiwan's foreign trade increased rapidly and a trade surplus resulted every year since 1981. Due to the successive accumulation of foreign exchange reserves, the government decided to adopt a strategy of economic liberalization and internationalization in 1985. However, they did not reduce the pressure of the rapid appreciation of the NT dollar against the US dollar, and avoid the occurrence of the so-called financial "high fever" involving many speculative activities.

An important event in this period was the lifting of Martial Law in 1987 and its profound effect on social order and political stability. Society as a whole suffered from social disorder and political instability which deteriorated Taiwan's investment climate. By 1991 however, Taiwan seemed to have overcome the challenges and resumed its strong growth pattern.

This paper will not only explore the period of financial "high fever" and the social and political conflicts, but will also examine the responses and adjustments to these conditions. I also hope to analyze the fundamental reasons behind the quick adjustment process.

II. Financial "High Fever"

In 1987, Taiwan's foreign exchange reserves reached US\$76 billion and the gross savings ratio was 38.5 percent, but there were few avenues to channel this massive amount of funds. As a result, the rate of interest dropped sharply and many banks became reluctant to accept deposits. Underground investment companies were able to attract many investors due to their high interest levels. These illegal investment operations usually

engaged in speculative activities in real estate or the stock market. Consequently, the price of real estate skyrocketed and the stock market was extremely volatile. The number of underground investment houses expanded to over four hundred but as the stock market cooled down, many of these enterprises went bankrupt. However, it was not only these speculative operations which wildly gambled looking for investments, but society as a whole seemed hooked on this activity in the 1980s.

1) Real Estate

When too much money chases too few products, prices will invariably rise. From 1981 onwards, savings increased very rapidly, while investment did not increase correspondingly. In areas where investment could occur, such as real estate, the effect was gigantic with the price of land increasing by ten to twenty fold from 1987 to 1990. This phenomenon produced two results: a deterioration of income distribution; and increased production costs. The latter result has fueled inflation, and the former effect has made it impossible for a middle-income family to purchase a home.

2) The Stock Market

The origin of stock markets lies in the need for a capital market. In Taiwan, this financial area has been extremely speculative and during the latter part of the 1980s, when it was a strong bull-market, the number of stockbrokerages were twice that of the companies whose stocks were trading. The prices of stocks rose more than fifteen-fold in only three years. Ironically, one-fifth of Taiwan's population engaged in the trading of stocks at the peak of the trading activity and the daily value of stock transactions rose as high as NT\$200

billion, or five percent of GNP in 1989. A large part of society including teachers, college students, government employees and housewives gave up their regular activities and indulged in the casino-like stock speculation.

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 had dropped to 2,500 points. Although the market had been characterized by its volatility, this severe fluctuation finally closed many of the stock-trading firms and the perception of the market as a "sure-thing" for large returns was shattered.

3) The Gambling Craze

The lack of investment channels for the huge amounts of savings led to serious levels of gambling in Taiwan society. From North to South, the island was swept with betting activities. This included everything from traditional lottery tickets, to highly illegal motorcycle races and this led to the unfortunate term of "Republic of Casino" used to describe the ROC.

4) Rapid Appreciation of the NT Dollar

Owing to the rapid expansion in the volume of exports vis-a-vis imports, Taiwan 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 NT dollars, the Central Bank must purchase the US currency and issue NT 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 US currency to the Central Bank of China. Therefore, the excess supply of foreign exchange caused the NT dollar to gradually appreciate from a rate of NT\$39.1 : US\$1 in January 1986 to a rate of 35 : 1 for the greenback in January 1987, and by January 1989 it was 26 : 1. Thus, the NT dollar appreciated by fifty-three percent from January 1986 to the same month in 1989. This rapid appreciation of the NT 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.

III. 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 implementation of the Labor Standards Law and the encouragement from ambitious politicians. From 1986 through 1989, labor disputes mainly took place in both public and large private firms, but not in small businesses. The disputes were focussed 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. To cope with this unfavorable condition, a large capital outflow took place. Many enterprises were forced to look for investment and production opportunities outside of Taiwan.

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 governmental 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 can not be finished by their expected completion dates due to local opposition. In the private sector, many plants and factories can not be established as was expected due to local residents' protests. This has meant that major projects such as 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 rises in different commodity imports. Street demonstrations prevailed for a short period of time.

IV. Political Conflicts

The lifting of Martial Law resulted in a difficult time for Taiwan, and society suffered from political instability and social disruption. 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 separation movement. This political movement's concept was to establish the Republic of Taiwan instead of the Republic of China. This separation 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.

V. Responses and Adjustment

The financial "high fever", social movements and political conflicts constituted severe challenges for Taiwan's authorities. How to respond to these impacts and properly adjust society was of utmost concern. From 1990 to 1992, this priority was largely met as is

illustrated by the return of both stability and prosperity.

1) Tight Monetary policy

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

Previously, many underground investment companies made use of the revenue earned from the stock market and new deposits to repay high interest. When the stock price dropped dramatically, many companies which held large amounts of stocks were dealt a critical blow. Even more importantly, the government started to take effective actions to check their activities. Most underground investment companies went bankrupt and gradually disappeared. In early 1990, the price of real estate started to fall and dropped by twenty to thirty percent by 1991. The stock market has recently been very stable in comparison to the past and the stock traders have thus become much more reasonable and careful in their stock trading and this financial area no longer occupies the numbers of players or traders as in the past.

2) Direct Investment to the ASEAN and the Mainland

Faced with a sharp reduction in export competitiveness and labor disputes, many trade-oriented industries struggled to survive. During this critical period of adjustment, some industries found the ASEAN countries desirable investment locations and were offered preferential conditions. In particular, there were no labor disputes and land and labor were

cheaper in comparison to Taiwan. Slightly later in this adjustment process, Mainland China emerged as a desirable investment location with preferential treatment, and no language barriers or cultural handicaps.

The direct investment flows to the ASEAN and the Mainland have given rise to "hollowing-out" concerns for Taiwan industry. At this point there is no definitive evidence that there is need for concern in this respect, but on the other hand, the direct investment has achieved three goals: 1) it has helped to diversify foreign markets for Taiwan products; 2) it has enhanced the trade relation between these areas and Taiwan; and, 3) it has rescued many small businesses from bankruptcy.

3) Capital Outflow

Due to the worsened investment climate and political instability in Taiwan in the 1980s, 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 US, Canada and Australia only due to risk avoidance and may not help to create any real trade opportunities for Taiwan. This has played a role in the foreign exchange reserves dropping from US\$75 billion in 1989 to US\$63 billion in 1990, but on the other hand such a reduction has relieved pressure on the NT dollar to appreciate against the US dollar.

4) Improved Relations between Labor and Management

The labor-management disputes worried enterprises and the government for only a short time. From 1990 onwards, labor movements disappeared and the numbers of labor-

dispute cases dropped substantially. There are many reasons behind this improvement in relations: 1) labor mobility is extremely high in Taiwan and dissatisfied workers easily move to other firms; 2) looking at East Asia, excluding Japan, Taiwan's wage rate is very high and even surpasses Hong Kong or Singapore, even though the per capita 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.

5) The Enhancement of Environmental Protection

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 have been moved out. The pollution by factories located in industrial areas is 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 substantial amounts 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 even establishing new operations.

Thus far, the anti-nuclear sentiment is still very strong and the establishment of the fifth power plant is being stymied by local residents. Nevertheless, the environmental protection movement has become much more rational and certainly less radical.

6) The Six-year National Development Plan

In order to raise national income, to plant roots for future industrial potentiality, to equalize regional development, to equalize regional development, and to improve the quality of life, the government has initiated the Six-year National Development Plan. The focus of the plan is on the improvement of the infrastructure. To implement the plan, NT\$8,200 billion is needed to be spent over six years (1991-1996). The huge amount of capital needed for the budget may place a great burden on the government budget, but it will make a positive contribution by stimulating economic activity, dampening the prospects of recession, and by upgrading industry.

7) The Improvement of Social and Political Conditions

In May 1990, the new cabinet took office. To resume order and to stabilize political conditions, the cabinet adopted a series of effective measures. 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 separation movement which became more active in 1991 than ever before. Fortunately, the vast majority of the Taiwan public do not support it. Two pieces of evidence can be given to support this claim: 1) in the very recent National Assembly election, the opposition party (whose basic platform was Taiwan independence) was predicted to win at least one third of the total votes. The final result was a very disappointing 24% of the total votes, and those opposition candidates who strongly supported the separation idea were especially

unsuccessful; 2) in the recent demonstration organized by the opposition party for direct presidential elections, the repeated claim that 30,000 supporters would participate was later an embarrassment when only 4,000 rallied. The opposition party, after impressive gains only a short while ago, has largely alienated itself from most of the Taiwan public due to its independence crusade.

VI. Underlying Reasons for Quick Adjustment

During the 1980s, Taiwan faced many challenges and was reeling from both internal and external impacts. However, as we move into the 1990s we see that Taiwan has overcome many of these difficulties and adjusted to the new conditions. One may wonder at how this was managed and perhaps the explanation may be as follows:

1) The Wealth of the People

Through the endeavors of the past decades, Taiwan 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 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) The Absence of an 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 decade of the 1980s is concerned, the unemployment rate was 2.1 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 deficit. 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 NT 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) An Open-door Policy 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.

5) The Resilience and 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.

VII. Concluding Remarks

During the last forty years, Taiwan has experienced many critical moments and difficult circumstances. The Mainland attempted to invade in 1949 and 1958, and even now there is a persistent political threat from the Beijing government. Diplomatic failure forced withdrawal from the United Nations and a loss of formal recognition from the US, Japan and all other developed nations resulting in almost total diplomatic isolation. In addition, with almost no natural resources, Taiwan faced both oil crises together with hyperinflation.

Taiwan, as the last free province of the Republic of China has struggled to remain on the world platform, and through the promotion of economic relations has maintained physical trading arrangements with 140 countries. The tide has now turned for Taiwan and countries now are eager to have contact with this diplomatically isolated island.

Entering the 1980s Taiwan saw many challenges but was able to achieve high

economic growth averaging 8 percent, mild inflation at 3.1 percent, and unemployment only reaching 2.1 percent. Foreign debt is negligible and a trade surplus consistently occurs every year resulting in foreign exchange reserves of US\$83 billion in 1992. Even more importantly, wealth is in the hands of the people and most of them enjoy a prosperous lifestyle.

In view of the recent developments in Taiwan's internal and external conditions, though many people are worried about the impacts of the separation movement on Taiwan's economic development, we are still optimistic for the future which is based on two assumptions: firstly, the relationship between the two sides of the Taiwan Strait can be further improved since the achievement of the Mainland's economic reform in the last ten years has enhanced the policy-makers' confidence; and secondly, political and social stability in Taiwan can be improved, since the people of Taiwan realize that these must be maintained for further growth. With this in mind, it can be expected that in the next decade, Taiwan will experience moderate growth and its people will enjoy an increasing quality of life.

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