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Occasional Paper

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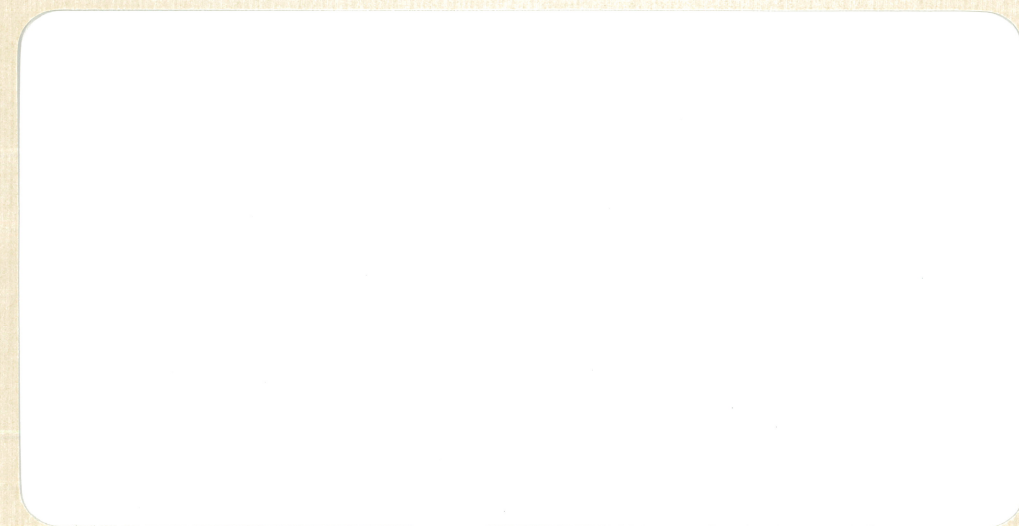
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**Taiwan's Economic Position
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I. Introduction

There are many factors to determine a country's economic position in a region or in the world. Traditionally, a large population, extensive territory and rich natural resources have been regarded as the main requirements for a country's economic position. However if the country does not experience significant economic development, it is impossible to raise its economic position. By contrast, if the country is endowed without rich natural resources or a large territory, but has achieved rapid economic growth and equitable income distribution, its global economic position will then be raised and is likely to draw the attention of the world. Taiwan is such an example of an economy with limited natural resources but which has substantially improved its economic position over the last four decades.

The purpose of this paper is to explain how Taiwan can further raise its economic position in the East Asian regional restructuring setting. For doing this, we

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shall: analyze Taiwan's position in the early stage of its economic development; discuss the change in the economic structure of East Asia; explore the barriers to the formation of a regional economic community; examine the rise of Taiwan's economic position in East Asia; and further examine the regional role of Taiwan. Finally, we shall make some concluding remarks.

II. Taiwan's Position in the Early Stage of its Economic Development

The evolution of Taiwan's position can be seen from its geographical constraints and economic conditions. As a small island, Taiwan is situated off the southeast coast of Mainland China and on the Western edge of the Pacific Ocean. The total land area of Taiwan, including the Pescadores and other outlying islets, is 36,000 square kilometers. Even though Taiwan is small as compared with Korea, Japan and the Philippines, it has played a key role not only in a regional strategy but also in the balance of power in the Western Pacific area.

Taiwan is located at a strategic position, and is a good point for watching the Southeastern Coast of Mainland China from the west side of Taiwan, the Philippines from the south, and Korea and Japan from the north, and is also a mid-way island used for blockading the channel from Japan and Korea to the Strait of Malacca. Thus, Japan waged the Sino-Japanese War and occupied Taiwan in the late Ching Dynasty (1895-1945). During World War II, Japan made use of Taiwan as a springboard to attack Southern China and Southeast Asian countries. After 1950, the United States used Taiwan as a strategic base for protecting the Western Pacific Ocean from the attack of

communist forces¹. Consequently, Taiwan made a great contribution to the security of the Western Pacific Ocean from 1950 through 1980.

Before the 1960s, from an economic point of view, Taiwan was not as important as today in the world economy. Taiwan was still a backward and underdeveloped area, and in many regards Taiwan had to rely on U.S. aid². In the 1960s, Taiwan's economy took off and achieved high economic growth with stable price fluctuations, and its foreign trade rapidly expanded in the Japanese and American markets. However, the trade with the East Asian countries experienced only a slow growth rate. During that period of time, Taiwan had no opportunity to enjoy indirect benefits from the Korean War, but later did economically benefit from the Vietnam War³. The representatives of the Republic of China were forced to withdraw from the United Nations in 1971, which also indicated that Taiwan was not a large economic power but only a small island on the world map. At that time, Taiwan's GNP ranked no. 39, per capita GNP ranked no. 42, total trade ranked no. 25 and foreign reserves ranked no. 27 (see table 1). Many powerful countries, except the United States, paid little attention to the existence of Taiwan⁴.

III. Changes in the Economic Structure of East Asia

From the 1950s onwards, East Asia has been directly and indirectly influenced by world superpowers. However, due to unbalanced regional economic development in East Asia, the position of the world superpowers has shifted.

Table 1: The Change in Taiwan's Position in the Global Economy
(1972 -- 1991)

(Ascending order)

	1972	1981	1991
GNP	39	32	21
GNP/Per Capita	42	34	25
Total Trade	25	22	14
Exports	23	16	12
Imports	27	22	17
Foreign Reserves	27	14	1

Sources: 1. International Financial Statistics, IMF.
2. Quarterly National Economic Trends, Taiwan Area, the Republic of China, 1992.

1. The Influence of two superpowers with different economic systems

Before the 1980s the East Asian area was under the influence of two superpowers: the United States and the Soviet Union. The countries under the shadow of the Soviet Union were characterized by a centrally planned economy in which the private property system was strictly prohibited, inward looking economic policies were emphasized and people had little freedom (Mainland China, North Korea, Vietnam, Laos and Cambodia). Their economic growth was stagnant and their living standards were very low.

However, the countries under the influence of the United States were characterized by market economy conditions in which the private property system was esteemed, outward-looking economic policies were stressed, and their people enjoyed freedom, such as Japan, South Korea, the Republic of China on Taiwan, Hong Kong and the ASEAN countries. Their economic growth was high and their living standards greatly improved. Due to the differences in their economic systems, these two groups had low trade interaction with each other and were basically in a conflict situation.

After the mid-1980s, the influence of the Soviet Union tended to decline. In particular, after Gorbachev adopted political and economic reforms and the Berlin Wall was torn down, the Soviet empire quickly collapsed and now has little influence in East Asia. This change has been, no doubt, dramatic, and has had a great impact on the countries with centrally planned economies in the East Asian area. In fact, Mainland China has gradually changed its economic system since 1979⁵ and has had remarkable achievements in economic development, which in turn has exercised great influence on

Vietnam.

In view of its poverty and backwardness, the Vietnam government started to launch its economic reforms and adopt an open-door policy in the mid-1980s. Laos and Cambodia are still involved in military conflicts and thus find it difficult to change their economic systems. As for North Korea, its economy is still a closed and centrally planned one, and they have few allies.

Faced with so drastic of a change, many people have tended to agree that the United States is the only superpower which combines not only military strength but also economic capacity. The Soviet Union has disintegrated and its former member-states have separated into individual republics and none of them as of yet have achieved economic growth and political stability.

2. The Influence of Two New Superpowers with Similar Economic Systems

In view of the economic developments in the 1980s, it may be too early to conclude that the United States is the only superpower in the world, and many people are inclined to agree that Japan has become another superpower able to share the regional advantage with the United States, which can be seen from the comparison of the two countries. In terms of per capita GNP, the United States increased from U.S.\$10,630 in 1979 to U.S.\$21,790 in 1990 and its growth rate was 104.99% while Japan increased from U.S.\$8,810 to U.S.\$25,430 and its growth rate was 188.64% in the same period of time. The interesting thing is that the per capita GNP of the United States in 1979 was larger than that of Japan while the per capita GNP of Japan in 1990 was larger than that of the United States, because Japan maintained higher economic

growth as compared with the United States. From 1980 to 1990, Japanese economic performance was much better than the United States' not only measured by economic growth but also by inflation. The inflation rate in Japan was 1.5% while that in the United States was 3.7%. (see Table 2).

Table 2: Comparison of Economic Conditions Between the U.S. and Japan

	GNP Per-capita				Average Annual Rate of Inflation		
	Dollar US\$		Average Annual Growth Rate (%)		(%)		
	1979	1990	1960-79	1965-90	1960-70	1970-79	1980-90
U.S.	10,630	21,790	2.4	1.7	2.8	6.9	3.7
Japan	8,810	25,430	9.4	4.1	4.9	8.2	1.5

Source: The World Bank: *World Development Report*, 1981, 1992.

In East Asia, Japanese exports account for a large proportion of the market, as well as does Japanese direct investment. The enterprises in this area prefer making use of Japanese-made machinery equipment and parts because Japanese after-sale service is often much better than American competitors and their prices are also low, so that most countries in East Asia have a trade deficit with Japan(see Table 3). From 1980 onwards, Japanese enterprises have made direct investments in the manufacturing and

Table 3 : The U.S. and Japan's foreign trade position in the East Asia

		1960		1970		1980		1990	
		Export	Import	Export	Import	Export	Import	Export	Import
Korea	U.S.	11.67	42.37	47.12	29.47	26.52	22.17	29.91	24.27
	Japan	63.72	20.70	28.16	40.98	17.43	26.55	19.44	26.60
Hong Kong	U.S.	20.39	12.20	35.82	13.20	26.15	11.84	24.12	8.07
	Japan	6.17	15.95	7.10	23.86	4.61	22.96	5.70	16.09
Indonesia	U.S.	37.04	17.85	13.02	17.82	19.64	13.00	13.10	11.45
	Japan	10.97	19.61	40.81	29.41	49.26	31.49	42.54	24.79
Malaysia	U.S.	-	-	13.01	8.60	16.35	15.08	16.95	16.95
	Japan	-	-	18.33	17.50	22.82	22.83	15.31	24.19
Philippines	U.S.	50.00	46.21	41.64	29.46	27.54	23.52	37.98	19.54
	Japan	24.04	23.66	40.21	30.64	26.61	19.91	19.85	18.45
Taiwan	U.S.	11.50	38.11	38.08	23.87	34.12	23.59	32.35	23.05
	Japan	37.67	35.33	14.56	42.83	10.97	27.02	12.40	29.24
Thailand	U.S.	16.62	17.40	13.45	14.85	12.66	14.46	22.71	10.78
	Japan	21.06	26.71	25.52	37.42	15.10	21.19	17.21	30.36
Singapore	U.S.	10.08	10.49	11.10	10.83	12.51	14.11	21.26	16.08
	Japan	6.53	21.73	7.61	19.38	8.05	17.95	8.75	20.12
Mainland	U.S.	-	-	-	-	5.42	19.64	8.24	12.10
China	Japan	1.06	0.14	12.27	29.07	22.23	26.50	14.28	14.06

Sources: 1. Direction of Trade Statistics, International Monetary Fund, 1992.
2. Taiwan Statistical Data Book, 1992.
3. Foreign Trade of China 1970 to 1979, Institute of Developing Economies.

service sectors as well, such as department stores and shopping malls. Due to large direct investments made by Japan in East Asia, Japan has maintained a close relationship with the East Asian area as compared with the United States. Particularly, since the late 1980s, Japan started to make direct investments in Mainland China, and attempted to dominate the development of the Northeastern area which has very rich natural resources and good transportation. However, it can not be ignored that the United States is still important to the East Asian area, not only because the United States can provide a potential market for their exports but also because some of the East Asian countries still need U.S. military protection even though the influence of the United States in this area has gradually declined.

Nevertheless, it has become clear that East Asia is no longer under the shadow of the United States and the Soviet Union but its economic development is greatly influenced by the United States and Japan in the sense that Japan provides capital and machinery equipment for this area and the United States provides capital and a huge market for their products. Thus, the most important transition in this area is that the contradiction of different economic systems is being gradually substituted by competition which prevails in a market economy.

IV. Barriers to the Formation of an Economic Community in East Asia

Faced with the ongoing trend of regionalism, can East Asia form an economic community similar to NAFTA (North American Free Trade Agreement) or follow the model of increasing integration in the European community? Thus far, a definitive

answer can't be given, even though there already are some economic organizations in East Asia, such as ASEAN (Association of South Eastern Asian Nations) PECC (Pacific Economic Cooperation Conference), PBEC (Pacific Basin Economic Council), and APEC (Asia-Pacific Economic Cooperation)⁶. However, these are not as effectively organized as NAFTA or the EEC. Recently, there are many propositions for the formation of a regional economic community, such as a Northeast Asian economic Zone, Yellow Sea Zone, South China Economic Zone, Japan Sea Economic Zone, etc. however, these propositions seem somewhat naive. If they can become possible, it may take a long time.

Hampering regional integration in East Asia are several political asymmetries which exist between countries: (1) Mainland China vs. Taiwan, (2) North Korea vs. South Korea, (3) Japan vs. remaining East Asian countries, and (4) Greater China vs. ASEAN. Only when these political conflicts are resolved can there be a possibility for this area to achieve the formation of an economic community.

1. Mainland China vs. Taiwan

The Beijing government has a strong desire to unify the whole of China and urges "one country with two systems" which means the Beijing government is the central governing body, while the Taipei government is a local one. Correspondingly, the Taipei government insists "one country with two political entities" and has designed a three-stage unification plan. As for "one China", both sides have no common opinion. Under ideological inconsistency and political confrontation it is very difficult for them to undertake a one-on-one dialogue for solving the issue of

unification. With this in mind, the establishment of any economic zone must be based on political considerations.

2. North Korea vs. South Korea

As compared with the development of the relationship between Mainland China and Taiwan since 1987, South Korea has issued national unification proclamations with North Korea for about two decades, however, there has been little progress. North Korea continues to use a centrally-planned economy and does not enjoy political democracy. Also in contrast, Chinese people on the two sides of the Taiwan straits have resumed their close relationship, while Korean people on the two sides of the thirty-eighth parallel are still strictly prohibited to have exchanges. Furthermore, there is no sign indicating that North Korea would like to transform its economic system from a controlled economy to a market economy.

3. Japan vs. the remaining East Asian countries

From the 1970s onwards, owing to the achievement of rapid economic development, Japan has become increasingly ambitious to act as a leader in East Asia, and has attempted to break through various barriers by any possible means for achieving this goal. However, countries in this area are not willing to accept Japan as a leader. In part, this is due to the Japanese government not having apologized to the East Asian countries for crimes committed during World War II. Although the Japanese government has tried to improve its relationship with these countries through economic and cultural channels, the people in this area still fear the rise of Japanese

military forces.

4. *Greater China vs. ASEAN*

The so-called “Greater China” area includes Taiwan, Hong Kong, Macau and the Mainland. So far, this area has developed a type of economic relationship through trade and capital flows. Even though this relationship is loose, the ASEAN is afraid of the influence of Greater China on its development. It can not be denied that overseas Chinese in ASEAN are influential for economic activities. If a Greater China region can be successfully formed, it would dominate the ASEAN’s economic activities and further affect their political development.

From the previous analysis, it can be seen that there are many difficulties for the East Asian countries to form an economic community. The key problems are twofold. Firstly, the attitude of ASEAN toward Greater China and Japan: some leaders of the ASEAN wish to play an important role in East Asia, but they have worries that Chinese will dominate their economic activities and they also have a fear that Japanese militarism could rise again. Secondly, the attitude of Chinese people and Korean people toward Japan: Japan has become a powerful country in the world, but Japanese friendship with the Chinese and Koreans has not improved to an adequate level. The main reason is the refusal of the Japanese government to apologize to the Chinese and Koreans for their war crimes during World War II. Consequently, this condition is unfavorable to the formation of an economic community in East Asia⁷.

V. The Rise of Taiwan's Economic Position in East Asia

Successful achievements of economic development are easily recognized and appreciated. The economic miracle of Taiwan's development has been generally accepted. The rise of Taiwan's economic position mainly relies on its sustained and rapid economic growth. Before 1980, many developed countries broke their diplomatic relationships with the Republic of China on Taiwan and rejected contact with R.O.C. officials from Taiwan because Taiwan was not important to them. However, at the same time, Taiwan did its best and improved its economy quickly and satisfactorily. When Taiwan had accumulated a huge level of foreign exchange reserves, (more than US\$80 billion) the whole world started to pay attention to Taiwan's economic development and there was a gradual change in attitude towards Taiwan. The importance of Taiwan in East Asia can be expressed in terms of its foreign trade, external investment and economic assistance to other countries.

1. Taiwan's economic development and Japan

Taiwan was occupied by Japan for fifty years, and was recovered by the Chinese government in 1945. Since the 1950s, Japan has been restored from its war-time destruction and has become the most important supplier & commodities including machinery equipment and materials. For instance, more than 40 percent of Taiwan's imports came from Japan in 1971 and even today, the imports from Japan still account for 23 percent of total imports. Also, in the 1970s many Japanese small businesses set

up facilities in Taiwan as joint ventures and these provided a good opportunity for Japanese small businesses to continue to survive and to adjust themselves to the new conditions in Japan.

On the other hand, Taiwan's enterprises have made use of Japanese-made machinery and materials and provided commodities for exports. From the late 1970s onwards, Taiwan became a potential competitor of Japan in many sectors, and many Taiwan-made commodities have tended to substitute for Japanese-made commodities not only in the ASEAN but also in the world market.

2. Taiwan's economic development and Mainland China

The successful achievement of Taiwan's economic development has exercised a great and profound impact on the economic reform and open-door policy in Mainland China⁸. The four Asian dragons' economic development (particularly, Taiwan's economic development) has encouraged the policy-makers in the Beijing government to change their ideology and policies and they have adopted many policies which were previously carried out in Taiwan⁹. Furthermore, the remarkable achievement of economic development in the past 10 years in Mainland China has enhanced the policy-makers' confidence in further economic reform.

During the last 10 years, the economic relations between Taiwan and Mainland China have greatly improved. The bilateral trade has substantially increased but the investment in the Mainland made by Taiwan's businessmen has sharply risen, which is of critical importance to the Mainland because the Mainland lacks capital and is in need of modernized management. The contribution to the expansion of foreign trade and the

improvement of the coastal area should thus be largely attributed to Taiwan's enterprises. In addition, the large remittances made by the Chinese in Taiwan to the Mainland every year have helped the Mainland greatly¹⁰.

3. Taiwan's economic development and the ASEAN

In the 1980s, the ASEAN countries underwent a remarkable achievement of economic development. The most important reason was that the ASEAN had adopted an open-door policy, and foreign investment also made a contribution to its rapid economic growth. In fact, the ASEAN has learned many lessons from the experience of Taiwan's economic development. For instance, Taiwan's economic development has mainly depended on the development of small businesses, and the expansion of foreign trade. It should be noted that Taiwan's small businesses, played a crucial role in maintaining the economic growth of Taiwan through the channeling of foreign investment into the ASEAN. In the last eight years, Taiwan ranks second as the largest investor in Thailand as well as first in Malaysia, second in Indonesia and first in the Philippines. Due to the increase in foreign investment in the ASEAN, Taiwan's trade with the ASEAN countries has correspondingly risen.

4. Taiwan's economic development and South Korea

Taiwan and South Korea are often identified as models of successful economic development. By nature, the two models are different in many respects. Before 1992, the two countries had closely cooperated in order to fight against the influence of socialist regimes¹¹. Due to the fact that Taiwan reached the take-off stage earlier than

South Korea, South Korea learned from Taiwan's experiences before the 1970s and then started to learn more about Japan's experiences from then on. In fact, both South Korea and Taiwan have learned from each other. For instance, the government officials in Taiwan visited South Korea for learning about the Korean public housing program and water pollution clearance program, and South Korea sent officials to Taiwan to learn about the development of small businesses. In late 1992, the government of South Korea broke its diplomatic relations with the Republic of China, and all the official cooperation had to be terminated.

In addition to the severing of the two countries' diplomatic relationship, Taiwan and South Korea have been keen competitors not only in the world market but also in Mainland China. This in itself is a stimulus for both countries to upgrade their respective industrial structures.

5. Taiwan's economic development and the rest of East Asia

The rest of East Asia includes North Korea, Laos, Cambodia, Vietnam and many islands in the Western Pacific Ocean, North Korea is still a closed economy but Vietnam has changed completely over the past six years. Taiwan has made large investments in Vietnam, and the bilateral trade has increased rapidly. Reports indicate that Laos and Cambodia are also interested in foreign investment to stimulate their economic development. If these two countries can maintain peace and stability, much of Taiwan's investment would be shifted to this area.

The above analysis has revealed that the role Taiwan has played has become increasingly important over time in East Asia. Its importance lies in the fact that

Taiwan can not only provide this area with its economic development experiences, but can also make large investments. Thus, Taiwan is no longer an isolated island but an invaluable model and an active contributor to many developing countries for their economic development.

VI. The Role of Taiwan in East Asia

As a member of East Asia, the Republic of China on Taiwan should play a more important role in East Asia. The following has been proposed and partly carried out already.

1. As an example for countries to transform from an underdeveloped stage to a developed stage

During the past four decades, Taiwan may be the only economy to successfully transform from a poor society to a rich society with the merits of : rapid economic growth with equitable income distribution; sound public finance without a debt burden; and mild inflation with low unemployment. Its economic development can thus be used as a model for developing countries.

2. As a training center

“Don’t give one a fish but teach one how to fish”. This is an important proverb for less-developed countries. After World War II, many countries gained their independence and many of them also received foreign aid, but only a few of them have

achieved rapid economic growth and improved their living conditions. Taiwan is a successful example to follow. The development of small businesses and the development of education programs are not only helpful for stimulating economic growth but for improving income distribution, many developing countries are interested in these experiences and Taiwan has the ability to set up training centers to help them build up their small businesses and improve their educational systems.

3. As a financial center

Taiwan has large foreign exchange reserves, high foreign investment, increasing external investment and advanced information systems and these may meet the requirements for building up as a financial center for East Asia. As a financial center, capital could be effectively channeled from suppliers to demanders. Since the 1980s, Taiwan's financial sector has been gradually liberalized with many private banks and insurance companies established which have a free hand to manage capital allocation. The stock market, money market and foreign exchange market have also been greatly improved.

4. As a storage and transfer center

Taiwan has been equipped with quality harbors, strong transportation links and effective management, and these requirements enable Taiwan to play a role as a storage and transfer center. Since Taiwan is located in a strategic position, many commodities can be stored in Taiwan and then transferred to the East Asian countries at the appropriate time. Particularly, for Mainland China, this center is especially important.

By means of sea transportation and air transportation, this center may be more effective than any other place in the Mainland.

5. As a benefactor in East Asia

To help the poor and to rescue the needy should be the responsibility of developed countries. Taiwan has now become a developed economy and has the capacity to help developing countries when they encounter disaster and suffer starvation. During the last ten years, Taiwan has made significant contributions to African countries, East European countries and South Asian countries in this regard. In fact, Taiwan could do more, if opportunities were offered to Taiwan.

VII. Concluding Remarks

Finally, it may be reasonable to make the following concluding remarks:

Firstly, in East Asia, there is a strong trend for countries which undertook the restrictive operation of a centrally planned economy to gradually adopt the system of a market economy. This is helpful for this area to eliminate economic conflicts and introduce trade competition. However, it is almost inevitable for these countries to bear the problems of hyperinflation. How to help them through their shortages and instability should be the responsibility of developed countries.

Secondly, a regionalism trend has emerged and the East Asian area is faced with the situation of rising protectionism. It is thus not easy for East Asia to form an economic community, similar to NAFTA, in order to combat with the protectionist

countries, since there are many barriers to overcome. However, some kinds of economic cooperation can be established and especially if the political confrontation between countries can be eliminated, there is a possibility for the East Asian area to form an economic community.

Thirdly, at this point, Taiwan has no diplomatic relations with the main East Asian countries, but has strong economic ties with them through bilateral trade, direct investment and economic cooperation programs. As a newly developed economy, Taiwan should make more contributions to the East Asian area by means of capital and technology exchanges and the experiences from economic development.

It can be expected that East Asia will be a promising area in the 21st century. Since East Asia is endowed with rich natural resources and plentiful human resources, this area has great potential to become increasingly developed. The experiences of Taiwan's economic development should be constructive and useful in this respect to help this area to achieve its goal.

Notes:

1. When the Korean War broke out in 1950, the United States entered to protect the Western Pacific Ocean from the attack of communist forces.
2. The U.S. aid to Taiwan started in 1951 and ended in 1965, and the initial amount of the U.S. aid was US\$1,482 million which was allocated as general economic aid, development loan funds and surplus agricultural commodities under P/L 480.
3. The Vietnam War lasted for more than ten years (from the mid-1960s to 1975), and the bilateral trade between south Vietnam and Taiwan rapidly increased.
4. By 1980, all the developed countries had broke their diplomatic relations with the R.O.C.. Although the United States recognized the P.R.C. in 1979, it still maintains semi-official relations with the R.O.C. and permitted the government of the R.O.C. to set up many offices similar to consulates in major cities of the U.S. to deal with economic and cultural affairs.
5. The Beijing government announced economic reforms and an open-door policy in late 1978, and the new policies were carried out from 1979 onwards.
6. Refer to the materials for the 8th Pacific Economic Community Seminar held in Taipei on December 17, 1992, organized by the Chinese Taipei Pacific Economic Cooperation Committee.
7. After World War II, the German government apologized to its neighboring countries for its military incursions.
8. During the period of military conflicts between Taiwan and Mainland China, the people in Mainland China learned nothing about Taiwan's economic development, but when the Beijing government and the U. S. set up their official relationship in 1992, many officials from Mainland China had the opportunity to learn about the remarkable achievement of Taiwan's economic development and found that Taiwan had transformed from a poor society to a rich one. In view of such a big gap between Taiwan and Mainland China, policy-makers had to change their economic system so as to save their party and their power.
9. For instance, the establishment of special economic zones in Mainland China is a copy of Taiwan's export processing zones. The measures for the encouragement of foreign investment in Mainland China is another copy of Taiwan's Statute for the Encouragement of Investment.
10. No exact estimate for the amount of remittance made by the Chinese in Taiwan to Mainland China has been made. Many people believe that the remittance amount is significant. In 1992, more than one million people in Taiwan visited Mainland China for sightseeing, visiting relatives and for business. If the average spending per person is US\$3,000, the total should amount to US\$3-4 billion.
11. During that period of time, to fight against communism and the communist party was the common goal of the R.O.C. and South Korea.

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