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Occasional Paper

CHUNG-HUA INSTITUTION FOR ECONOMIC RESEARCH

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Republic of China

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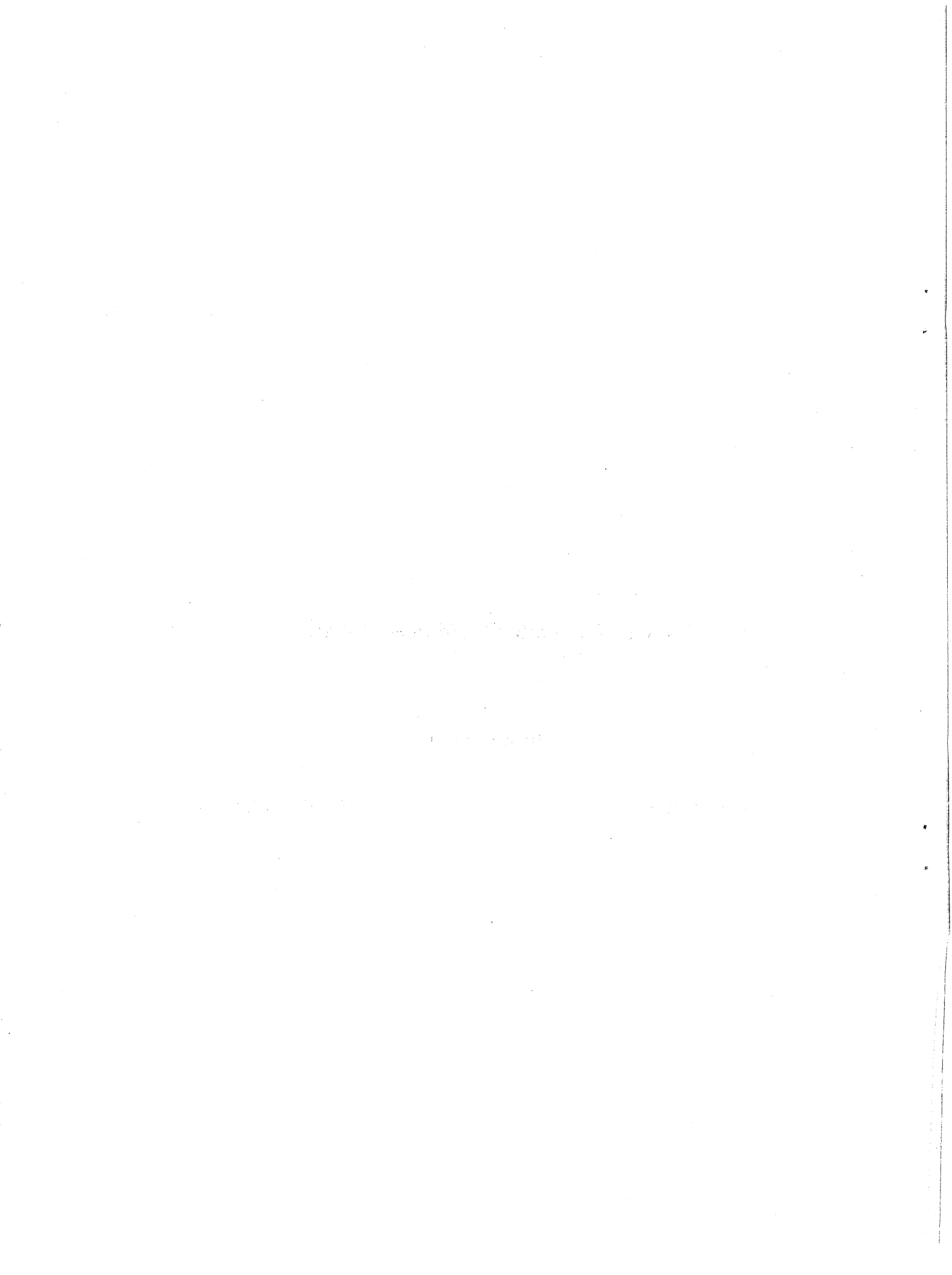
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Current Economic Conditions of Taiwan*

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I. Current Economic Conditions

In 1992, the world economy was in recession. However, as compared with many developed and newly industrialized countries, Taiwan achieved a high rate of economic growth, despite it being faced with many unfavorable conditions. If expressed in terms of the rate of change in gross national product, the rate of economic growth was 6.06 percent, and the per capita GNP was US\$10,215 and increased by 16.2 percent. As for the GNP, domestic demand made a greater contribution than foreign demand, because of the sluggishness of Japanese and European markets. Concerning domestic demand, fixed capital formation had a higher growth rate than the previous two years, and this in part reflects the positive effect of the implementation of the Six-year National Development Plan.

There was no serious inflation at this time and the consumer price index

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increased by 4.5 percent because of the rise of food prices in the first part of 1992, while the wholesale price index fell by 3.1 percent which in large part was attributable to the appreciation of the N.T. dollar against the U.S. dollar. At the same time, export prices fell by 7.3 percent and import prices fell by 5.4 percent. However, what people are the most concerned with is the price of real estate, which is still the highest in the world. Other factors such as the unemployment rate were low (just 1.5 percent) and the shortage of labor was a problem being addressed with the introduction of guest workers but was still an important issue.

II. Challenges to Economic Growth

It should be noted that though Taiwan had a remarkable achievement of economic growth in 1992, there are still many challenges facing Taiwan's economic development. The more important are the protection of agricultural products, the "hollowing-out" problem of industries, land constraints and problems with the investment climate.

1. The Protection of Agricultural Products

From an economic point of view, Taiwan should give up the production of many agricultural products since the comparative advantages have been lost. However, from the social and political points of view, Taiwan should maintain production capabilities for key agricultural products, such as rice, since national security is a consideration. This consideration is based on the vulnerability of Taiwan to a naval blockade and the

high dependence Taiwan already has on imported energy and food commodities.

At this point, there are two possible threats facing Taiwan's agricultural sector; one is from GATT and the other is from Mainland China. If Taiwan becomes a member of GATT, Taiwan must bear the responsibility to follow all the regulations set by GATT. Tariffs imposed on the import of agricultural products will then be substantially cut and many major agricultural sectors will not be able to survive, and this may cause social unrest and political instability since the government will have to deal with the livelihood of four million farmers. Further, if the trade between Taiwan and the Mainland becomes open and direct, Taiwan will not be able to prevent the import of agricultural products from the Mainland. Since the prices of Mainland agricultural products are extremely low, many of Taiwan's agricultural products will not be able to compete with the imports from the Mainland. This may result in heavy disruption to the agricultural sector.

2. The "Hollowing-out" Problem of Industries

Due to the deteriorating investment climate and rapid appreciation of the N.T. dollar against the U.S. dollar in the late 1980s, many small businesses lost their competitiveness. In response to the change, they had to leave Taiwan and move to the ASEAN, Mainland China or Vietnam. When they set up factories there, they not only survived but had the opportunity for further development. These responses have correspondingly reduced private domestic investment in Taiwan over the last three years, which has caused many people to worry about whether many of Taiwan's industries will experience problems of "hollowing-out". Recently, the Mainland has

shown its determination to continue economic reforms and open-door policies in the coastal areas and in the inland as well. Even more importantly, there is no longer a requirement for foreign investment in the Mainland to create foreign exchange. This change is obviously very attractive to foreign investors, and the inland areas of the Mainland are seeing increased investment because the wage rate and the cost of land are very low as compared with the coastal areas. This region can also provide a large market for products and many large firms in Taiwan have become interested in making direct investments in the inland areas of Mainland China.

3. Land Constraints

In Taiwan, the arable land only accounts for one-fourth of the total land, and more than 20 million people live in this concentrated area. Under the condition of a high ratio of population to land, the land problem has long been a serious one. During the last six years (1987-1992), due to the high level of excess savings and highly speculative activities, the price of land has skyrocketed and consequently resulted in windfall profits for land speculators. Landowners thus have a high degree of wealth in comparison to non-owners. This high price of land has therefore caused two serious problems: one is to deteriorate the equality of income distribution and the other is to add to the burden of production cost, which in turn reduces the competitiveness of products. This is also one of the reasons why many firms prefer moving to neighboring countries.

4. Investment Climate Problems

During the late 1980s, Taiwan's investment climate became worse because of financial over-speculation, social movements and political confrontations. These conditions reduced Taiwan's competitiveness and forced many firms to leave the island and move to foreign countries. Thus far, even though financial over-speculation has been reduced, and social movements have been eliminated, two problems have not yet been solved, namely: the land problem as mentioned earlier; and political instability.

After the lifting of Martial Law, Taiwan's independence became a claim of the opposition party. This claim is very dangerous to Taiwan's prosperity and security. This claim can not be accepted by the majority of the people on the island since the movement would cause two risks: the Beijing government would make use of military force to attack Taiwan if the movement solidified; and the people on the island would be separated into two groups with an internal struggle. In consideration of these two risks, and if the independence movement grew substantially in popularity, no private enterprises would dare to make long-term investments on the island and under these conditions, Taiwan would become a second Lebanon.

III. Measures to Resolve the Challenges

Faced with these four major hurdles, the government has taken and plans to take various measures to overcome these challenges. Some of these policies can be looked at now, but some still need time for evaluation.

1. The Six-year National Development Plan

The focus of the plan is on the improvement of infrastructure and the betterment of the quality of life. Its accomplishment needs funding of at least NT\$8,200 billion (or US\$316 billion). From 1991 onwards, the government started to spend a large amount of capital for the implementation of the plan. So far as the last two years (1991 and 1992) are concerned, this spending did help prevent Taiwan's economy from slowing down and assisted in maintaining high economic growth. However, recently, the plan has had several criticisms, such as: excessive government spending has resulted in a high budget deficit, and the issuing of so many bonds will be a heavy burden in the years to come; also, many large projects have not yet been carefully evaluated, and the government did not give priority to the projects which are urgently needed. Thus, the new cabinet which took office in February, 1993 will evaluate the entire plan and its development.

2. The Statute for Upgrading Industries

At the end of 1990, when the Statute for the Encouragement of Investment expired, the government adopted the Statute for Upgrading Industries by means of encouraging enterprises to enhance their research and development and introducing new technology into their operations. In July 1992, the government also approved a six-year Science and Technology Development Plan. The primary problem with this plan is that small businesses dominate Taiwan's industries and they are not interested in R&D if they have alternatives to choose from. To tackle this problem, public research institutes have been assigned to enhance their R&D capabilities so as to help small businesses

raise their level of technology.

3. The Measures to Tackle Land Constraints

In view of the significance of land constraints for the investment climate, the government is selecting measures which are more effective for reducing the price of land. In late 1992, there was a controversial proposal that the government should adopt a land value increment tax based on a property's actual market value rather than on the officially determined value which is much lower than the actual market value. This current evaluation process has created opportunities for speculators to avoid taxes. Policy-making in this regard has been heavily subject to the pressure from interest groups, and obviously, it is a tough problem for the government to solve. In 1990-1991, the price of real estate dropped sharply in the United States, and in 1992, the price of real estate dropped by about 50 percent in Japan because of an "assets recession". But in Taiwan, the price of real estate fell only by 20-30 percent from 1990 to 1992 as compared with its price at the peak period. So far, the land problem is still the most important socioeconomic problem to solve in Taiwan.

4. The Development of Democracy

It can not be ignored that the development of democracy has deeply influenced prosperity and recession. Since the lifting of Martial Law in 1987, political conflicts have become a mixed issue in Taiwan. Inner-party democracy has become the source of conflicts within the ruling party and the Taiwan independence movement is considered a national problem. However, the ruling party is adjusting itself with the

times and the opposition party is considering the seriousness of its claim. It is expected that the political conflicts can be eliminated and social unrest can be settled.

IV. The Development of the Economic Relations between Taiwan and the Mainland

The development of the economic relations between Taiwan and Mainland China has become a focus of both sides of the Taiwan Straits. Since 1987, the economic relations between the two sides have rapidly developed through trade, investment, tourism and visiting relatives. Influencing the trend, the government attitude toward the cross-strait relations is of importance and the strong motives of the people will play an increasingly important part.

1. Bilateral Trade

From 1987 to 1992, the commodity exports to the Mainland were more than the commodity imports from the same area. The commodity exports to the Mainland accounted for 2.29 percent of total commodity exports of Taiwan in 1987; 4.38 percent in 1989; 6.12 percent in 1991; and 7.72 percent in 1992. The commodity imports from the Mainland accounted for 0.83 percent of total commodity imports of Taiwan in 1987; 1.12 percent in 1989; 1.79 percent in 1991; and 1.55 percent in 1992, which resulted in an increasing trade surplus with the Mainland amounting to US\$937.59 million in 1987, and US\$5,168.96 million in 1992.

2. Unilateral Investment

So far, the government in Taiwan still does not allow any firms to make direct investments in the Mainland, but actually, many small businesses have made investments there from a third country base. According to the official estimate, the accumulated investment made by Taiwan's firms by 1992 amounted to US\$4.5 billion. Most of Taiwan's investments were made in Guandong Province and Fujien Province. Recently, however, investments have extended to the Shanghai area, Shandong Province and the Laoning area. The majority of Taiwan's investments are made in labor-intensive and trade-oriented industries.

3. Unilateral Capital Movements

In addition to unilateral investment, capital movements are also unilateral. This includes tourism spending in the Mainland and private remittances to relatives in the Mainland. The accumulated remittances to relatives up to 1992 were US\$2 billion, and the accumulated tourism spending and the money for visiting relatives was about US\$8.4 billion. Totally, it amounted to more than US\$10 billion. This capital outflow is helpful for relieving Taiwan's foreign exchange reserve pressure in the short-run.

V. Prospects for Taiwan's Economy

Even though Taiwan has many economic and political problems to tackle, I am confident that Taiwan can overcome its difficulties and cope with the new set of world

conditions. It is reasonable to forecast that Taiwan can maintain economic growth of 6-7 percent in the years to come. Faced with keen world competition, Taiwan's foreign trade level will reduce its growth rate but will still play a leading role in economic growth. However, Taiwan's exports will be diversified to global markets rather than concentrated on the U.S. market. Mainland China will be a potential market, and Taiwan will have preferential treatment in this area. Therefore, the trade with the Mainland will continue to increase.

Taiwan will have mild inflation and very low unemployment. Income distribution will continue in its direction of inequity but the overall quality of life will be slowly improved. Furthermore, Taiwan will play a more active role in East Asia and the world as well.

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