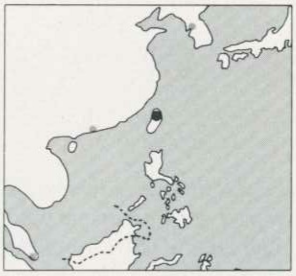
Taiwan: Rich with Potential



By Liu Wen-fu

It was a good year for the Taiwanese economy in 1987. A real growth rate of 11.2%. A boost in per-capita GNP to US$4,985, putting the island 30th in the world and fourth in Asia after Japan, Singapore and Hong Kong. A 21.8% expansion of its trade surplus to US$19,031.7 million, an all-time high. And all this despite a substantial revaluation of the new Taiwan dollar and sometimes bitter frictions with the United States. Although Taiwan has its share of problems, the vibrant economy is rich with potential for further growth.

The Taiwanese economy has long drawn its vitality primarily from small and medium-sized enterprises. Responsive and flexible in the face of changes, and able to "scrap and build" with relative ease, these highly resilient enterprises account for some two-thirds of Taiwan's exports. Their foreign shipments range from light electric and electronic products to textiles, footwear, toys, sporting goods and plastics. It is a classic case of successful economic development using the comparative advantage of labor-intensive products in a low-wage economy as a strategy for industrialization.

Astute decision

Taiwan has striven since the 1970s to improve its infrastructure and promote direct investment from industrially advanced countries as a way to expand exports. By doing so, it has acquired the production and management know-how it needed in order to develop export-oriented industries.

Taiwan was also astute in hitching its economic wagon to the vast U.S. market. Merchandise exports to the United States as a percentage of total exports exceeded 44% annually from 1983 to 1987. Its trade surplus with the U.S., already substantial, expanded even more rapidly following the G-5 meeting of finance ministers and central bankers in September 1985 which sent the Japanese yen soaring against the U.S. dollar. Taiwan stepped in to fill the gap as prices for Japanese goods soared. The widening trade gap has not been an unmitigated blessing as it has drawn harsh criticism from U.S. politicians and businessmen.

The trade surplus does at times seem out of control. Between 1985 and 1987 alone, it increased from US$10,026.7 million to US$16,009.6 million. A number of reasons are generally cited for the expansion. First, the new Taiwan dollar remained undervalued for many years. Second, the Taiwanese market is still not sufficiently open to foreign goods, as can best be seen in the island's high tariffs. Since 1986, the U.S. government has applied strong pressure on Taiwan to adopt a more equitable posture in fields as diverse as exchange rate adjustments, market liberalization, intellectual property protection, finance, insurance and services. At the annual Republic of China-U.S. bilateral trade talks held in Taipei on April 26, 1988, Taiwan accepted U.S. demands for participation in the trust business by foreign banks operating in Taiwan, purchases and management of Taiwanese shares by foreign insurance companies, and the issuance of credit cards based on the new Taiwan dollar. But Taiwanese officials rejected most U.S. requests for liberalizing the agricultural market, including the abolition of import restrictions on 60-odd items.

Taiwan was even more reluctant to revalue its currency than it was to liberalize its domestic market. A higher exchange rate for the new Taiwan dollar would make its products, most of them labor-intensive, low-value-added consumer goods, more expensive on the U.S. market. That would leave them vulnerable to substitution by even cheaper products from other developing countries. Yet the Taiwanese currency did begin to appreciate gradually against the U.S. dollar after dropping to U.S.$1 to NT$40.4 at the end of August 1985. What made the difference was the September 1985 G-5 meeting. At the end of April this year, the new Taiwan dollar was trading at U.S.$1 to NT$28.6, an appreciation of 41.3% from before the G-5 gathering. The revaluation was the sharpest for any of the Asian NICs.

Taiwan's trade structure began chang-

Despite a revaluation of the Taiwan dollar last year, per-capita GNP rose to the fourth-largest in Asia and the island had a record trade surplus with the United States.

Table 1 Major Economic Indicators for Taiwan

(percentage change over previous year)

	Real GNP growth rate	Industrial production	Urban consumer prices	Money supply (M_1B)	Total deposits	Total loans & investment
1983	7.9	14.1	1.4	17.5	27.0	15.7
1984	10.5	12.2	−0.03	9.3	21.0	11.9
1985	5.1	1.4	−0.2	11.7	23.4	6.4
1986	11.6	14.9	0.7	47.3	25.0	5.7
1987	11.2	12.4	0.4	38.2	28.0	16.3

Note: Money supply (M_1B) includes net currency issued, net checking accounts, passbook deposits and passbook savings deposits.
Source: "Industry of Free China," Feb. 1988

ing around the autumn of 1987 under the impact of the currency adjustment and the opening of the domestic market. The trade surplus shrank on a month-to-month basis for five consecutive months from November 1987 to March 1988, finishing at US$162.6 million, the lowest level in five years. The United States surpassed Japan as the largest importer of Taiwanese-made products in January 1988, becoming Taiwan's largest partner in both import and export trade.

Table 2 **Taiwan's Foreign Trade**

	Imports		Exports		Balance (US$ million)	Import share by country (%)		Export share by country (%)	
	Value (US$ million)	Change from year before (%)	Value (US$ million)	Change from year before (%)		Japan	U.S.	U.S.	Japan
1983	20,287.1	7.4	25,122.7	13.2	4,835.6	27.5	22.9	45.1	9.9
1984	21,959.1	8.2	30,456.4	21.2	8,497.3	29.3	23.0	48.8	10.5
1985	20,102.0	−8.5	30,722.8	0.9	10,620.8	27.6	23.6	48.1	11.3
1986	24,164.6	20.2	39,789.2	29.5	15,624.6	34.2	22.4	47.7	11.4
1987	34,506.5	42.8	53,538.2	34.6	19,031.7	34.3	22.1	44.2	13.0

Source: "Industry of Free China," Feb. 1988

Promising partner

In order to cope with the changing trade situation, Taiwan is looking to Japan as its most promising export substitution market. Trade between the two countries is presently heavily imbalanced in Japan's favor. The deficit, the largest Taiwan has with any trading partner, reached a record US$4,860 million in 1987, up 31.4% from a year before. The government, however, is hoping for a change. According to a five-year (1988–92) market diversification and import expansion plan announced by the Ministry of Economic Affairs' Board of Foreign Trade in February 1988, exports to Japan are projected to increase an average 27% per annum, while imports from Japan should rise only about 17% annually. By 1992, the share of imports from Japan in Taiwan's total import value is expected to drop from 34.3% in 1987 to 27%.

Taiwan's export-market diversification measures call for developing markets in Western Europe and trading directly with the East European countries of Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, Romania and Yugoslavia. Taiwan's greatest interest, however, lies in the vast potential market on the Chinese mainland. Already there has been a sharp increase in visits as well as in the flow of goods between Taiwan and the People's Republic of China. In the six months after visits by Taiwanese residents to their relatives on the mainland were approved last November 2, a total of 77,000 Taiwanese visited the mainland. Indirect trade between the two sides in 1987 meanwhile totaled some US$1,500 million, with US$1,200 million in exports from Taiwan and US$280 million in exports from China. Major products now exported to the mainland include home electrical appliances, machinery, foodstuffs, chemical products and textiles.

Taiwan's indirect investment in China has also soared. By the end of February there were 46 joint ventures between Taiwanese and Chinese enterprises in Fujian Province across the Taiwan Strait, with the Taiwanese partners investing a total of US$4.45 million. Taiwanese enterprises have also invested in Guangdong, Zhejiang and other provinces. Taiwan's ruling Kuomintang (KMT) is expected to review its policy toward the mainland at the 13th KMT National Congress in July, and many observers predict the official ban on direct investment in China will be lifted, at least partially.

Capital provider

Other Asian countries hope Taiwan will use its huge foreign reserves, exceeding US$70 billion, to supply them with capital through the Asian Development Bank (ADB). Taiwan is also considering joining such key international economic organizations as the IMF, GATT and the OECD as a way of improving its status in the global community. It already has plans to set up an overseas economic cooperation fund of the order of US$1 billion by the end of 1988. The scheme is designed to develop new trade markets through positive financial support for Taiwan's neighbors in Asia.

There is ample reason for all this advanced planning. Taiwan's labor-intensive industries are rapidly losing their comparative advantage as a result of the appreciation of the new Taiwan dollar, a sharp rise in domestic labor costs, mounting competition among the NICs themselves and the growing challenge that is presented by the "semi-NICs," countries like Thailand and Malaysia that are starting to play their own game of economic catch-up. The Taiwanese economy has major weaknesses, as can be seen in the relatively small share of key industries in total economic output.

Yet plans for the future development of the Taiwanese economy do not call for promoting heavy industry. Rather, the government's development strategy gives top priority to investments in high-tech industries such as electronics, information processing, automobiles and machinery. To this end, the government in Taipei is determined to push ahead with policies to liberalize and internationalize the economy, removing or relaxing foreign exchange and trade controls and reducing protective measures for domestic industries. Change will not come overnight, but Taiwan is clearly moving to become a more active participant in the world economy.

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