# Taipei,China

*A massive earthquake struck Taipei,China in 1999, causing serious damage to infrastructure. Reconstruction work was swift and resulted in only a marginal decline of GDP growth in 1999 compared with government targets. A recovering global economy boosted exports, and better economic growth is projected for 2000.*

## RECENT TRENDS AND PROSPECTS

Economic performance strengthened in the first half of 1999 as the economy began to recover from a modest growth slowdown following the Asian financial crisis. However, a massive earthquake struck on 21 September 1999, causing considerable damage to the productive capacity of the economy, particularly to physical infrastructure. For example, the microchip makers at the high-tech industrial park in Hsin-Chu City suffered an estimated $320 million in production losses because of power supply interruptions. Despite this setback, real GDP growth in 1999 was 5.7 percent, only marginally lower than the target of 5.8 percent, and more than 1 percent higher than growth in 1998.

Strong performance of the external sector was an important factor in the recovery. The trade balance for 1999 amounted to $15.1 billion, a sharp increase of 46 percent from 1998. While exports declined 9.5 percent in 1998, in 1999 they grew 6.8 percent, led by semiconductors and notebook computer sales. Exports also benefited from the recovery in Asia and strong import demand from the United States. Merchandise imports grew by 2.8 percent in 1999, in contrast to a 7.4 percent decline in 1998. Machinery and electrical equipment made up the largest share of imports. Japan was the largest source country, accounting for 25.7 percent of total imports.

The growth rate of the industry sector rose to 4.3 percent in 1999 from 2.7 percent in 1998. This was largely propelled by growth in the electronics industry, which benefited from the recovery of the global economy, higher prices, and a boost in Y2K-related demand. Growth in the service sector was modest at 6.3 percent, slightly higher than the previous year. Good weather contributed to the recovery of the agriculture sector from a 6.6 percent decline in 1998 to a 2.9 percent growth in 1999.

Investments grew by 2.1 percent in 1999, less than the 10.4 percent growth the previous year because of a sluggish housing market, fewer large commercial airplane purchases, and a sharp deceleration in the investment growth rate. Consumption expenditure also decelerated, growing by only 4.2 percent in 1999 compared with 7.8 percent in 1998. The only two strong areas of consumption spending in 1999 were transportation and communications, and medical care and health services.

The savings rate has slowly declined for several years, partly reflecting the aging of the population. However, the savings rate still remains high compared with many Asian economies. As a percentage of GDP, nominal gross fixed capital formation declined marginally, from 24.9 percent in 1998 to 24.4 percent in 1999.

The inflation rate was exceptionally low in 1999, essentially because of weak domestic demand. Falling raw material prices contributed to a decline of 4.5 percent in the wholesale price index in 1999. The unemployment rate rose slightly from 2.7 percent in 1998 to 2.9 percent. The labor force grew to 9.7 million, a 1.9 percent increase from 1998. The increase could not be absorbed by the labor market, partly owing to the slow expansion of service sector employment.

Although the amount of income tax collected increased moderately, total tax revenue dropped 6.6 percent in 1999. This resulted partly from less tax income on security transactions due to weak stock market performance. Although nontax revenue posted growth, the reduction in tax revenue caused current revenue to decrease 2.2 percent. Current expenditures were constrained to offset this drop, shrinking by 3.9 percent in 1999, in contrast to growing 9.4 percent in 1998. Monetary policy remained cautious in 1999. The money supply (M2) increased modestly to 9.2 percent from 8.6 percent the previous year.

GDP growth is projected to accelerate slightly, to above 6 percent in 2000 and 2001. Reconstruction of earthquake-damaged structures will provide much of the stimulus; the government pledged nearly NT$100 billion, including infrastructure rebuilding and subsidized loans for new housing. This will further widen the fiscal deficit. Private sector fixed capital formation is also likely to accelerate as build-operate-transfer projects, such as the planned high-speed train, get under way. Export performance is expected to be stronger during 2000 as the Asian region continues to recover, and growth in the United States and other industrial country markets remains buoyant. Prices of industrial raw materials and oil should either remain stable or increase marginally, while exports should be strong, particularly those from the electronics subsector. Increasing government and private investment in plants and equipment will require more imports.

Reflecting stronger aggregate demand, inflation is projected to grow at 1.9 percent in 2000 and 2 percent the next year. There will be little inflationary pressure from external factors, as the import price index is likely to grow moderately during these two years.

**Table 2.4 Major Economic Indicators, Taipei,China, 1997-2001**
**(percent)**

| Item | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|
| GDP growth | 6.7 | 4.6 | 5.7 | 6.3 | 6.2 |
| Gross domestic investment/GDP | 24.2 | 24.9 | 24.4 | 24.2 | 24.5 |
| Gross domestic savings/GDP | 26.4 | 26.0 | 26.0 | 26.8 | 27.2 |
| Inflation rate (consumer price index) | 0.9 | 1.7 | 0.2 | 1.9 | 2.0 |
| Money supply (M2) growth | 8.0 | 8.6 | 9.2 | 9.3 | 9.0 |
| Fiscal balance/GDP | -3.8 | -3.3 | -4.2 | -6.0 | -5.8 |
| Merchandise exports growth | 5.4 | -9.5 | 6.8 | 12.5 | 11.5 |
| Merchandise imports growth | 10.1 | -7.4 | 2.8 | 15.8 | 13.4 |
| Current account balance/GDP | 2.4 | 1.3 | 3.0 | 1.8 | 1.5 |

*Sources*: Wu (1999); staff estimates.

Further recovery of domestic demand is expected to increase the growth rate of goods and services imports to 15.8 percent and 13.4 percent in 2000 and 2001, respectively. Consequently, the current account balance is projected to be $5.7 billion in 2000, and $5.3 billion in 2001.

## ISSUES IN ECONOMIC MANAGEMENT

Taipei,China managed its macroeconomy well throughout the Asian crisis, benefiting from its large foreign exchange reserves and minimal foreign debt. The nonperforming loan ratio was low and the capital adequacy ratio of most banks remained above the 8 percent stipulated by the Bank for International Settlements. In addition, a 9.7 percent rate of return on net investment invigorated the financial sector.

The industrial structure was another important factor behind the macroeconomic resilience. Small and medium-size enterprises, which contribute approximately 50 percent of total export revenues, dominate this sector. Since the early 1990s, semiconductor and electronics have replaced the construction industry as the principal engine of growth, providing extra strength and dynamism to the economy. The government also effectively used monetary policy to maintain liquidity and moderate interest rates during the financial crisis.

These export-oriented companies have demonstrated their ability to adjust quickly to a rapidly changing external environment. Government policy should encourage them to maintain their international competitiveness. These corporations need to be increasingly agile, flexible, and pragmatic in reacting to the changing demands of international markets.

## POLICY AND DEVELOPMENT ISSUES

Taipei,China is expected to enter the World Trade Organization (WTO) in mid-2000. In preparation, policymakers will reduce tariffs to improve market access. For instance, the average nominal tariff rate of 8.3 percent will be reduced to 7.6 percent upon WTO entry. Government procurement procedures have been streamlined to be compatible with the WTO norms. Nontariff barriers in agriculture were substantially dismantled and the barriers on 18 products marked for elimination. Entering the WTO should provide manufacturing benefits, but will also probably disrupt the agriculture sector. The economy seems to have lost competitiveness in the agriculture sector, but has gained significant advantage in high-tech and electronics products. Loss of comparative advantage in agriculture should not be seen as negative, but as a stage in the economy's evolution to a fully industrialized status. Therefore, policymakers should not yield to pressure to protect the agriculture sector.

The reconstruction process after the earthquake consumed funds originally intended for stimulating domestic demand and strengthening infrastructure. The construction of the high-speed railway system between Keelum and Kowshon may be delayed. To bridge the investment gap that will ensue from the budget reallocation, the private sector can be called on to support the government. Infrastructure projects initially can be financed by the private sector through build-operate-transfer or build-operate-own projects. Cooperation between the government and the private sector could reduce the government's financial burden, promote private investment, and increase operational efficiency. However, because of lack of experience in these operations, the government and financial institutions are moving slowly.

Since the late 1980s, the traditional sectors of the economy have languished. The economy has developed a dualistic character, with a traditional sector co-existing with a modern high-tech export-oriented group of industries. In the traditional sector, nonperforming loans have increased and profitability and investment have decreased. These industries, particularly the small and medium-size ones, need to be restructured. Their technology is not being upgraded and production modes are inflexible. The government has provided loans for upgrading technology, labor skills, and marketing endeavors. The impact so far, however, has been small because of limited funds. Efforts in this area need to be intensified and more resources committed to assisting small and medium-size enterprises, particularly in the traditional sectors.

WTO membership and the associated financial liberalization are sure to usher in financial internationalization and enhance competition in the domestic financial markets. To increase competitiveness in the banking and financial sectors, the government needs to promote consolidation through mergers and acquisitions. Initial efforts are being made in this direction, but more definitive measures are needed.

Gender differences in earnings persist. The female-to-male earnings ratio averaged 64 percent during 1988-1993 and edged up 67 percent during 1993-1997. Earnings gaps within occupations grew over time. Despite the Labor Standards Law, women do not receive equal pay for work of equal value, and the equal pay law must be better enforced. Employment redistribution can be a viable policy option, because the within-occupation pay inequality generally results from gender segregation across enterprises. Hence, equal pay for equal work within a firm will have little effect on the overall gender earnings gap unless the segregation issue is addressed.

Taipei,China is one of the few developing economies that succeeded in attaining progress with income equality. Although the Gini coefficient (a measure of inequality) began to rise after 1984—increasing from 0.29 that year to 0.32 in 1993—inequality has remained low for the past four decades. Rapid export-oriented growth created a large demand for both low-skilled and highly skilled labor. Brisk and timely development of the agriculture and industry sectors ensured participation of farmers and industrial laborers in the economy, which reduced income inequality. A rapidly growing labor demand resulted in high increases in wages, particularly for young and low-skilled workers. This trend helped narrow wage disparities.

However, since the early 1990s, the rise of a dynamic and skill-oriented export sector has resulted in a widening of differentials as traditional industries have grown more slowly. Upward movement in the stock market during that period favored the wealthier segments of the society and reinforced this trend. Adopting more progressive taxation and restructuring traditional sectors should help stop the trend toward disparities in income and increases in income inequality.