



## Taipei, China

**E**conomic growth in Taipei, China moderated in 1995. Growth during the early part of the year was maintained at 1994 levels and both private consumption and investment continued to expand. However, difficulties faced by the financial sector and the real estate market during the second and third quarters of the year resulted in GDP growth for the year as a whole being slightly below that in 1994.

Over the next couple of years, growth is expected to continue at a moderate pace; policymakers are consistent in their desire to maintain the expansion of the economy at the current rate. Prospects for the economy of Taipei, China will continue to depend on a more robust recovery of the world economy and on the speed of industrial restructuring. The move toward high-skilled, technology-intensive industries has been taking place but needs to proceed more rapidly if the economy is to remain dynamic and competitive.

The increasing indirect trade links with the People's Republic of China will continue to have an important bearing on the performance of the Taipei, China economy. Both domestic political stability and political and economic relations with China will be significant for future economic growth. Exports to China accelerated and total exports reached a record level during 1995. Imports also grew at an accelerated pace as both private consumption and investment increased. The trade and current account surpluses were again large in 1995 and, although these have been reduced considerably in recent years, they are expected to remain substantial over the next several years. Some uncertainty about

Taipei, China's membership in the WTO may have an impact on the performance of the external sector. In general, however, prospects for the economy continue to be favorable.

### **Recent Trends and Prospects**

*Growth, Investment, and Employment.* In 1995, GDP growth declined to 6.3 percent from 6.5 percent in 1994, mainly as a result of a contraction in the growth rate of the services sector. The share of agriculture in GDP continued to decline and is now only 3 percent (Figure 2.4). After a fall in agricultural output during 1994 of over 4 percent because of a series of typhoons, there was marked recovery during 1995 and the sector grew by 7 percent. The industry sector, now comprising almost 39 percent of GDP, expanded by 6 percent in 1995, improving on the 5.7 percent growth rate achieved the year before. Both manufacturing and energy output increased at an accelerated pace, while there was a slight decline in the growth rate of the construction sector. During 1994 and early 1995, there had been increased construction activity to beat a deadline for expected changes in zoning and construction laws. This resulted in oversupply and a subsequent decline in activity over the latter half of the year. The services sector growth rate declined from 7.8 percent in 1994 to 6.3 percent during 1995. The sharpest contraction was in financial services where, over the year, several scandals hit the banking sector, credit cooperatives, and the stock market. In addition, the real estate market suffered as a result of the problems in the construction sector. Despite

these setbacks, the share of services in GDP was maintained at almost 60 percent.

After a small decline in the ratio of gross domestic investment to GDP during 1994, there was an increase during 1995 to 24.5 percent of GDP. Although there had been some fears that private investor confidence may have suffered owing to the problems with the financial sector, these fears appear to have been short-lived. There was increased growth in private investment, mainly as a result of strong export performance. Public sector investment, however, increased at the same pace as in the previous year with infrastructure projects accounting for the bulk of such investment activity.

The savings rate in Taipei,China has declined gradually over recent years and is now around 26 percent of GDP. Gross domestic saving continued to exceed investment and, as a result, a resource surplus remained; although at 1.9 percent of GDP in 1995, it was significantly lower than in the late 1980s when it was 7.5 percent of GDP. The resource gap is expected to remain positive over the next few years. Foreign direct investment from Taipei,China continued to expand during 1995 with the bulk of outflows destined for

the People's Republic of China. Investment from Taipei,China to the Philippines also increased as economic conditions in the Philippines continued to improve.

Private consumption continued to expand fairly rapidly during 1995 although at a lower rate of under 10 percent from 12.7 percent in 1994. Government consumption expanded quite rapidly at close to 4 percent during 1995 after relatively low growth during the previous year of a little over 2 percent. Most of this expansion was a result of increased expenditure on civil service salaries.

With the continued growth of the economy, unemployment remains low at 1.7 percent of the labor force. Nevertheless, the shift in economic structure toward a more services-based economy has led to sizeable differentials between wages in manufacturing and higher wages in the more rapidly expanding services sector. Manufacturing wages have been repressed by the need for industry to remain internationally competitive whereas this has not been as important a consideration with services, which are to a large extent nontradeable. As a result, shortages of labor have developed in manufacturing in recent years. On the other hand, high services sector

**Table 2.4 Major Economic Indicators: Taipei,China**

		1993	1994	1995	1996	1997
Gross Domestic Product	% change	6.3	6.5	6.3	6.4	6.3
Agriculture	% change	5.4	-4.4	7.0	0.5	0.8
Industry	% change	4.1	5.7	6.1	6.2	6.2
Services	% change	7.9	7.8	6.3	6.9	6.6
Gross Domestic Investment	% of GDP	25.2	23.9	24.5	24.7	25.4
Gross Domestic Saving	% of GDP	27.0	25.8	26.3	26.6	27.1
Inflation Rate	% change in CPI	2.9	4.1	3.7	3.7	3.3
Money Supply Growth	% change	15.1	14.0	8.5	11.2	11.1
Merchandise Exports	\$ billion	84.3	92.2	111.2	126.5	143.4
	% change	4.5	9.4	20.5	13.8	13.4
Merchandise Imports	\$ billion	72.7	80.3	98.2	111.4	127.2
	% change	7.0	10.3	22.4	13.5	14.1
Current Account Balance	\$ billion	6.7	6.2	7.2	7.8	7.7
	% of GDP	3.0	2.6	2.8	2.8	2.6

Sources: Chung-Shu Wu, "Taipei,China Economy: Recent Developments and Near Future Outlook," Academia Sinica (mimeo, December 1995); and staff estimates.

wages have encouraged young persons to gain the advanced academic qualifications in fields such as banking and finance that are relevant to the requirements of an expanding services sector. In addition, the supply of such high-skilled labor has been augmented in recent years by the return of Taipei,China nationals from the US with postgraduate degrees, attracted by expectations of high salaries and easy employment opportunities in a home environment. However, even though the services sector accounts for over 50 percent of employment, it has not expanded fast enough to employ all the high-skilled workers available and, in consequence, there is unemployment among this category of workers.

Over the next couple of years, the Taipei,China economy is expected to continue growing at rates similar to those in the recent past: 6.4 percent in 1996 and 6.3 percent in 1997. After the recovery of the agriculture sector following a series of natural disasters, the growth rate is expected to slow down with the sector expanding at rates of 0.5 percent and 0.8 percent over the next two years. The share of agriculture in GDP will continue to decline, albeit marginally. The industry sector will maintain a relatively high growth rate and, in both 1996 and 1997, this is expected to increase to 6.2 percent. Manufacturing, in particular, is projected to increase its growth rate slightly over the next two years, spurred by continued good export performance. Services sector growth is expected to rise to an average of over 6.7 percent annually in 1996 and 1997. Financial services in particular will pick up in 1996 and the increasing specialization of the sector in high value-added services is expected to continue.

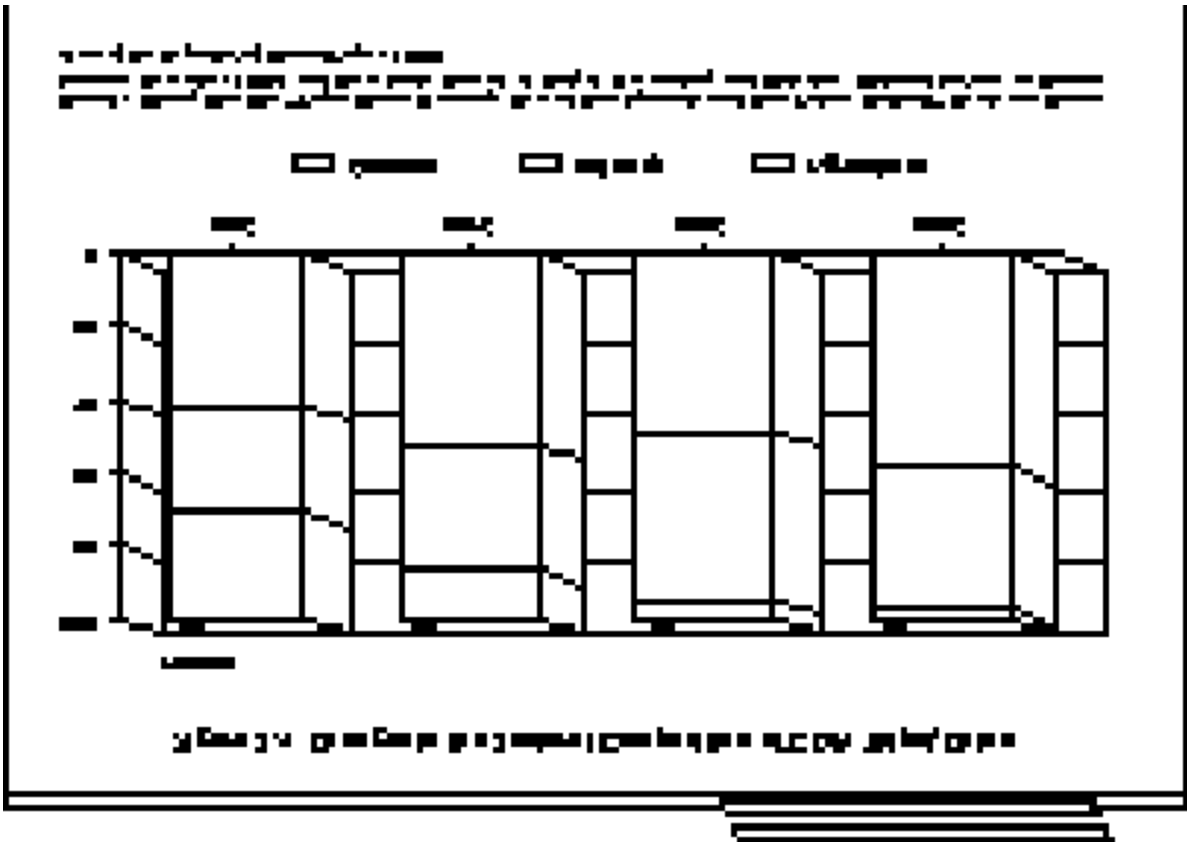
With the slight increase in economic growth, gross domestic investment as a share of GDP is expected to expand slightly to around 24.7 percent during 1996 and to 25.4 percent in 1997. Gross domestic saving as a proportion of GDP will also rise slightly to 26.6 percent during 1996, increasing again to 27.1 percent in 1997. Gross domestic saving will continue to remain above gross domestic investment; however, the surplus will remain relatively small. Both private consumption and government consumption will continue to increase, with continued expansion in economic activity. The level of unemployment is likely to remain low and,

with the share of services in the economy continuing to expand, the surplus of skilled workers now available for employment in the services sector is likely to diminish over the next two years.

*Budget, Money, and Prices.* The depressed activity in the real estate and stock markets in 1995 had a negative impact on indirect tax revenues; however, this decline was matched by increases in direct tax revenues, particularly from income taxes. As a result, government revenues grew at a slightly higher rate during 1995 than they had in the previous year. Owing to the downsizing of government, current expenditure did not grow as fast during 1995 as in 1994, resulting in an increase in the current surplus. However, capital expenditure necessary for the implementation of the Six-Year National Development Plan increased during 1995. Such expenditure grew at over 7.5 percent, leading to total expenditure exceeding total revenue by a significant amount. Total consolidated government expenditure, both current and capital, was over 29 percent of GDP. Tax revenues, on the other hand, were less than 24 percent of GDP, leading to an overall deficit of 5.5 percent of GDP, only slightly less than the overall deficit during 1994.

Over the past three years, there has been a decreasing trend in the growth rate of money supply (M2), resulting from the tight monetary policy being pursued by the Central Bank. In 1995, the target was to keep the growth rate of M2 below 15 percent. During the first half of the year, however, money supply grew by only slightly more than 10 percent and the slump in the real estate and stock markets during July and August contracted the growth of the demand for money even further. Despite attempts by the Central Bank to alleviate the situation, the growth rate of M2 was only 8.5 percent during 1995, well below the target rate.

The series of typhoons that struck Taipei,China during 1994, which resulted in higher prices of most essential food items, did not recur in 1995. A more moderate growth rate of the economy accompanied by slow growth in money supply resulted in the inflation rate declining to 3.7 percent in 1995 compared with over 4 percent in the previous year. Food prices did not increase much during 1995 and there was a moderation in



land and property prices as a result of the oversupply of housing. Most of the increases were in education and entertainment fees and in the prices of imported goods.

Given the expected growth rate over the next two years, consolidated government revenues are likely to increase by 4.5 percent during 1996 and a little over 6 percent the following year. While current expenditure is expected to increase at lower rates in 1996 and 1997, increased capital expenditure on the Six-Year National Development Plan is expected to expand the overall deficit to around 5.7 percent during 1996, declining to 5.4 percent the following year.

Both the slowing down of the economy and a deliberate loosening of monetary policy are expected to lead to a slight increase in the growth rate of M2 during 1996 to a little over 11 percent. This growth is, however, still lower than the Central Bank target. Consumer price inflation over the next two years is expected to be in the range of 3.3–3.7 percent annually. Although inflation in Taipei, China is fairly low by international standards, policymakers would like to keep the inflation rate below 4 percent.

*External Trade and Payments.* Export performance reached a record level during 1995 with growth reaching close to 21 percent. Chemical exports grew at a phenomenal rate of close to 40 percent and both machinery and electrical equipment displayed robust increases. Exports to the People's Republic of China through Hong Kong increased rapidly and, for the first time, Hong Kong became in 1995 the largest trading partner of Taipei, China, replacing the US. Exports to both the US and Japan, the third largest trading partner, also increased substantially in 1995.

On the import side, raw materials and capital goods continued to dominate. There was a sharp increase in the total value of imports, with the growth rate exceeding 22 percent. Chemicals had the highest growth rate, exceeding 38 percent during 1995, while both machinery and electrical equipment imports also grew at a rapid pace. A slight depreciation of the New Taiwan dollar (NT\$) helped boost imports, as did substantial increases in private consumption. In addition, machinery and equipment needed for the Six-Year National Development Plan

and infrastructure rehabilitation added to the high import growth rate.

Despite import growth exceeding export growth, the trade surplus increased slightly from \$12 billion during 1994 to \$13 billion during 1995. The current account surplus increased to \$7.2 billion in nominal terms; and, as a ratio of GDP, it rose to 2.8 percent during 1995 compared with 2.6 percent in the previous year. As in 1994, the NT dollar depreciated slightly during 1995. Some of this was due to a stronger dollar in world markets; however, some of it was also because of large capital outflows, mainly a result of uncertainty about relations with China.

With the continuing high growth of China's economy and with the demand for its exports remaining strong, exports from Taipei,China should also continue to be buoyant. Export growth is expected to be around 13-14 percent annually over the next two years. Strong domestic demand and continued investment in the Six-Year National Development Plan is expected to keep imports growing at a fairly high pace. However, the growth rate will fall to around 13-14 percent annually over the next two years. As a result, the trade surplus will increase and the current account is expected to maintain a surplus of 2.8 percent of GDP in 1996 and 2.6 percent in 1997.

### **Policy and Development Issues**

The main uncertainty facing the Taipei,China economy is of a political nature. The domestic political situation, with presidential elections scheduled for early 1996, will determine to some extent future relations with the People's Republic of China. In fact, China's policies and attitude toward Taipei,China are perhaps the most pressing policy issues facing the island economy. For example, although China's application to join the WTO is still pending, this has created serious doubts whether Taipei,China

will be allowed membership. Some complications could also arise during 1997 as Hong Kong reverts to China, and the future framework for trade and investment links between Hong Kong and Taipei,China will need to be considered. As a result, uncertainty regarding external sector performance and, thus, the growth of GDP has become of concern to policymakers.

The Taipei,China economy has matured considerably in recent years and is fast becoming a primarily services-based economy. The move toward high value-added industry and sophisticated commercial and business services has succeeded reasonably well and the economic restructuring of Taipei,China is expected to continue. The surplus of highly skilled and educated people available should help this process considerably and all indications are that appropriate changes in investment patterns are already taking place. Changes in the industrial structure toward high technology industries and activities should also help alleviate concerns about Taipei,China's competitiveness.

However, with the changing structure of the economy, some concerns are being expressed about possible shortcomings of the country's present infrastructure. With higher income levels and increasing affluence, the demand for better quality urban services, such as for improved public transport and urban roads, has been increasing. The Six-Year National Development Plan emphasizes the upgrading of urban infrastructure to keep pace with this demand, and increased spending under the Plan should help alleviate these problems. Problems with the financial markets must also be addressed. With increased liberalization expected, there is a need to ensure adequate regulatory safeguards to reduce uncertainty. The slow pace of the privatization program must also be dealt with. On balance, however, the Taipei,China economy appears to be on a path of stable growth and increasing affluence.