



Taipei, China

The region's financial crisis has left Taipei, China largely untouched. Reforms in the banking and financial sectors are to continue. Policy to encourage high technology, which will bring about a number of structural changes, remains active, but needs to gain momentum.

RECENT TRENDS AND PROSPECTS

In a year of unprecedented turmoil in Asia's financial markets, Taipei, China has managed to avoid a major financial crisis. Not only has it survived this turbulent period, but its economy grew at 6.8 percent during 1997, slightly faster than in the previous two years. This was largely due to sustained growth in finance, insurance, real estate, and social services. While the manufacturing sector is still recovering from its previous slowdown, the recovery is noticeable, and the growth rate is a little more than 4 percent.

Despite the higher growth rate and only a modest increase in the labor force, unemployment rose to 2.7 percent, a little higher than in 1996. However, the current rate is still relatively low by international standards, and future unemployment rates are not expected to be much higher.

Gross domestic investment as a percentage of GDP increased slightly compared to 1996. This was due mainly to an increase in private investment, as investment in public enterprises grew only slightly, and several public investment projects fell far behind schedule. Government investment increased by less than 2 percent. By contrast, the growth rate of private investment more than doubled in 1997, compared with 1996, to just under 13 percent. The primary cause was the optimism generated by the stock market boom.

With the strong growth in income tax collection, overall government current revenues rose by

10.6 percent in 1997, but government current expenditures grew only 5.8 percent. Nevertheless, total revenues still fell short of total expenditures by about 5.7 percent of GDP, largely because of the implementation of government investment projects that had fallen behind schedule in previous years.

Slow growth of the money supply (M2) at 7.2 percent was largely an outcome of the Central Bank's anti-inflationary policy and weak demand for bank financing by the construction industry. The former has proven successful to the extent that consumer price inflation was about 1 percent, the lowest rate since 1987. The depreciation of the Japanese yen, which reduced the prices of imports from Japan, helped keep the inflation rate down.

Exports grew by more than 5 percent in 1997, with exports of heavy industrial products holding up particularly well. In sharp contrast, agricultural and processed agricultural exports continued their slowdown, shrinking by as much as 19 and 34 percent, respectively. Livestock epidemics explain some of this slowdown, but it also reflects a general decline of the agriculture sector.

The value of imports rebounded in 1997, growing by about 10 percent after stagnating in 1996. The principal imports were machinery, electrical equipment, and chemicals, which together accounted for more than 45 percent of total imports in 1997. As in 1996, imports of consumer goods grew more rapidly than imports of capital goods and raw materials. This may reflect an increasing consumerist orientation in a maturing economy.

As a result of the faster growth of imports, the current account balance declined to a surplus of 2.7 percent of GDP, a marked fall from the 4 percent surplus in 1996. Under pressure from a strong US dollar, the New Taiwan dollar depreciated an average of 15 percent. Despite the depreciation, the trade surplus did not increase further in 1997.

After a slight decline to 5.8 percent in 1998, real GDP growth is expected to recover in 1999. Accordingly, government current revenues are also projected to pick up in 1999. In an attempt to bring down the budget deficit, the government's capital expenditure will be more conservative. Projections indicate that the ratio of government expenditure to GDP will decrease by 3 percentage points over the next two years, down from 28 percent in 1997. By contrast, because tax revenues will exhibit stable growth, the overall deficit to GDP ratio will decrease by less than one percentage point in 1999.

The money supply will grow slightly faster in 1998 and 1999 than in 1997, with a growth rate of about 7.4 percent. The Central Bank's anti-inflationary policy and the direct financing of businesses supported by the stock market will be responsible for the low monetary growth.

With aggregate demand increasing as a result of sustained growth of the economy, depreciation of the New Taiwan dollar, and continuing steady

growth in service prices, the consumer price index is expected to grow at 3.2 percent in 1998 and 2.2 percent in 1999.

CRITICAL ISSUES IN SHORT-TERM ECONOMIC MANAGEMENT

Taipei, China has been relatively insulated from the region's currency turbulence. However, the continued emphasis on advertising the economy's successes has raised some concerns that the government has not paid sufficient attention to how Asia's financial crisis might affect the domestic economy and what adjustment strategies it should pursue. Two areas in particular deserve attention.

The first is the domestic economy. Current projections of both private consumption and investment growth for 1998 may turn out to be overly optimistic. At the same time, fears of creeping inflation may lead to tight monetary and fiscal policies. Given that the economy is not at present overheated, some flexibility in short-term macroeconomic management, including the provision of adequate liquidity through the banking system, would seem to be prudent.

The second area is the external economy. Taipei, China should maintain its open trading system even in the face of a declining trade surplus. In

Table 2.4 Major Economic Indicators: Taipei, China, 1995-1999
(percent)

Item	1995	1996	1997	1998	1999
Gross domestic product growth	6.0	5.7	6.8	5.8	6.2
Gross domestic investment/GDP	23.7	21.2	21.8	22.6	23.4
Gross domestic saving/GDP	25.6	25.1	24.7	24.9	25.2
Inflation rate (consumer price index)	3.7	3.1	0.9	3.2	2.2
Money supply (M2) growth	9.4	9.1	7.2	7.4	7.4
Fiscal balance/GDP	-7.4	-7.4	-5.7	-5.3	-4.8
Merchandise exports growth	20.0	3.8	5.2	6.8	7.0
Merchandise imports growth	21.2	-0.1	10.1	9.5	10.0
Current account balance/GDP	2.1	4.0	2.7	1.5	0.8
Debt-service/exports	0.1	0.1	0.1	0.1	0.1

Sources: Directorate-General of Budget, Accounting and Statistics data; Wu (1997); and staff estimates.

this respect 1998 will be a crucial year. Even without a devaluation of the People's Republic of China's (PRC's) renminbi, Taipei, China's exports will slow down. Maintaining a free trade stance will be crucial for the future of not only the domestic economy, but also of free and open trading in the region.

POLICY AND DEVELOPMENT ISSUES

The economy is still undergoing considerable structural transformation, in particular, the industry sector is continuing to experience major structural changes. Light and labor-intensive manufacturing activities are declining in importance, and efforts to increase the share of capital-intensive and high-technology activities are under way. In the changing global trade environment, promoting specific industries in which the economy may have distinct comparative advantages continues to be a major challenge.

To make the process of structural transformation as smooth as possible, two policy areas deserve particular attention, namely, liberalizing financial and capital markets in the face of the continuing turmoil in the region and continuing with the plan to convert Taipei, China into a regional center for financial and high-technology-based economic activities. Successful implementation of these two related sets of policies could go a long way toward ensuring the economy's transition to a high-technology base. However, the problems involved could also be formidable.

Capital markets are being liberalized with the introduction of new financial instruments and the pledge by monetary authorities to lift capital controls by 2000. However, the ad hoc committee, which consists of Ministry of Finance and Central Bank representatives, has suggested strengthening financial institutions along with carrying out further liberalization. The recent currency crisis seems to have strengthened the position of those who argue for a slower pace of reforms. Historically, Taipei, China's financial liberalization has been gradual; too slow according to some critics. However, such a step-by-step policy may be defensible, as it probably played a major role in protecting the economy from the financial turmoil of 1997.

Reforms under discussion include allowing commercial banks to become involved in investment

banking by entering the securities and bond markets. The authorities also launched a domestic futures exchange, thereby giving companies the option to hedge risks without going offshore. In addition, the central government has taken steps to privatize state-run banks, a plan that was boosted by constitutional reforms passed in July 1997 that shrank provincial governments and stripped them of their substantial assets.

The objective of ensuring smooth maturation and playing a significant role in the next century has led to the formulation of a scheme—the Asia-Pacific Regional Operations Center plan—to turn Taipei, China into a regional financial and economic center. The idea is to attract private capital flows, especially to high-technology industries, such as microchips and semiconductors.

For a comprehensive plan of this type to succeed, a number of developments will be necessary. To begin with, it will require free mobility of goods, services, capital, human resources, and information, which will call for institutional and regulatory reforms. Furthermore, physical infrastructure will need to be improved to support the movement of productive factors into increasingly sophisticated activities. At the same time, specific supporting sectors, such as financial services, telecommunications, and air transportation, would have to be liberalized further.

Along with the push for high-technology industries, Taipei, China is also aiming for stable relations, and even direct business and transport links, with the PRC. Positive developments in this direction will help improve the general business climate. In particular, the environment for implementing the objectives of the Asia-Pacific Regional Operations Center plan will be more favorable. To sum up, from a long-run perspective Taipei, China is continuing the transition from labor-intensive activities to capital-intensive and high-technology activities. Such a transition has posed complex problems of competitiveness, skill bottlenecks, and internal and external balance. Nevertheless, an export-driven, high-technology future appears to be attainable. However, to realize this vision, the challenges noted must be tackled boldly and imaginatively through flexible, short-term, macroeconomic policies and strategies for long-run transformation.