Taiwan Is At Economic, Political Crossroad

by Mary Burdman

In the wake of the parliamentary elections in Taiwan on Dec. 2, President Chen Shui-bian is left trying to form a "National Stabilization Alliance" in order to govern. While relations with the Chinese mainland are certainly an issue in Taiwan politics, this and other questions are secondary to what is on the minds of the population, the business community, and any serious politician: the crash of the economy. Since the end of 2000, Taiwan's exports—which account for half of the economy—have been collapsing at record rates, while unemployment and factory closings have soared. Taiwan, undergoing the first full-year of economic contraction in a half-century, is now in its worst economic crisis. The Asian Development Bank warned on Nov. 9, that Taiwan's economy will contract by 2.1% this year.

Indeed, as is widely appreciated on the Chinese mainland, only its rapidly growing economic relations across the Taiwan Strait has saved Taiwan from an even worse disaster.

Taiwan is in the same condition as just about every other nation in Asia, except for China and India: dangerously dependent upon exports of computer technology, especially to the United States. Taiwan, like the other "Asian Tigers," became enmeshed in the "Washington Consensus-New Economy" world empire—different from the historic one-product colonial economic model mainly in that it lasted only a fraction of the time.

Taiwan is now at a crossroads. Since President Chen Shui-bian, of the Democratic Progressive Party (DPP), was elected in March 2000, both opposition leaders and his administration have made efforts to improve economic relations across the Taiwan Strait. The efforts by the opposition, especially the formerly ruling Guomindang (better known in the West as the KMT), and the much smaller New Party, were much stronger.

The DPP is officially in favor of some form of Taiwan independence, but Chen himself has been very low-key on this question. He even gave support to the proposal, made by former KMT Prime Minister Vincent Siew, to form a "cross-Strait common market." Siew and other opposition leaders, such as James Soong, have visited the mainland to discuss such policies during the past year.

Pressure from the Taiwan business community prompted Taipei on Nov. 7, to finally lift its 50-year-long ban on direct trade, financial, and investment links with the mainland. While clearly an important development, especially after the extreme anti-mainland posture imposed by the former President—the Dale Carnegie-style "democrat" Lee Teng-hui of the KMT—the rapidly growing integration of the "greater China" economies, by itself, is not an answer to the current world crisis.

The Direction Of The Economy Must Change

The *direction* of the Taiwan economy must change. Its valuable capabilities—in such advanced technologies as nuclear energy and high-speed railroads; in its potentially very capable *Mittelstand*-style industrial structure of advanced and flexible small and medium-size firms; in its financial resources (Taiwan has some $109 billion in foreign exchange reserves, the third-largest accumulation in the world)—must be applied to cooperation not only with mainland China, but with Southeast Asia, where Taiwan also has many links.

Like Japan, Taiwan has followed an unwise economic path in recent years. It has become ever more dependent upon production of computer chips and other information technology (IT) products, as more and more factories located *outside* of Taiwan. While Taiwan has the world's two largest computer-chip makers, in 2000 (according to the official Institute for Information Industry), almost 50% of Taiwanese IT production took place in overseas factories. While an important motivation for the exodus of Taiwan IT producers to the mainland is the 20% cheaper labor there, other costs of production, such as transport, are not so favorable. At the same time, this process is leading, as it is in Japan, to the danger of a "hollowed out" and greatly weakened domestic Taiwan economy.

Amid these economic trends, the political situation in Taipei is hardly firm. Before the December elections, the 225-member Parliament had been dominated by the KMT, which had ruled in Taiwan since fleeing from the mainland in 1949. This time, the KMT, which had already lost MPs to the new People First Party, led by former Presidential candidate James Soong, lost its 110-seat majority, winning only 68 seats. The DPP itself won 87 seats, up from 66, and now must form a coalition. The KMT has bowed out of the "National Stabilization Alliance," although there have been a number of MPs defecting from the KMT. Potential coalition partners are either—in the worst case—Lee Teng-hui's radical anti-China party, the Taiwan Solidarity Union, with 13 seats; or, in a far better case, the People First Party, which won 46 seats. Soong's policies are generally in favor of improving economic relations with the mainland.

Economic Crash

Economic gloom has been gathering fast in Taiwan this year. Real estate and stock market contractions from the 1990s have left the banking system with more than 11% of its loans gone bad. Taipei has been attempting to implement a Japan-style bank "reorganization"—merging its 50 banks into ten or so institutions—with Japan-style lack of success. A NT$500 billion ($15 billion) "national stabilization fund"

Taiwan President Chen Shui-bian is trying to form a "National Stabilization Alliance," as Taiwan's economy crashes.

had been put together to bail out the falling stock market last year, and proceeded, as the *Taipei Times* wrote, to "lose its shirt in the futures market" in 2000.

By May 2001, as the "New Economy" imploded, the economy had fallen to its lowest level since 1975. Relentlessly, with month-by-month declines, Taiwan's overseas trade has contracted by half.

By the end of the third quarter, the economy had contracted by 4.2% year-on-year. Unemployment has been rising since October 2000. By October 2001, the unemployment rate had hit a record high of 5.33%, up from 5.26% in September. Already, 4,200 Taiwanese factories have closed this year, and the government forecasts that the number of closures will rise to 6,000, in addition to 5,000 factory closings in 2000.

Taipei plans to cut 15,000 civil service jobs next year, including in state-run manufacturing. Over the next four years, civil service jobs will be cut by an average of 1%, or 6,000 jobs per year.

In September, Taiwan was hit by the worst drop in exports it had ever experienced. Exports fell 42.5% compared to last year, while imports went down 40.4%, and the trade surplus, 64%. Worst hit were the electronics and telecom sectors—more than one-third of exports—which were down 50-58%.

Industrial output, which has been contracting, often at a double-digit rate, since February, fell 14.1% in September and another 6.7% in October. Worse, export orders are crashing. Orders fell 20% in June from a year before, and then a record 27% in September. The process continued in October, with orders down 12.3%. Overall, according to the Ministry of Economic Affairs, exports are expected to contract by at least 17% this year. The United States buys about one-fifth of Taiwan's exports.

Even more serious has been the growing influence of the anti-nuclear-power lobby in Taiwan. The "green" lobby is strong within the DPP. Last December, the government decided to stop the proposed construction of a fourth nuclear power plant, and the project remains in jeopardy, even though the Supreme Court had overturned the government decision and the former parliament had passed a resolution by a vote of 135-70 to support the plant. The KMT had strongly supported the pro-nuclear resolution.

Growing Integration

In August, Taipei's 120-member Presidential Economic Advisory Council called for increasing transport, trade, investment, and commercial links with the mainland. On Nov. 7, Taiwan's Mainland Affairs Council chairwoman Tsai Ing-wen announced that Taiwanese can now invest directly in the mainland Chinese economy. The Taiwanese cabinet approved a proposal ending the $50 million limit on individual investments in China, and ending the ban on direct investment. In addition, offshore units (in this case, "onshore" on the mainland) of Taiwan banks will be able to remit money to and from Taiwan. "Political problems take more time to resolve so we try to resolve economic problems first. This is a move in a good direction. It can't be bad," Tsai Ing-wen said.

Despite the earlier restrictions, there are already some 50,000 Taiwanese investors in China, including 24,000 of Taiwan's 80,000 manufacturers. Taiwanese businesses have already invested some $60-70 billion in China since relations improved beginning in the late 1980s. Until now, they have had to conduct trade or investment through companies incorporated in places such as Hong Kong. In late November, both sides also announced easier visa rules.

Of real interest, is the potential for increased financial cooperation in these times of looming crisis for the dangerously overvalued U.S. dollar. China has announced it is already diversifying its holdings into euros. While the virtues of the current Maastricht Treaty-defined euro are limited, the decision indicates the concern about the strength of the U.S. dollar. Even more notable, have been ongoing background discussions about the potential for gold-backed euros, Russian rubles, or Chinese yuan, as sounder alternatives to the dollar. China, with some $209 billion in reserves, is officially second to Japan, and Hong Kong holds some $107 billion in foreign reserves, only slightly less than Taiwan.

It must be stated, that financial cooperation is *not* on the agenda now; China is doing its all to ensure the internal strength of the yuan, and remains very cautious about any potential external financial links. For Taiwan, the issue is also extremely sensitive, because it is heavily dependent upon the United States for exports and military supplies. Any move even toward the euro, would not be acceptable in Washington.

In September, proposals were being made by the Taipei Finance Ministry, to allow foreign banks to buy controlling interests in Taiwan banks. This idea was not welcomed in Beijing—in contrast to its response to the decision to allow much easier financial and investment ties between the two sides. That, Lu Nanping, deputy director general of China's State Administration of Foreign Exchange, said on Nov. 7, is "a very good thing. . . . As long as Taiwanese authorities act, banks on both sides will benefit. Otherwise, third parties—like Citibank—will earn the money."