

The Balance of Payments Adjustment Process in Taiwan, Republic of China

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It is my pleasure to attend the Conference on International Payments Imbalances in the 1980s, and to be invited to comment on the paper by Jeffrey Sachs. Since only the tables of his paper have just been made available, it is impossible for me to give comments. Therefore, I would like to take this time to present a brief account of the balance of payments adjustment process in my country, a topic closely related to Sachs's paper.

Our current account shifted into surplus in 1981, and thereafter the magnitude of the surplus rose steadily over the years. By 1987, the surplus reached US\$17.9 billion, accounting for 18 percent of that year's GNP. However, the current account surplus was reduced sharply in 1988. In the first half of the year, the surplus decreased to US\$4.5 billion, less than half the level in the same period of last year, and represented only 7 percent of GNP. For the development of our current account balances, see table 1.

Although the expansion in our current account surpluses has driven the economy to grow rapidly, it has also created the problems of misallocated resources and excess liquidity, both putting upward pressures on domestic prices. To redress the external imbalances, our private and public sectors have actively applied the following corrective measures over the years:

(1) Appreciation of the N.T. dollar.

Since September 20, 1985 (the day before the G-5 Plaza Meeting), the N.T. dollar has appreciated 40 percent against the U.S. dollar, while the bilateral trade-weighted real effective exchange rate index of the

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Table 1
Current Account Balances of Selected Countries, 1980 to 1988
Billions of U.S. Dollars

Year	Japan	Federal Republic of Germany	Taiwan R.O.C.	Korea	Singapore
1980	-10.75	-15.90	-.91	-5.32	-1.51
1981	4.77	-3.40	.52	-4.65	-1.47
1982	6.85	4.96	2.25	-2.65	-1.30
1983	20.80	5.40	4.41	-1.61	-.61
1984	35.00	9.65	6.98	-1.37	-.39
1985	49.17	17.03	9.20	-.89	-.01
1986	85.83	39.75	16.22	4.62	.54
1987	87.00	45.40	17.93	9.85	.54
Jan.—June 1987	43.72	22.27	9.44	4.61	n.a.
Jan.—June 1988	43.49	23.76	4.45	6.07	n.a.
Percentage change, Jan.—June 1987 to Jan.—June 1988	-.5%	6.7%	-53.0%	32.0%	

Source: IMF, *International Financial Statistics*, Sept. 1988.

N.T. dollar also went up 8 percent, to a level of 103. (The base year is 1979, when the current account was in balance.)

The appreciation of the N.T. dollar has changed the relative prices of domestic and foreign products, thus reducing the trade surplus. Simultaneously, because of the appreciation of our currency and the decline in oil prices, our terms of trade improved. This has in turn increased the purchasing power of our people's personal income, enabling them to buy more and to increase imports.

(2) Reduction of customs tariffs and elimination of a customs valuation increase of 20 percent added to the CIF value of imported goods.

We have lowered import tariffs gradually. By August of this year, the effective tariff rate had declined to 5.5 percent, marginally higher than the 3.8 percent rate of the United States in 1987. Furthermore, between 1980 and 1986 we completely phased out the policy of adding a customs valuation increase of 20 percent to the CIF value of imported goods. These two measures have reduced the prices of imported goods significantly.

(3) Opening up of the domestic market.

At the end of September of this year, only 398 import items remained on the prohibited and controlled list, representing 1.5 percent of all import items. These items, which include drugs and weapons, are prohibited or controlled purely for reasons of public health, national security, and the maintenance of benevolent customs.

Factors such as the cut in import tariffs, the opening up of the domestic market, and the aggressive marketing of imported goods, have all contributed to a rate of growth of imports that since 1985 has outstripped the rate of growth of domestic production. Consequently, the import penetration rate has increased. Take cigarettes as an example; imports were first permitted only just last year. During the first eight months of this year, imported cigarettes already amounted to some US\$100 million and took up a 17 percent market share. (Of the imported U.S. cigarettes, Winston and Marlboro represented the lion's share. It should be noted that while the importation of cigarettes contributes only marginally to the adjustment of our external imbalances, it brings great hazard to the health of our public.)

Following the opening up of the commodities market, the services market is gradually becoming accessible. Foreign banks are now permitted to establish a second branch in southern Taiwan, in addition to one in Taipei. The insurance and leasing sectors are opening up as well. Furthermore, American fast food chains, such as McDonald's, Wendy's, Hardee's and Pizza Hut, are now conspicuous through Taiwan.

(4) Expansion of direct investments abroad.

The appreciation of the N.T. dollar and the rise in labor costs have caused our labor-intensive industries to slowly lose their comparative advantage, thus forcing them to move their operations abroad to such countries as Thailand and Malaysia, and even to mainland China. Increasing our overseas investments is a sure-fire way to reduce the exports of our domestic products.

(5) Shift to expansionary fiscal policy.

Government spending in fiscal year 1989 (from July 1988 to June 1989) will increase 17.3 percent over that of the previous fiscal year. The budget deficit will account for 16.5 percent of government spending, indicating that the government has begun to adopt an expansionary fiscal policy in order to stimulate domestic demand.

(6) Phasing-out of the tax rebate system.

Since 1984, 1,366 export items have been deleted from the tax rebate system, and the remaining ones will be removed eventually.

(7) Relaxation of foreign exchange controls.

With the drastic relaxation of foreign exchange controls in July 1987, no restriction remains on current account transactions, while the controls on capital transactions are very limited. As a result, service and transfer payments have increased greatly. Substantial outflows of private capital have ensued since early 1988.

Our external imbalances have shown effective adjustment as a result of the redress measures described above. Comparing the first half of this year with that of last year, the reduction in our current account surplus, in both absolute amount and percentage terms, stood as the highest among all industrialized and newly industrialized countries. As

Table 2
Domestic versus External Sources of Growth in GNP, Taiwan, R.O.C., 1980–88

Year	Domestic Demand (Percentage Points)	Net Exports (Percentage Points)	Total Real Growth in GNP (Percent)
1980	6.76	.35	7.11
1981	2.59	3.15	5.74
1982	.17	3.21	3.38
1983	3.93	4.03	7.96
1984	6.35	4.21	10.56
1985	.68	4.45	5.13
1986	4.32	7.33	11.65
1987	12.82	-.96	11.86
1988 (est.)	12.63	-5.39	7.24

Source: DGBAS, ROC, *National Income in Taiwan Area, ROC (1951–1987)*, December 1987.

table 1 indicates, between these two periods our current account surplus decreased 53.0 percent. Japan showed a negligible 0.5 percent drop, whereas Germany and Korea posted increases of 6.7 percent and 32.0 percent, respectively.

Looking at the sources of growth in our GNP, since 1987 the contribution to the real growth rate of GNP from net exports has been negative. Of the estimated 7.2 percent real GNP growth in 1988, 12.6 percentage points will come from domestic demand, whereas -5.4 percentage points will come from net exports. Our economic growth has shifted gear from foreign demand to domestic demand, giving evidence that the adjustment of external imbalances has been effective. For the sources of our economic growth, see table 2.

We understand that there is still much room for improvement in our external imbalances. Just as the buildup of current surpluses occurred over a period of years, it will take time to redress the imbalances. But we are proceeding in the right direction, and we will continue to do so in the future.

I would like to conclude my presentation by noting that the current account surplus of one country is the counterpart to the current account deficit of others; therefore, the balance of payments adjustment should be symmetrical. We are all very pleased to know that U.S. productivity has risen and that unit labor costs have declined; these factors, coupled with the depreciation of the U.S. dollar, have helped to increase the competitiveness of U.S. products. Consequently, both nominal and real trade deficits have decreased. Nevertheless, we all agree that the U.S. trade gap must narrow further. Numerous economists (including many who are present here) believe that the major factor causing the U.S.

trade deficit is her fiscal deficit.¹ If the U.S. fiscal deficit could be reduced further, this would help to restore international payments balances. Concurrently, we earnestly hope that the United States will reduce her protectionist measures, as they are not only detrimental to the benefits of the U.S. consumers, but also harmful to the healthy development of the world economy.

References

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¹ See Helkie and Hooper (1987) and Sachs and Roubini (1987).