Japan and the World Economy 22 (2010) 254–263

Contents lists available at ScienceDirect

Japan and the World Economy

journal homepage: www.elsevier.com/locate/jwe

The strategies adopted by Taiwan in response to the global financial crisis, and Taiwan's role in Asia-Pacific economic integration

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ARTICLE INFO

Keywords:
Global financial crisis
Regional economic integration
Industrial policy
ECFA

ABSTRACT

The global financial crisis that began in 2008 exposed weaknesses in Taiwan's industrial structure and in the structure of its foreign trade; it also pointed out the importance of industrial upgrading and transformation if Taiwan is to remain economically competitive. The aim of this paper is to explore the strategies that Taiwan has adopted in response to the global economic crisis, and the medium- and long-term strategies that Taiwan will need to adopt in the face of the trend towards economic integration in the Asia-Pacific region.

1. Introduction

The sub-prime mortgage crisis in the U.S. was the prelude to a financial and economic crisis the effects of which have been felt all around the world; those economies in Europe and the Americas whose financial sectors had been highly internationalized and whose economies were closely linked to the U.S. were particularly badly affected. As the level of financial internationalization in Taiwan is still relatively low, the extent of asset destruction in Taiwan was limited. However, the Taiwanese economy is heavily dependent on exports, and the destruction of wealth in Europe and North America led to reduced demand for imports, which had a severe impact on Taiwan's export performance. The financial crisis revealed a number of weaknesses in Taiwan's industrial structure and the structure of its foreign trade. The fall in the purchasing power of American consumers had an indirect impact on Taiwan's exports. In the first quarter of 2009, exports fell by over 30%. Adding to this the effects of weak domestic demand, Taiwan's first-quarter economic growth rate was an unimpressive −8%. The question of how the Taiwanese economy has coped with the recent crisis, and how Taiwan can upgrade and transform its industries so as to protect itself from the impact of a similar impact in the future, is an important one.

At the same time, the global trend towards regional economic integration continues unabated. Taiwan's diplomatic isolation has made it difficult for it to participate in this process of regional integration, and there is a risk that Taiwan will become marginalized. There is a need for in-depth research to determine what strategies Taiwan should adopt in response to this situation.

This paper has two main objectives: Firstly, to explore the impact of the global financial crisis on Taiwan and the strategies that the Taiwanese government has adopted to cope with the crisis. Secondly, to analyze the role that Taiwan plays within the Asia-Pacific regional economy and the strategies that Taiwan should adopt in response to the trend towards regional economic integration.

The paper is divided into five sections. Following on from this Introduction, Section 2 analyses the impact of the global financial crisis on Taiwanese industry and the Taiwanese economy as a whole. Section 3 describes the medium- and long-term strategies that Taiwan has adopted in response to the financial crisis, while Section 4 explores the role that Taiwan plays within the Asia-Pacific regional economy and the strategies that Taiwan will need to adopt in response to the process of regional economic integration; the final section presents the concluding remarks.

2. The impact of the global financial crisis on Taiwan's industrial structure and overall economy

The recent global financial crisis has had a serious impact on Europe and the U.S., causing their economies to contract and purchasing power to shrink. Europe and North America are the main export markets for Taiwanese industry, so Taiwan has also been severely affected by the crisis. The manufacturing sector accounts for by far the bulk of Taiwan's exports, and the impact here has been especially pronounced. The largest share of Taiwan's fixed capital investment is concentrated in the IT and electronics industry; this sector's export performance has been severely affected by the worsening of the global economic climate, and manufacturers have responded by cutting back on capital expenditure. The impact of the global economic downturn has

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doi:10.1016/j.japwor.2010.06.006

also spread upwards through the value chain to gradually affect the shipment performance of manufacturers of large-sized LCD panel, memory, and PC components. Several cyclical industries that had been expanding vigorously before the crisis – including the chemicals and plastics industry, the iron and steel industry, the cement industry, the shipping industry, etc. have also felt the effects of the global economic downturn.

The banking and insurance industries were the "epicenter" of the financial crisis. As might be expected, the asset management business and mutual fund business, which had been growing rapidly in recent years, both contracted. Falls in the value of overseas assets, the need to make increased provision for bad debt, and the reduction in the interest rate spread between deposits and loans, will all have had an impact on earnings in the banking and insurance industry. With business falling off, the relevant departments have been shedding staff. However, the impact of the global financial crisis on Taiwan's financial sector has been mitigated to some extent by Taiwan's relatively low level of financial internationalization.

What with the impact of layoffs and pay cuts, negative growth in real wages, falling house prices, and dramatic fluctuations in the stock market, Taiwanese consumers have seen a dramatic contraction in their personal wealth. Consumer spending has fallen as a result, leading to low growth rates in the commercial sector.

The effects of the financial crisis have thrown into sharp relief the excessive concentration of Taiwan's exports in a handful of industries and the overall weakness of the industrial structure. The main imbalances in Taiwan's industrial structure can be outlined as follows (Wang and Wei, forthcoming):

Firstly, Taiwan is excessively dependent on the electronics and IT sector. The information and communications technology (ICT) industry, chemical industry and metallurgical industry between them account for around 70% of Taiwan's GDP, and 60% of Taiwan's exports. The 19.17% growth rate that the electronics and IT sector posted in 2007 contributed 2.14% to Taiwan's overall economic growth rate (Table 1). However, with the worsening economic climate in Europe and North America leading to lower demand for imports, there was a pronounced deterioration in the export performance of Taiwan's ICT industry; the industry's exports declined by 34.20% in the first half of 2009.

Secondly, Taiwanese industry is largely engaged in original equipment manufacturing (OEM) and original design manufacturing (ODM) production. Most of the patents that Taiwanese manufacturers secure relate to production process technology; the overall level of value-added is low, and Taiwanese companies lack the strong brands that they would need to gain full benefit from their R&D activities. Taiwanese products are heavily concentrated in the mid-stream and upstream segments of the value chain, with intermediate goods accounting for over 70% of total exports (Fig. 1). As a result, of this situation, Taiwanese companies generally have only limited knowledge of trends in consumer demand for the final goods that are produced using their intermediate goods.

Thirdly, of Taiwan's "Two Trillion, Twin Star" industries, the semiconductor (DRAM) industry and large-sized TFT-LCD panel industry are both cyclical, capital-intensive industries that are highly vulnerable to economic downturns.

A fourth point is that, while the service sector accounts for around 70% of Taiwan's GDP, its level of competitiveness is low, the pace of industry upgrading has been slow, Taiwan's service industries have found it hard to internationalize, and the service sector as a whole has done little to help Taiwan's manufacturing industries add value, or to integrate their operations with those of manufacturers to enhance Taiwan's overall competitive advantage. The service sector's GDP contribution rate in 2007 was 2.93%, only slightly higher than that of the manufacturing sector (2.70%) (Table 1). The small size of Taiwan's domestic market, combined with shortages of human talent and capital and inadequate investment in R&D have imposed constraints on the extent to which the service sector has been able to internationalize or grow its exports. Even so, the importance of the service sector to Taiwan's economy should not be underestimated; the financial sector, wholesale and retailing, logistics and the restaurant business in particular account for a large share of employment in Taiwan.

3. The policies adopted by the Taiwanese government in response to the global financial crisis

As regards the measures adopted by the government in response to the global financial crisis, as with many other countries, Taiwan has relied heavily on monetary and fiscal policy to cope with the impact of the crisis (Wang and Wei, forthcoming). The Taiwanese government adopted a relaxed monetary policy and cut interest rates so as to boost bank liquidity. In terms of fiscal policy, the government allocated NT$500 billion to support a range of public construction projects over a period of 4 years. The

Table 1
Taiwan's economic contribution rate from each industry.

	All industries	Agriculture	Manufacturing + mining	Manufacturing	Information industry	Service industries
Real GDP growth rate						
2003	3.50	−0.06	4.00	5.34	9.58	3.39
2004	6.15	−4.09	8.94	9.74	14.51	5.28
2005	4.16	−8.07	6.34	6.96	17.95	3.53
2006	4.89	6.09	7.04	7.51	18.10	3.93
2007	5.72	−2.91	9.31	10.29	19.17	4.30
Growth contribution (%) = industry's real GDP growth rate (current year) × that industry's share of real GDP (previous year)						
2003	3.50	0.00	1.13	1.26	0.73	2.37
2004	6.15	−0.07	−2.54	2.34	1.18	3.68
2005	4.16	−0.13	1.85	1.73	1.57	2.44
2006	4.89	0.09	2.10	1.92	1.79	2.70
2007	5.72	−0.04	2.83	2.70	2.14	2.93
Growth contribution rate (%) = industry's growth contribution/growth contribution by all industries						
2003	100	0.00	32.29	36.00	20.86	67.71
2004	100	−1.14	41.30	38.05	19.19	59.84
2005	100	−3.13	44.47	41.59	37.74	58.65
2006	100	1.84	42.94	39.26	36.61	55.21
2007	100	−0.70	49.48	47.20	37.41	51.22

Source: Statistical Yearbook, Directorate General of Budget, Accounting and Statistics, Executive Yuan (2009).