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**CHUAN LYU LECTURES**

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***Subject:***

***Can Taiwan's Economic Miracle  
Persevere? An Examination of  
Its Past and Future***

**by: Mr. LI-PEI WU**

**Chairman & Chief Executive Officer**

**GBC Bancorp and General Bank, Los Angeles**

**CAN TAIWAN'S ECONOMIC MIRACLE PERSEVERE?**

## **I. INTRODUCTION**

### **Taiwan's Economic Miracle**

We all have heard about Taiwan's economic miracle. Just what is so miraculous about this miracle? Chart 1 shows some very spectacular statistics. Other than a little blip caused by the Oil Crisis, in the last 30 years Taiwan's annual real GDP growth has maintained within the range of 5-12% while keeping the unemployment rate below 3%, and low inflation rate. The extraordinary accumulation of foreign reserve is another good indication of Taiwan's competitive edge in the world market and its ability to create national wealth. Whether compared to other developed or developing countries, these statistics clearly qualify to be considered of miraculous proportions.

As a lifetime banker I spent three decades in Taiwan personally witnessing these economics changes unfold. I then spent another 30 some years in America helping my bank clients here and those inside Taiwan carry out business transactions here and there. I believe as a long term observer I have good insight as to how and why this economic miracle could have happened the way it did in spite of the fact that Taiwan is but a small island nation of now 22 million people and extremely lacking in natural resources. I can still remember how poor we were growing up, and when you look at Taiwan today you have to admit it has come a long way. I was there every step of the way and I will go beyond the surface to examine the past, the present, and offer my future perspectives.

Aside from the economic considerations, I will discuss some other driving forces behind the 50 years of economic development starting in 1949, areas involving changes in the social power structure, unique ethnic/culture factors, and domestic and international events, etc. I have also seen some red lights signaling troubles to be reckoned with.

In a nutshell, if you analyze this miracle carefully you will have to come to the conclusion that it was fraught with many factors connected with luck, coincidence, even accident which the Taiwanese people took advantage of to turn in their favor. Some of these factors came from inside like the delicate relations and interaction between the "native Taiwanese" and the "mainlanders", and the controversial land reform. Others came from outside international influences. One thing this miracle was not, it was not the result of genuine governmental planning or leadership. This means if a responsible government had thrown in its fair share of contribution, this historical miracle would have gone many many extra miles.

## **II. HISTORICAL PERSPECTIVE**

### **The Popular Belief:**

Taiwan's economic takeoff started in the 1960's. This phenomenal success was widely believed, though not necessarily entirely true, to have derived from the following causal factors:

- 1) Successful implementation of a compulsory education system from 6 to 9 years. This has helped improved the quality of Taiwan's labor force tremendously.

- 2) Ten National Projects—in the '70s the national government moved to establish basic infrastructure, such as airports, highways, railroads, seaports etc., and basic industries such as steel, petrochemicals, shipbuilding etc., and utilities, to form a foundation for other industries. The results were mixed and not as claimed by the government.
- 3) Export-oriented policy—it started as an import substitution policy to the government's credit but the export boom did not come about via government policy but stemmed from other reasons.
- 4) Small and medium enterprise structure—this structure was the main backbone of the miracle but its formation and functions were more the result of private sector efforts rather than government policy, which accidentally sowed the seed through the land reform program in '50s.
- 5) Land reform program—it forced the native elite landowners to engage in business activities and became the main driving force of the economic machine later, but purely as an accidental consequence which I will explain.
- 6) High tech upgrades—when the economy hit the bottleneck in late '80s early '90s some low-tech down-stream items were developed in the computer industry but were mainly due to business sectors own ventures rather than policy-induced as claimed. The jury is still out as to how this area will eventually work out.

### **The Real Reasons – The External Forces**

- 1) Japanese Heritage—over fifty years of its occupation Japan constructed an excellent network of transportation and communication facilities, a population 90% literate and extremely law-abiding, and all the other infrastructure needed as its forward base for its WW II efforts. Taiwan was more advanced than any Asian country except Japan.
- 2) Mainlanders' Contributions—two million Chinese followed Chiang Kai-Shek to Taiwan many of whom were intellectuals and professionals who became the movers and shakers in many sectors.
- 3) The Korean War—the war was a real savior for Taiwan as it reversed U.S. policy on Taiwan from one of abandoning Chiang's regime as not worthy of support to one of the most staunch ally. The Seventh Fleet was dispatched to defend Taiwan. Taiwan was regarded as an "unsinkable aircraft-carrier" and military and economic aid started to flow in. The economy got a big boost from the war effort.
- 4) The Vietnam War—Taiwan was used as a supply depot to support the war effort and as a recreational center for military personnel. Again a shot in the arm to finance the economic development. Statistics showed a total of more than \$150 billion of U.S. aid was dispensed to Taiwan from 1951 to 1969 for those two conflicts in Asia.
- 5) Industrial Upgrade—end of '80s and early '90s saw the U.S. economy deep in cyclical recession caused by the end of the cold war and military spending cuts. A lot of Taiwanese American engineers and scientists became the victims of company downsizing and lost their jobs. The U.S. is the biggest beneficiary of Taiwan's brain-drain as each year more than 10,000 came to study and majority of them elected to stay in the U.S.—most of them science/technology majors. They were well groomed in the latest technology and they were now out of job. This happened to coincide with Taiwan's economy running into a bottleneck, desperately needing to replace its labor-intensive industries with ones of high capital and

technology. So through industrial and academic/research institutions' channels, a perfect match-making was done and a lot of these top brains relocated back to Taiwan and contributed to the first industrial upgrade there. So far this effort has been limited to the peripheral computer industry mostly, rather than the real high tech areas requiring R&D expenditures—a sign that indicates substantive and urgent assistance from the government and universities is needed, much like any other areas of industrial upgrade being contemplated now.

### **The Real Reasons – The Internal Forces**

1) Sense of Crisis—driven by the perpetual hostility and threat from a very unfriendly superpower neighbor China, Taiwanese people feel the constant pressure to have to excel in everything they do just to survive. And survived they have under their various colonial masters, always having to work extra hard to gain approval. Always maximum efforts. Example: paddy fields tilled all the way to the railroad tracks. Not an inch wasted. Former President Jimmy Carter was in a sense right when, responding to a reporter in Taiwan that he hurt the Taiwanese people by switching diplomatic recognition from Taipei to Beijing in 1979, he said that he gave Taiwan a chance to emerge from a crisis and become better.

2) Land Reform Program—What started out as the government's means to eliminate the power base of the native Taiwanese elite—part of a well orchestrated and ruthlessly executed scheme to severly weaken the native's potential for resistance—accidentally and luckily had the unexpected consequence of forcing these landlords into eventually transforming themselves into small and medium-sized entrepreneurs and the best contributors to the economic success story. Similar reforms were done in different parts of China but never could have succeeded due to strong resistance from vested interest groups and sometimes resulted in disturbances. Taiwan's economic structure, composed of these efficient, flexible and hardworking small and medium businessmen, is a far cry from Korea and Japan's large business and conglomerate structure. Lack of strong union movement also was very beneficial to these businesses. They are solid and financially conservative operators and not susceptible to any financial or economic storms at all.

3) Economic Free Rein—while the government was intent on controlling and dominating the political, military, and judicial aspects, it allowed the public to have a pretty free hand to exploit economic and business opportunities on their own. No worry for Big Government, but at the same time businesses simply didn't have the benefit of reasonable and normal assistance from their government considered indispensable in modern day global commerce. Much as in any colonial rule, studying and picking a career in politics, law, or the military is frowned upon and discouraged. Science, medicine, engineering and business are safe and potentially profitable and these few areas became where Taiwan's best talents devoted their careers. This freedom of business pursuits also fostered an environment conducive to small and medium size entrepreneurs who did flourish and become the locomotive of the phenomenal progress, effectively eliminating the need or possibility to form big businesses like what happened in Korea and Japan.

4) Cultural & Family Virtues—People of Chinese stock everywhere all seem to have the thrifty and hard-working habits, family tradition and the right culture to pursue economic interest and be good at it. They have succeeded no matter where they settle down and become influential citizens throughout Southeastern Asian countries. Taiwan is no exception. But by the same token the requirement for transparency in business practices is oftentimes neglected and not adhered to by ethnic Chinese, a flaw that can hinder their potential for greatness. What makes them could end up breaking them, as they say.

From the above analysis we know Taiwan's private sectors definitely have what it takes to move into the 21<sup>st</sup> Century and create even more miracles provided that the missing player so far, the government, can fulfil its proper role in formulating good policies, and furnish the necessary infrastructure to guide and help its businesses, instead of just being a passive bystander, insofar as economic planning and development is concerned.

### **III. CURRENT PROBLEMS**

Taiwan's economy peaked around 1995. In the last three years some symptoms have surfaced, such as slowed GDP growth rate, higher unemployment rate, declined international competitiveness, reduced foreign exchanged reserve and trade surplus, higher bankruptcy rate. During this past year the situation got worse as many problem loans came to the fore and some financial institutions and significant businesses went under. Like Japan, Taiwan may still be rich with substantial reserve, but businesses and consumers at large have suffered from these ailments. Both were rapid-firing models for quite some time creating dislocations between their businesses and the accounting/regulatory/banking systems that were needed to facilitate them. Both also were under expedient one-party domination. So it is pertinent to ask three questions right now:

- 1) Can Taiwan's miracle persevere?
- 2) Will Taiwan follow Japan's footsteps, which has for the past eight years been mired in recession?
- 3) What does it have to do with the Asian economic crisis?

Before we attempt to answer these questions let's look at some of the specific problems that have surfaced:

#### **Infrastructure Problems**

1) Accounting problems—In spite of the presence and influence of multi-national accounting firms in Taiwan, generally accepted accounting principles have not been practiced and properly consolidated financial statements are not presented as a rule. Typical of all Chinese society, accurate book-keeping is not normally followed. Even companies on Taiwan's stock exchange, many of them multi-national entities with subsidiaries all over the world, aren't any better. It is common practice for the parent company to inflate transfer prices to its subsidiary thereby overstating the parent company's financial results and strength which, in turn, are used to secure loans from its bank, or raise funds in the stock market. Basic inter-company transactions are not properly eliminated in consolidation to reflect the true state of affairs. When the government issued its edict to adopt the accounting profession's suggestion to correct these fallacies, the three super-powerful elder tycoons who head up the three major merchants associations came out openly to voice their strong defiance. The result? Tycoon 1, government 0 and the order was put off at least until next year.

2) Regulatory problems—Taiwan still has a long way to go in terms of setting up and executing sophisticated regulatory systems. A recent good example involved a conglomerate group that set up some bogus affiliates and bought the proxies to control a bank from which the group borrowed substantial money to artificially buy and bid up an affiliate's stock. It then used the exaggerated stock value to borrow more money from the bank to again inflate the stock price of the next affiliate so more money was borrowed. This process repeated itself several times until

finally these monies defrauded from the bank were transferred overseas, leaving the bank and some investing public all in financial ruins. The SEC regulations are so incomplete with loopholes abound it is no surprise that abuses such as transacting with false, borrowed or stolen I.D., insider trading, and money laundering are all daily common occurrences. So many businesses and individuals had gone bankrupt as a result of wanton abuses like these. On top of that, influential men are often above the law so enforcement is often discriminating. Businesses that have more serious problems or abuses but are well connected to the party in power, never have any trouble carrying on business as usual. If you have the connection you can fix anything—rule of man not rule of law. Thus a political big-shot owning, on the surface, 0.05% of a company's stock can be the chairman of the board with real power, not just an honorary position. Further-more, Taiwan's economic landscape is dotted with big and dominating Kuomintang-owned enterprises that set the bad examples for others to follow. For instance, the China Development Corporation (CDC) is such a "special" KMT-owned enterprise that neither the banking law nor the investment banking law can touch it, but runs one of the biggest banking and investment banking operations. How can there be any discipline, or social justice to support enforcement system? Political party-owned enterprise, have you ever seen one before?

3) Banking problems—banks are supposed to run a transparent operation giving no special favor to anyone and based strictly on business merits. Banks are to follow strict guidelines set by the regulatory agencies. I am a banker, I know. But not so in Taiwan. There are so many banks which became intertwined in a three-in-one Trinity relationship with Big Business and government that they can do any deal any way they want without regards to any regulations. The situation is so serious President Lee was heard questioning how could the auditors, from the regulatory agencies and the banks involved, fail to uncover total illegal excessive lending of as much as \$19 billion. Statistics show it is far easier for government/party-owned enterprises and big businesses to borrow from banks than small and medium enterprises which actually are much more efficient and productive and have contributed the most to Taiwan's economic boom. What an irony and how unfair! Since 1991, about 16 private banks have entered the banking scene and they are required to have no single owner possessing more than 5% of its stock for obvious reasons. The reality? All of them are in severe violation of the rule through various ingenious means and are securely under the control of big businesses—an open secret only responsible regulators are unaware of. The interference by governmental interests in the banking operation is particularly worrisome—it's like allowing the referee to play in the game! A recent example is banks being "asked" not to make margin calls to support government priority to save the stock market—two wrongs here, violation of rule and since when is government responsible for the performance of its stock market? With the advent of more and more big businesses, which of course will learn from the misdeeds of the government/party-owned businesses, I have to worry about the fate of Taiwan's banking industry which is supposed to finance the next phase of Taiwan's economic expansion. Is Taiwan going to learn from Korea and Japan's dilemma? Moody's has already downgraded the rating of many Taiwanese banks.

4) Government/Kuomintang enterprises-They are a problem area as stated before. Efforts are underway to privatize the government owned businesses but so far they are falling into the hands of other big businesses or Kuomintang Party-owned enterprises, such as CDC mentioned before which was ranked as the second largest only next to the Taiwan Bank.

### **Policy-Induced Problems**

Historically the refugee Chiang regime never had any intention of settling down and develop the island's economy. Its whole purpose was the daydream to retake the mainland

someday. In the 50's 80% of the national budget was for the military which by the 60's still accounted for about 45%--leaving very little for economic development at all. When military spending was finally scaled back, money went mostly to debt-service and social programs. The impact of this policy was that economic development was sacrificed and delayed. Subsequently when the pendulum swung the other way, so much had to be made up very little attention was given to the environment and quality of life issues. These are still big problems for Taiwan so this miracle didn't happen without its social cost.

Now, in response to the economic red lights mentioned before and to prevent situation from getting worse, the Taiwan government undertook a vigorous but disputable series of support measures worth over \$28billion or over 10% of GDP to:

1) Support stock prices—a \$8.7 billion stabilization fund was provided by large banks, insurance and pension funds to support stock equity prices which otherwise could be used to stimulate the economy or for other more constructive purposes. Stock transaction taxes were reduced to help big brokers and big accounts at the expense of treasury coffers. The ownership limit for foreign purchase of a single stock was raised to 50%, encouraging speculative hot monies to destabilize the market.

2) Boost economic activities—banks were pressured to continue to loan to troubled businesses as well as to lower their loan rates in violation of basic sound bank practices. Funds were also used to rescue some high-profile corporations and troubled financial institutions. Additional assistance came from Kuomintang-owned businesses to bail out some problem banks. Just so that banks' published results would not suffer as a result of undertaking such support measures, their loan loss provisions are spread out over multiple years and problem loan classification standards are eased. This kind of compromise runs counter to the urgent requirement for reporting transparency. Moody's is concerned that these support measures would undermine Taiwan's already eroded global competitiveness. These short-sighted stop-gap expedient actions will no doubt cover up a lot of weaknesses and would-be failures in the banking and industrial sectors and simply prolong the pain and agony.

## **Taiwan-China Relations**

Given the problematic political relationship between the two countries with no solution in sight, the current investment and trade commitment in China is both too much in terms of magnitude and too concentrated in terms of dependency risk. This problem will be discussed in greater detail as a separate subject Thursday.

## **One-Man Rule**

Before the current administration, the two former President Chiangs did not get involved in economic matters and entrusted them to their key aides who had established channels to hear grievances, suggestions, formulate policies and take actions. With the Taiwanization of the ruling party, many high-profile business leaders have moved to the nerve center of the party machine and have easy and frequent access to President Lee Teng-hui. What came out of this new situation is excessive and undue influence of Big Business on government policy and decision-making. Lee himself has been prone to influence peddling and would make policy or decision over the objection of his related cabinet members and at the expense of existing rulings or guidelines. This pathetic problem of "rule of man not rule of law" reached its height perhaps in the case of the two Korean presidents who were indicated and punished for the high crimes of selling off their offices to the chaebols and big banks. Two things should be learned

from this example—one, governments have to keep Big Business at arm's length at all times and two, how in the world could they have hidden all those bribe monies from auditors? With the emergence of bigger and bigger businesses, which is inevitable due to the need for high cap and high tech plus the privatization of government-owned businesses, Taiwan needs to be on the lock-out for its "politicized businessmen" wielding undue power and authority over matters strictly in the domain of government. We have already seen officials or legislators serving as hit-man or consultant for Big Business, or businessmen serving in legislature or official capacities--all with potential for conflict of interest. We can not let big businesses corrupt or control the government process.

#### **IV. THE SOLUTION AND CONCLUSION**

Now let's try to answer the three questions posed earlier. Would Taiwan follow in Japan's footsteps? In spite of some similarities perhaps not. Japan is seriously burdened with a highly protected and inefficient economic structure, a four-decade-old one party rule, deeply entrenched bureaucracy ill-equipped to accommodate legitimate business needs, labor unions that resist industrial upgrade, and corporate community that refuses badly needed restructuring. Japan, Inc. is just too helplessly paralyzed and unable to confront the vested interests to effect necessary reforms such as opening its market and expanding domestic competition. Japan's hardship is more entrenched. Taiwan's structure is more open, flexible, and has an army of very efficient small and medium businessmen to lead the charge. Big businesses are relatively new-comers and not yet out of control.

Are Taiwan's problems caused by the Asian economic crisis? Taiwan's foreign exchange reserve is still very substantial (about \$90 billion) and it hardly has any foreign debt (a meager \$250 million) to make it vulnerable to the impact of the crisis. Taiwan's malaise is more deep-rooted in the infrastructure problems and it actually started before the economic crisis. Its bank capital adequacy ratio is above international average. Its small and medium enterprises are crisis-proof.

The key question is will the miracle persevere? Taiwan has come to another critical crossroads. This time around we don't think we can expect the luck, coincidence, or accident that saved and helped us before to be there again. This time it is going to take real planning, and real action to pull us through, particularly from the government insofar as providing the indispensable infrastructure, probably more in accounting, regulatory, banking, taxation, fiscal, monetary, environmental and social welfare systems than anything else. It also calls for the government to come up with a forward-looking, full-scaled, balanced, global and long-term industrial policy to overhaul the industrial structure that will carry Taiwan successfully into the 21st century. Government must appropriate a sufficient budget to assist businesses to expand into the international arena wherever economic wealth and quality of life can be optimized. The private sectors are in good shape, as always. The key factor is now the government.

I have to keep pounding on the absolute need and the urgency for the Taiwan government to stop its business as usual attitude and live up to its responsibility. I mentioned earlier Taiwan's global competitiveness has declined, specifically from No. 16<sup>th</sup> to 18<sup>th</sup> according to the 1999 IMD report. Taiwan as a very small island nation is exceedingly dependent upon international commerce for survival. Thus the key to its success has to lie in its relative competitiveness in the world market which, in turn, is decided by its government's abilities to manage problems and crises as well as its formulation of wise policies, plans, and practices to steer the economy to the right direction and goals. The IMD report specifically identified the following areas as having poor performance--illegal insider transactions, domestic consumption,

science & technology, and business management. If Singapore could continue to rank as high as No. 2, it behooves us to reflect why Taiwan, with the miracle and all, was so far behind?

A new world economic order has emerged whereby rapid changes are the rules rather than the exceptions and that will dictate that only those that can anticipate and swiftly adapt will survive. Taiwan needs a government that can detect and forecast its emerging trends and problems, open up its market fully for competitive efficiency, ensure transparency in all government and business activities, and promulgate economic and industrial policies and action plans to deploy and optimize its national resources around the globe.

And to ensure a good partner in the government, one that doesn't have to carry the heavy burden of the past imposed by the Big Business and special interest groups, the Taiwanese people need to clear their last hurdle in their long road to full democracy by allowing the now matured opposition party to take over the government. A new government with a clean slate and a resolve to genuinely serve the people will lead them to another even more spectacular miracle, except that this time it won't be just in economic terms!