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ECONOMIC FREEDOM INOCULATES TAIWAN AGAINST THE ASIAN ECONOMIC FLU

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Despite relentless news reports regarding the current Asian economic crisis, the Republic of China on Taiwan (ROC) continues to demonstrate that economic growth in the region is not dead. For example, as stock markets plummeted during 1997 in Thailand, Indonesia, and Korea by 55, 52, and 42 percent, respectively, the stock market in Taiwan grew by 18 percent. And as inflation for that year approached 12 percent in Indonesia and 8 percent in Thailand, it crept up by a minuscule 0.2 percent in Taiwan. Taiwan is an important example of an Asian country whose government respects democracy, the rule of law, and economic freedom. It owes much of its continued success to free economic institutions and its chosen path of development.

To promote such economic growth, the government has largely avoided interfering with the people's right to take risks, create wealth, and keep more of what they earn. Money-losing ventures are allowed to go bankrupt rather than being propped up by government assistance. Relatively low tax rates, a transparent regulatory framework, prudential supervision of banks, sound legal infrastructure, and conservative fiscal policy have helped Taiwan's government create the institutions necessary to preserve the health of its economic system and maintain an environment conducive to free enterprise.

Taiwan's leaders have long sought to create an environment that would allow many small and medium-sized enterprises to compete in the global economy. This policy promoted entrepreneurship, delivering greater employment opportunities and higher living standards to the people. Over time, the enterprises evolved from home-based light manufacturing to such high-tech industries as semiconductor and computer memory board plants. The key advantage to developing small and medium-sized enterprises is that such firms are better able to adapt to changing circumstances and to capitalize on a country's comparative advantage. In addition, because of their greater numbers, small and medium-sized enterprises are less likely to form bonds of corruption with government and banks on a scale that could jeopardize the entire economy. Competition among several domestic firms also lessens the risk of poor management and failure of a handful of enterprises, which could create a national crisis leading to an international bailout.

Taiwan's recent economic performance attests to the prudence of the government's policies. On top of healthy stock market increases and low inflation, Taiwan's economy is bucking the trend in projected growth in gross domestic product. Its GDP is expected to continue growing by nearly 7 percent in 1998, even as analysts expect negative growth in Indonesia and Thailand and just over 2 percent growth in Korea. And although Taiwan's currency

depreciated by just over 15 percent in 1997, it still fared far better than those of Korea, Thailand, and Indonesia, which lost more than half their value.

The Challenges Taiwan Faces. Taiwan's economic performance has been achieved through its free-market institutions, not through government planning and intervention. Moreover, it was achieved during a time of intense democratic competition, not through the promised stability of Asian authoritarianism. Yet Taiwan still faces tough challenges at home and abroad. At home, the government must continue down the path of economic freedom by further lowering trade barriers, opening the economy to foreign competition, and lowering taxes and other barriers to wealth creation. These measures will be critical to the success of Taiwan's bid to join the World Trade Organization (WTO).

Abroad, Taiwan faces the threat of military invasion, embargo, or intimidation from the Chinese mainland, and an intense diplomatic campaign by the government of the People's Republic of China (PRC) to keep it from playing any significant role in the international system. At the same time, Taiwan's economy also would be hurt significantly by an economic downturn on the mainland. Much of the light manufacturing that used to be run out of people's homes in Taiwan is now run on the mainland with Taiwanese management and capital. Thus, the health of an increasing share of Taiwan's economy is tied to the successful implementation of economic reform in China. In addition, the recent round of currency devaluations throughout the region will make Taiwan's exports relatively more expensive, potentially weakening Taiwan's international competitiveness.

How Washington Should Respond. Such challenges notwithstanding, Taiwan's economy has a proven record of adjusting to meet the ever-rising demands of the global economy. Its low debt, high rate of savings, and strong economic growth are reasons for optimism. Further economic development and international competitiveness are issues that will need to be addressed by ROC leaders, but there still is much to learn from Taiwan's model that could well avoid future crises like those now plaguing many other Asian economies. To promote more effective methods of economic development and a more peaceful and stable environment for economic freedom and democracy in Asia, U.S. policymakers should:

- **Strongly support Taiwan's participation in international organizations and its accession to the World Trade Organization.** At the very least, Taiwan's economic success gives it the capital and experience to address key international challenges. Its bid to join the WTO should proceed at its own pace, regardless of Beijing's desire to join first. Beijing's success in shutting Taiwan out of the international community has limited Taiwan's ability to offer its advice and assistance to troubled Asian economies through such organizations as the International Monetary Fund, World Bank, or United Nations.
- **Sell defensive arms to Taiwan.** Under the terms of the 1979 Taiwan Relations Act, the United States is required to assist Taiwan in providing for its self-defense. Considering China's provocative military exercises and nuclear-capable missile tests in the vicinity of Taiwan in 1995–1996, the continued sale of defensive arms, especially for missile defense, is appropriate.
- **Include Taiwan in foreign travel.** More and more policymakers are traveling to Asia to gain firsthand knowledge of the region. Unfortunately, many of those who travel there—especially to China—do not stop in Taiwan. Omitting a vibrant democracy and successful economy from their Asian itinerary leaves an unfortunate gap in their knowledge and understanding of what makes the region tick.

Understanding and appreciating the "Asian way" of economic development will not be passé as long as the correct Asian model is chosen. Taiwan's model is one of commitment to the creation and maintenance of the institutions necessary for free markets to function. It facilitates people's creative spirit by avoiding burdensome taxation and over-regulation. Best of all, it is based on economic freedom and competitive democracy and does not need the international community to bail it out.