

The Global Economy: Past Evolution and Future Prospects 全球經濟的演變與展望

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Conference on the Opportunities for the Development of Taiwan
under the New Global Situation

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Introduction

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- ◆ The De-Coupling of Global Economic Growth
- ◆ The Sub-Prime Mortgage Loan Crisis
- ◆ The Risk Factors
- ◆ Future Prospects
- ◆ Opportunities for Taiwan
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Economic Globalization

- ◆ The globalization of markets for goods, services and factors (capital—tangible and intangible--and skilled labor)
- ◆ The growth of international trade
 - ◆ Economic communities, unions and free trade areas and agreements
 - ◆ Global supply chains—international division and sub-division of labor
 - ◆ The entry of new players (China, India, Russia, Eastern Europe and countries from the former Soviet Union)
 - ◆ The consolidation of production
- ◆ The growth of international capital flows (direct and portfolio investment and hot money)
- ◆ The implications of economic globalization
 - ◆ Realization of the economies of scale
 - ◆ A rise in the rate of return to intangible capital (investment in innovation, R&D capital, intellectual property and brand names)
 - ◆ An increase in global industrial concentration

Advantages of a Large Domestic Market

- ◆ A large domestic market allows economies of scale to be realized.
- ◆ A large domestic market also allows the economy a significant influence on the development and setting of technological standards for products and services in the domestic as well as the world markets.
- ◆ A large domestic market also enhances the returns to R&D and other forms of intangible capital, including intellectual property and brand names. Economies of scale in the creation and utilization of intangible capital imply that the rate of return increases more than proportionally with the size of the market. The fixed development costs of innovative technologies and products or the promotion of a brand name can be more easily recovered from a large base of domestic demand.
- ◆ Reputation and reliability are particularly valued in the large markets.
- ◆ Taiwan firms can therefore profit by leveraging their intellectual property and brand names in the Mainland market.

The Rise of Asia

- ◆ The “wild geese flying pattern”
- ◆ The rise of the Indian economy
- ◆ The share of World GDP—from less than 5% to approximately a fifth
- ◆ The transformation of the rates and directions of East Asian trade—from less than 20% to more than a half intra-regional trade
- ◆ The “ASEAN + 3 (China, Japan and South Korea)” Free Trade Area

The Growth of the Chinese Economy and the Pattern of World Trade

- ◆ Because of the rapid economic growth of Mainland China, and the demand and supply that such economic growth has generated, the economies of East Asia now trade more with one another than with economies outside of East Asia, including the United States. This is a sea change compared to twenty-five years ago. Interdependence of the East Asian economies has been rising over the years and dependence on the United States and Western Europe has declined.
- ◆ Mainland China has become the most important export market for most East Asian economies and runs trade deficits vis-à-vis almost every one.
- ◆ Mainland China has been a staunch supporter of the ASEAN Free Trade Area and has offered “early harvest” to ASEAN countries to foster the ASEAN-China Free Trade Area and the ASEAN + 3 (China, Japan and South Korea) Free Trade Area.

The Wild-Geese Flying Pattern

- ◆ The "wild-geese-flying pattern" metaphor of East Asian industrial migration over time, first introduced by the Japanese economist Akamatsu, can apply to Chinese provinces and regions. East Asian industrialization started in Japan in the 1950s and successively migrated to Hong Kong, Taiwan, South Korea and Southeast Asia as the real wage rates in these economies rose and sometimes also as export quotas were imposed by developed economies, and then to Mainland China. But industrialization can continue to migrate and spread within Mainland China just as it did before, from the coastal region gradually to the inland region, province by province, region by region, until most of China becomes industrialized eventually.
- ◆ Taiwan entrepreneurs can play the role of the agent of change (as they did in Southeast Asia and in the coastal region of Mainland China) by leading the migration of industries within the Mainland. But to do so they need to begin to focus on the domestic market.
- ◆ Possible intensified economic cooperation with Fujian where Taiwan entrepreneurs have natural advantages and as an export manufacturing base has lower transportation costs than elsewhere in China.

The De-Coupling of Global Growth

- ◆ It used to be “When America sneezes, Asia catches a cold.”
- ◆ However, the final demand for consumption in Asia has come into its own because of the rapid growth of per capita real GDP in both China and India and elsewhere. The largest market in the world for cell phones is in China. The automobile markets with the highest rates of growth in the world are in China and India.
- ◆ Both China and India are relatively immune from the economic slowdown in the U.S.
- ◆ Moreover, since Chinese exports to the U.S. consist mostly of lower-priced manufactured products, they are more recession-proof as formerly affluent consumers shift to lower-priced products.
- ◆ There continues to be abundant liquidity in the East Asian commercial banks whereas in the U.S. credit has virtually dried up.
- ◆ If anything there will be an increase in the flow of portfolio investment and hot money into China and India.

The Impact of the Sub-Prime Mortgage Loan Crisis

- ◆ The U.S. demand for imports will likely decline with the reduced household consumption, or at a minimum the rate of growth will decline.
- ◆ Such decline will have a negative effect on the rate of growth of Mainland Chinese exports to the U.S. and hence on Mainland Chinese GDP, but the effect is expected to be marginal.
- ◆ The overall economic slowdown in the U.S. will last a while, until more positive and certain expectations are restored for both firms and households, probably after the Presidential election in November.
- ◆ The U.S. dollar will continue to weaken relative to other reserve currencies as the net inflow of capital, especially that of direct and portfolio investment, is reduced.

The Impact of the Sub-Prime Mortgage Loan Crisis

- ◆ Mainland exports to the U.S. constitute between 8% (Mainland estimate) and 12% (U.S. estimate) of Mainland GDP; however, the direct domestic value added content of Mainland exports to the U.S. is quite low, averaging 17.7%. Thus, the Mainland GDP originating from Mainland exports to the U.S. is only approximately 2.2% (12% times 18% = 2.16%).
- ◆ 2.2% of GDP is reasonably significant and will result in hardships in some localities if completely lost. However, even if real Mainland exports to the U.S. falls by 10% (which is considered unlikely), it will cause Mainland GDP to fall by only 0.22%, which is clearly tolerable, especially if the remaining 97.8% of the Mainland economy continues to grow.

The Impact of the Sub-Prime Mortgage Loan Crisis

- ◆ If the indirect domestic value added of Mainland exports to the U.S. is also taken into account, a 10% decline in Mainland exports to the U.S. may result in a decline of Mainland GDP of no more than 0.5%.
- ◆ However, the impact may be quite severe on certain localities where most of the economy is dependent on exports, e.g., the cities of Dongguan and Shenzhen in the Province of Guangdong, Kunshan and Suzhou in the Province of Jiangsu, where the value of exports is much greater than the local GDP. Measures must be put in place in these localities to take care of expected lay-offs of workers as a result of the slowdown in export demand.

The Impact of the Sub-Prime

Mortgage Loan Crisis—De-Coupling

- ◆ In general, the phenomenon of “decoupling” is expected to be operative. Mainland economic growth is largely unaffected by external developments, including a possible economic recession in the United States. The other so-called BRIC countries—Brazil, Russia and India—are even less dependent on exports. Brazil has recently discovered huge oil reserves and should be entering a new era of rapid economic development, financed by its new found oil wealth instead of foreign loans. Russia has already been benefiting from the high world price of oil and is not a major exporter of manufactured goods and hence will be relatively unaffected by external developments. India is also not a major exporter, except in computer software, and its economic growth is mostly internally driven.
- ◆ The BRIC countries can be expected to maintain their rates of growth, more or less, and the rest of the world, including developing East Asia, should be able to manage.

The Risk Factors

- ◆ The impact of the sub-prime mortgage loan crisis and the U.S. Economic slowdown
- ◆ The risks of global inflation
- ◆ The asset price bubbles
- ◆ Environmental degradation and climate change
- ◆ Geo-political risks
 - ◆ A Taiwan Straits crisis
 - ◆ A Middle East crisis that results in the interruption of the oil supply
 - ◆ The rise of protectionism

Future Prospects

- ◆ The East Asian economies should continue to do well, despite the Sub-Prime Mortgage Loan crisis in the U.S. The rates of growth will probably slow by a percentage point or two but will remain high.
- ◆ The new economic landscape with a rising Asian share of world GDP
- ◆ The importance of global cooperation to prevent climate change
- ◆ The “ASEAN + 3 (China, Japan and South Korea) Free Trade Area”
- ◆ Intra-East Asian economic and financial cooperation

Opportunities for Taiwan

- ◆ The global environment does not favor the traditional final market of Taiwan products—U.S.A. The United States will be entering a period of very slow growth, if not an outright recession.
- ◆ Fortunately, the fastest-growing economies of the world—the BRIC countries (Brazil, Russia, India and China)—are relatively immune to the slowdown in the United States. This is known as de-coupling of the global economy.
- ◆ Taiwan should take advantage of this opportunity to expand its trade and investment with these economies.

Opportunities for Taiwan

- ◆ With the election of Mr. MA Ying-Jeou as President in Taiwan, there is now significant reduction in the risks of instability in East Asia.
- ◆ The peaceful election in Taiwan also greatly enhanced confidence in the democratic process—”painfully slow but ultimately sure”.
- ◆ Taiwan is ready to take advantage of its economic complementarity with the Mainland.

Economic Complementarity

- ◆ The economies of the Mainland and Taiwan are at different stages of economic development.
- ◆ Taiwan has a per capita GDP of approximately US\$18,000 compared to US\$2,500 for the Mainland.
- ◆ Taiwan has high real wage rates whereas the Mainland has relatively low real wage rates.
- ◆ Taiwan has a better educated labor force than the Mainland.
- ◆ The Mainland has more savings than can be productively invested on the Mainland.
- ◆ Taiwan and Mainland's exports are not competitive with each other.
- ◆ Taiwan's comparative advantage is increasingly in knowledge-intensive and intellectual property-intensive industries and sectors (e.g., Taiwan Semiconductor Manufacturing Corporation is a major intellectual property producer and accounts for almost half of Taiwan's patents granted by the U.S.) whereas Mainland's comparative advantage remains in labor-intensive light manufacturing and only recently begins to shift to capital-intensive heavy manufacturing.

The Comparative Advantages of the Mainland

- ◆ A high national savings rate of currently in the mid-40s. The Mainland is therefore self-sufficient in capital and not dependent on foreign direct investment or foreign loans to maintain its high rate of investment.
- ◆ An almost unlimited supply of surplus labor—almost 40% of the labor force in the primary sector (agriculture and mining) produces approximately 12% of GDP. There will not be any upward pressure on the real wage rate of unskilled entry-level labor for decades to come.
- ◆ A large domestic market permits the realization of economies of scale.

Taiwan Direct Investment in the Mainland Can be Win-Win

- ◆ Taiwan can make use of the Mainland economy not only as a manufacturing base for exports but also as a final consumption market, leveraging its intellectual property, know-how, brand names and reputation.
- ◆ Mainland can also benefit from the increase in GDP, employment and productivity resulting from the wider exploitation of Taiwan's intellectual property.
- ◆ The Mainland no longer needs money, so Taiwan investment into the Mainland must have an edge other than money: Foreign direct investment accounts for approximately 10 percent of gross domestic investment in Mainland China. The Mainland still welcomes foreign direct investment (FDI), but not because it needs the money, but because FDI brings with it technology, know-how, designs, markets, business models and methods that it does not have.

Trade in Services

- ◆ Tourism services-Jobs that cannot go away. The “Individual Visit Scheme” is the major generator of employment opportunities among the unskilled and low-skilled workers in Hong Kong.
- ◆ Educational services-there is a huge demand for university education from the Mainland and an excess supply of university places in Taiwan. So it is natural to consider the recruitment and admission of students from the Mainland. The cost is not an issue as many self-financed Mainland students currently study overseas in the U.K., the U.S. and elsewhere. This way Taiwan can also attract additional talents for its R&D activities. However, it requires selective reciprocal recognition of degrees and diplomas and eventually of professional qualifications.
- ◆ Healthcare services for Mainland residents.
- ◆ Demand for such services are high. Taiwan has an advantage over other economies in terms of the spoken language.

Concluding Remarks

- ◆ Ultimately East Asia can become a free trade area with free movement of goods and capital—free movement of labor will take a much longer time.
- ◆ Taiwan will specialize in R&D and upstream activities; Mainland will specialize in quantity manufacturing (both light and heavy industry) and provide the domestic market.
- ◆ Mainland will supply the light manufactured consumer goods.
- ◆ In the long run Taiwan can be to the Mainland as the Silicon Valley is to the United States.