

BTI 2008 | Taiwan Country Report

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Democracy	1-10	9.45	# 6 of 125	➔
Market Economy	1-10	9.21	# 5 of 125	➔
Management Index	1-10	7.04	# 7 of 125	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	22.7	HDI	-	GDP p.c.	\$	27,500
Pop. growth ¹	% p.a.	0.6	HDI rank of 177	-	Gini Index		33.8
Life expectancy	years	77.5	UN Education Index	-	Poverty ³	%	-
Urban population	%	-	Gender equality ²	0.69	Aid per capita	\$	-

Sources: Directorate-General of Budget, Accounting and Statistics (DGBAS), R.O.C. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

Executive Summary

Throughout the review period, Taiwan has remained a high performer in terms of institutionalizing both democracy and a market economy. A regime crisis evolved during the review period, and ultimately, the incumbent President Chen Shui-bian was threatened with a recall vote. The crisis, however, did not affect the economy too much, though it hindered the implementation of necessary reforms.

Notwithstanding the unresolved issue of national identity, Taiwan continues to consolidate its accomplishments in political transformation, including a high degree of stateness, meaningful elections, the absence of undemocratic veto actors, stable democratic institutions and a vibrant civil society. Although the corruption charges against President Chen Shui-bian and his government have led to even more political polarization on the island since 2005, neither the stability of the political system nor society's support for it was ever in doubt. Nevertheless, Taiwan's populace is increasingly fed up with the political standoff in the legislature.

Taiwan's economy bounced back strongly since the recession in 2000–2001, enjoying sound GDP growth of more than 4%, a healthy trade surplus, low inflation and (slowly) declining rates of unemployment. However, the government still runs a budget deficit that is hard to scale down because of rising demands in social welfare on the one hand and necessary weapons acquisitions for national defense on the other. Financial sector reform – though not a failure – is also protracted, especially with respect to the banking system and the credit market in general.

Taiwan's difficult relations with the People's Republic of China (PRC) remain the most important external factor affecting its political and economic system. The question of how to respond to the intensifying process of unofficial cross-strait economic integration continues to divide the two party camps, and it will be the

decisive issue in the upcoming 2008 presidential elections. National identity and the independence vs. unification conflict will gradually recede as economic considerations become more dominant.

History and Characteristics of Transformation

In Taiwan, political transformation took a backseat to economic transformation. The foundations of a sound market economy were laid in the 1950s under the authoritarian leadership of Chiang Kai-shek. During that time, the state intervened with a strong hand in economic affairs, regulating and protecting domestic markets. In the four decades of authoritarian rule following the Chinese Civil War in 1949, Taiwan moved gradually toward a social market economy and established rudimentary social insurance systems. Democratic transition started in 1986 with the illegal founding of the Democratic Progressive Party (DPP) on September 28th – which was tolerated at the time by the ruling Kuomintang (KMT) regime – and the lifting of martial law on October 15th of that year. More reforms followed, most importantly the legalization of new political parties in January 1991. In 1991 and 1992 respectively, Taiwan saw free elections to its central parliamentary bodies for the first time, the National Assembly and the Legislative Yuan, thus marking the end of the transition process.

During the rest of the 1990s, democracy matured by successive constitutional reforms that, along with other changes to Taiwan's political system, paved the way for the first direct presidential election held in early 1996. The incumbent president and KMT party chief Lee Teng-hui won this election and became Taiwan's "father of democracy." Successful democratic consolidation had already been achieved when Chen Shui-bian, an experienced DPP politician and former advocate of Taiwanese independence, unexpectedly won the March 2000 presidential election and made the KMT an opposition party for the first time since the exile government fled to the island in 1949.

The following four years saw severe legislative inefficiency as the partisan conflict between the ruling DPP and the KMT-led opposition, which commanded a majority in parliament, paralyzed the political process. Cross-strait relations further soured as the new president pursued an agenda of assuring Taiwanese sovereignty against Beijing's "one China principle" and pushed for a referendum law and a new constitution during the March 2004 presidential campaign. After the incumbent president secured a narrow victory by a margin of only 30,000 votes, Taiwan's democracy was hijacked by a legal brawl over the ballot's outcome as well as the investigation into an alleged assassination attempt on Chen and his running mate Annette Lu on the eve of the presidential election. Parliamentary elections in December 2004 did not overcome the impasse in the legislature, when Chen's ruling DPP and its "green camp" ally, the Taiwan Solidarity Union, failed to achieve an absolute majority. The following two

years were shaped by an ongoing paralysis of the Taiwanese parliament, rising partisanship when Chen's administration became entangled in corruption scandals, and a frustrated public that seemed to turn away from politics. However, political institutions proved strong enough to withstand the rough-and-tumble of the second Chen Administration.

In early 2007, Taiwan is preparing for the 2008 presidential election, which will likely be the first opportunity to overcome the deadlock in the Legislative Yuan. Parliamentary elections in December 2007 will be held under a new election law introducing a direct and proportional voting modeled on the Japanese system and will very probably result in a two-party system. This should stabilize Taiwan's domestic politics in the future, as the leading parties KMT and DPP will no longer be exposed to the pressures of their more radical allies in the "pan-blue" and "pan-green" camps.

Transformation Status

I. Democracy

Since the DPP government took over in mid-2000, Taiwan's democracy has remained stable overall; serious transformation-related shortcomings have been overcome. Since incumbent President Chen Shui-bian won the 2004 presidential election by a very narrow margin, deadlock in the legislature and strong partisanship have led to much frustration among the population. However, this has not jeopardized the stability of Taiwan's political institutions. Administrative systems remain functional, while public safety and order are assured.

1 | Stateness

Although Taiwan's status under international law is contested, the Taiwanese state (officially named Republic of China) enjoys effective power and authority over its territory, including the islands of Taiwan, Penghu, Mazu and Jinmen.

Monopoly on the use of force

The conflict over Taiwan's political future as an independent nation-state or as part of a new and unified China is yet to be resolved. The large majority of Taiwanese support the status quo in the Taiwan Strait, which best serves their security interests. However, most studies show that Taiwanese national identity has been continually strengthening since the early 1990s, deepening the people's identification with their state and their desire for sovereignty.

State identity

In Taiwan, state legitimacy is fully derived from a secular constitution. Religious dogmas play no role.

No interference of religious dogmas

Taiwan's civilian administration is generally sound and functional, though the second Democratic Progressive Party (DPP) administration has seen some cases of corruption. On various occasions, the opposition has accused Taiwan's court system of being too closely allied with the government. However, these accusations remain unconvincing and are obviously linked to political maneuvering.

Basic administration

2 | Political Participation

There are no restraints on elections in Taiwan, which are usually fair and undisputed. Although the 2004 presidential ballot saw the opposition “blue camp” accuse the incumbent president and his party of fraud, these accusations could not be substantiated and were finally dismissed by the courts. The significance of vote buying in local elections has declined over the years, though the practice continues.

Free and fair elections

All elected rulers have effective power to govern, and there are no veto powers or exclusive political domains that might negatively affect democratic participation. The Taiwanese military no longer plays an active role in domestic politics, as there are no active military officers in the civilian government and the military no longer administers internal security. The traditionally close connections between the armed forces and the Kuomintang (KMT) have been cut. The implementation of the National Defense Act in 2002 strengthened the institutions of effective democratic control of the security sector.

Effective power to govern

Freedom of association and freedom of assembly are unrestricted. Union activities are still constrained by law, but independent union organization has become more viable over the years. Since the founding of the Taiwan Confederation of Trade Unions in 1997, the island’s labor movement has gained much momentum and successfully pushed for more rights and better financial compensation for workers.

Association / assembly rights

Freedom of opinion and freedom of the press are unrestricted, as the latest Map of Press Freedom 2006 published by Freedom House confirms. Taiwan has over 350 privately owned newspapers, 150 radio stations and approximately 100 cable television stations. The mainland elite’s former control of these media to the disadvantage of other groups - Hoklos, Hakkas and aborigines - has practically vanished. Government and party investment in privately operated radio and television companies was prohibited in 2003. A legally independent National Communications Commission (under the Executive Yuan) was established in early 2006 to regulate and oversee the broadcast media. However, it was found to be unconstitutional by Taiwan’s courts, highlighting the sensitivity of media control in the post-authoritarian era. There are no restrictions on the use of the Internet, which is currently accessible to more than 60% of the population. Foreign media have free access to Taiwan and can work unrestrictedly, though measures have been taken against journalists of China’s Xinhua News Agency and the People’s Daily for their negative reporting on Taiwan.

Freedom of expression

3 | Rule of Law

The separation of powers into executive, legislative and judicial branches is well-established, and there is no extralegal execution of governmental power. However, the current government system suffers from an inconsistent constitutional relationship between the president and the parliament; while the popularly elected president appoints the head of the Executive Yuan (the premier) without the consent of parliament (the Legislative Yuan), the latter has the authority to dismiss the cabinet by a vote of no confidence against the premier. Since the president can dissolve the legislature in such a case, the powers of the parliament are limited and there are almost no institutional guards against political stalemate. Combined with highly competitive behavior, the zero-sum-game approach of Taiwan's political camps and the existence of a minority government, this has contributed to great institutional deadlock since the DPP takeover in mid-2000. Some traditional parliamentary powers are held by the Control Yuan, a constitutional body responsible for budgetary auditing and the investigation of government officials. Members of the Control Yuan are appointed by the president with the consent of the legislature. Due to political stalemate, the Control Yuan has not been operating since 1 February 2005, leaving a backlog of more than 24,000 unresolved cases and hampering effective budgetary auditing and inquiries into government officials.

Separation of powers

Judicial independence is well-established in Taiwan. Political influence on court decisions has not been observed, and the judiciary's reputation has improved substantially.

Independent judiciary

Political corruption receives a great deal of attention in the mass media and is prosecuted under criminal law. However, members of parliament, cabinet members and members of county and city parliaments enjoy immunity.

Prosecution of office abuse

Civil rights are well-guaranteed and protected, and those who violate them are taken to court. The judicial system provides ample opportunities to seek redress for rights violations, and Taiwan enjoys a very good human rights record according to all relevant international observer groups. However, improvement is wanting with respect to the protection of Taiwan's foreign workers community's civil rights.

Civil rights

4 | Stability of Democratic Institutions

As a rule, all institutions work according to fixed procedures and are sufficiently controlled by a working system of mutual checks and balances. However, institutional efficiency is hampered by the confrontation between a DPP-led

Performance of democratic institutions

minority government and a KMT-led opposition majority in the Legislative Yuan. Due to the island's history and the ideological polarization on the issue of Taiwanese independence, politics in Taiwan is still widely seen as a zero-sum game. Consequently, there is currently no embedded culture of compromise and cooperation that would help to overcome a deadlock caused by uncompromising competing powers in the government system.

All relevant political actors accept the democratic institutions as legitimate.

Commitment to
democratic
institutions

5 | Political and Social Integration

In recent years, a stable, moderate, socially anchored party system enjoying broad popular consent has emerged. This system, however, suffers from polarization, as the two opposing party alliances (the "blue camp" of KMT, PFP and New Party (NP) and the "green camp" of DPP and the Taiwan Solidarity Union (TSU)) take uncompromising stances on the issues of unification (with China) vs. (Taiwanese) independence and cross-strait policy. On the other hand, the party system is responsive to the populace's diverging opinions on these matters and aggregates societal interests fairly well. In addition, the two party camps do not diverge very much when it comes to other policy fields like anti-corruption, environmental protection, social welfare and industrial upgrading. Finally, the ideological cleavage within the party landscape may soon narrow substantially, as a new electoral law that does away with the old Single Non-Transferable Vote (SNTV) system, in which voters cast one vote for the candidates in their district while more than one seat is filled per district, will force the mainstream parties to soften their stances in order to attract more voters of the central moderate majority.

Party system

The network of interest groups is close-knit, politically influential and operates independently of the state. Problems remain concerning the impact of one-issue groups and their horizontal integration, as well as the establishment of organizational roof structures to make Taiwan's numerous interest groups more effective. Taiwan's civil society is still too much focused on ideological issues related to the unification-independence split, however, and there is still too little private engagement in terms of charity and volunteerism.

Interest groups

Voter turnout, which lies between 60% and 80% for national and local elections, suggests rather strong citizen consent to democracy. The few empirical studies on institutional trust and regime support provide a mixed picture. It was found, for example, that satisfaction and commitment to democracy is low and that there are moderate levels of alienation from the government. This must be seen in the context of high political polarization and public frustration with government efficiency following the DPP's rise to power in 2000, however, and should

Consent to
democratic
norms

therefore be considered short-term. The populace retains a strong general commitment to democracy.

Social self-organization has gained momentum since democratic transition. Taiwan's middle-class social movements, though not decisive for the transition itself, played an important part in the process of democratic consolidation thereafter. Today, they do a good job in defending the public's many interests and supporting non-violence, tolerance and a democratic culture. Taiwan's civil society is not defined along ethnic or other cleavages, and it does its fair share to generate interpersonal trust, which is high among the populace according to all relevant figures.

Associational
activities

II. Market Economy

Taiwan's market economy is generally well institutionalized and free. All key indicators show a high level of development with relatively equal income distribution. Among transformation countries in Asia and Oceania, Taiwan ranked first above both Singapore and South Korea, according to the 2006 Human Development Report (Figures for Taiwan are computed by Taiwanese authorities along HDI and GDI methodology because the island republic is not a UN member state and thus does not appear as a separate entity in HDR statistics).

6 | Level of Socioeconomic Development

The country's level of socioeconomic development permits adequate freedom of choice for all citizens. Fundamental social exclusion due to poverty is qualitatively minor and not structurally embedded. Income distribution — as measured by the Gini coefficient — is relatively equal and has slightly improved in recent years (2002: 0.345; 2004: 0.338).

Socioeconomic
barriers

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	297,668	305,624	331,007	354,918
Growth of GDP	%	3.6	3.3	5.9	4.0
Inflation (CPI)	%	-0.2	-0.4	1.6	2.3
Unemployment	%	5.2	5.0	4.0	4.1

		2002	2003	2004	2005
Foreign direct investment	% of GDP	17.7	17.4	18.4	19.7
Export growth	%	6.3	10.4	6.2	4.5
Import growth	%	4.9	13.1	21.3	3.9
Current account balance	\$ mn.	21,091	22,398	11,171	11,244
Public debt	\$ mn.	-	-	-	-
External debt	\$ mn.	45,033	63,054	80,888	86,732
External debt service	% of GNI	-	-	-	-
Cash surplus or deficit	% of GDP	-4.4	-2.9	-3.1	-3.3
Tax Revenue	% of GDP	12.6	12.7	12.9	14.1
Government consumption	% of GDP	14.0	14.1	13.6	13.4
Public expnd. on edu.	% of GDP	-	-	-	-
Public expnd. on health	% of GDP	6.0	6.2	6.2	6.2
R&D expenditure	% of GDP	2.2	2.4	2.4	2.5
Military expenditure	% of GDP	2.3	2.3	2.5	2.2

Sources: The World Bank, World Development Indicators 2007 | Ministry of Finance, R.O.C. | Directorate-General of Budget, Accounting & Statistics, R.O.C. | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

7 | Organization of the Market and Competition

Taiwan's market economy is institutionally sound with clearly defined and state-guaranteed rules for ensuring fair competition and largely equal opportunities for all market participants. Market actors face neither entry nor exit barriers. However, restrictions still exist on investments in and the transfer of technology to mainland China, hampering private entrepreneurialism to some extent.

Market-based competition

Compliance with the WTO regime, to which Taiwan gained access in January 2002, forced the island republic to abandon its last monopoly on tobacco and wine products, reduce the majority of its imported products to zero and to substantially liberalize its trade with mainland China. Up until now, Taiwan has not been a respondent in a single dispute case within the WTO. The Fair Trade Law that took effect in 2002 ensures a coherent and effective approach to combating monopolies.

Anti-monopoly policy

With the exception of cross-strait economic relations, the state refrains from intervening in investment planning and foreign trade. Intervention mainly takes place for security reasons and in order to control the level of Taiwan's trade dependency on China. Some 40% of Taiwan's exports and 70% of its outbound investment now go to the Chinese mainland. Trade over the Taiwan Strait has seen considerable intensification over the last years thanks to Taiwanese government policies that permit a rising number of Chinese products to enter the domestic market and relax investment regulations for Taiwanese companies doing business on the mainland. Direct trade across the Taiwan Strait remains prohibited, but the ruling DPP is under mounting pressure by Taiwanese businessmen, the "pan-blue" opposition camp and parts of its own rank-and-file to abandon the current restrictions and completely liberalize cross-strait trade.

Liberalization of
foreign trade

Taiwan's banking system is a weak point in this generally high-performing economy. While the ratio of non-performing loans declined steadily over the review period (October 2006: 2.39%), financial restructuring that began in the late 1990s with the aim of curtailing an overcrowded banking and credit sector has not made much progress. Taiwan has some 50 banks and over 300 rural credit cooperatives serving only 23 million people, and the average return on equity is the lowest in Asia. In addition, the banking system is very fragmented, with the top five lenders controlling just 35% of the market, compared to 60 to 80% in most developed countries. Long-time protection by central and local governments has made Taiwan's banking sector internationally non-competitive. This and labor union resistance to foreign investment (in response to fears of massive layoffs) have made internationalization, domestic mergers and privatization of government-controlled financial institutions difficult, which in turn has a negative effect on services and internal control mechanisms. Although the government established a Financial Supervisory Commission in mid-2004, this body was plagued by internal irregularities and has hardly been able to efficiently control the banking system so far. An amendment to the banking law, however, was passed in early March 2007 and will force the FSC to take a more proactive approach in shutting down troubled banks. This might give the commission a needed boost.

Banking system

8 | Currency and Price Stability

Consistent with the price stability of recent years, Taiwan had low inflation levels during the review period with consumer prices rising 2.3% in 2005 and 0.6% in 2006. The new Taiwan dollar has come under continuous, though moderate, upward pressure against the U.S. dollar, mainly because of the abolition of the renminbi peg to the U.S. dollar and a belief among international speculators that China would allow its currency to appreciate in the foreign exchange market.

Anti-inflation /
forex policy

Taiwan's foreign exchange policy, however, has been consistently linked to the goal of financial and economic stability. This has generated solid foreign exchange reserves of 260 billion U.S. dollars (June 2006), topped only by China and Japan. China's central bank has been independent since the mid-1980s and it enjoys a reputation of sound monetary supervision and control.

Taiwan's total public debt and budget deficit, which at the end of 2006 reached 31.4% and 2.4% of GDP respectively, are still problematic. This is largely due to the government's rising social security commitments, along with special off-budget packages and spending on infrastructure and defense, both of which are usually padded ahead of national elections. However, fiscal stability is a central pillar of Taiwan's overall economic policy. As the government must continue in its efforts to improve trade relations with China because of domestic pressure for cross-strait economic integration, future growth resulting from this process may pave the way for a successive reduction of the current debt and deficit figures in the coming years.

Macrostability

9 | Private Property

Taiwan's property rights regime is well-established and its market economy overwhelmingly based on private ownership.

Property rights

Taiwan's economy is mainly based on small and medium-sized private companies (around 90% of all companies), which are adequately protected by the state. The privatization process for Taiwan's numerous state-owned enterprises (SOEs) was initiated in 1989. Since then, 34 SOEs have been privatized, while 17 went bankrupt during the process. Currently, the state holds a majority in 26 enterprises (fiscal year 2005), and privatization continues. The process has been rather slow because of trade union resistance and – generally speaking – low profitability. However, privatization does follow market principles, and most criticism has been directed at the government's inability to privatize its SOEs quickly enough, rather than at any ostensible attempt by the authorities to build up state oligopolies.

Private
enterprise

10 | Welfare Regime

Taiwan's welfare regime made some further progress during the review period; it provides for substantial protection against poverty and other social risks. Compulsory national health insurance (NHI) was introduced in 1995 and covers a wide range of medical treatments for all employed citizens. Revenue is collected from monthly salaries (a premium rate of 4.55% was levied in 2006). Private enterprise employees have to pay 30% of the premium, employers 60% and the

Social safety nets

government 10%. Although rated as one of the best schemes in Asia, Taiwan's NHI is under-financed and seems to be on the brink of insolvency. Inflationary drug pricing on the part of hospitals and drug companies to finance under-the-table kickbacks seems to be one important reason for the scheme's problems. The government has taken action against these practices, however, and gradual consolidation of the system is to be expected. Comprehensive farmers' health insurance was introduced in late 2002 for all farmers over 15 years of age engaged in agricultural work for more than 90 days a year. This scheme has closed a serious gap within the national health insurance system, which did not include farmers. A compulsory national unemployment insurance scheme combined with a vocational training and employment service system took effect in January 2003, covering all employees. Although benefits are rather low, a key amendment to the Labour Insurance Law is currently under final legislative revision and will, among other things, broaden eligibility. Every retiree in Taiwan is entitled to a total maximum pension equal to 45 times his/her average wage in the six months before retirement. The Wage Arrears Repayment Fund set up by the government guarantees all former employees payment of the pension in the event that his/her company files for bankruptcy. A new pension act, which took effect in July 2005, introduced a portable individual retirement account system, obliging all companies to make regular payments. This has resolved the problem of low average life spans that characterize Taiwan's small and medium enterprises, where the bulk of the people work. In the past, many retirees were unable to build up sufficient seniority. The rights and interests of the disabled are protected as well. For example, all private enterprises with more than 100 employees must hire at least one disabled person, while all government offices, public schools and public enterprises with 50 or more employees are required by law to meet a 2% minimum quota for disabled employees.

According to the constitution, equality of citizens before the law is provided "irrespective of sex, religion, race, class, or party affiliation." This guarantee also includes the rights of disabled persons. Aside from the government's efforts to establish the necessary legal and institutional framework, a growing number of NGOs have ensured an increasing extent of equal opportunity in Taiwan. New legal provisions and institutional structures have strengthened women's and welfare rights over the last years. Most notably, the Women's Policy Guideline (January 2004), the Gender Equity Education Act (June 2004) and the Sexual Harassment Prevention Act (January 2005) have promoted women's rights and gender equality. Moreover, foreign spouses of Taiwanese from middle- and low-income families are now supported financially by the government. However, the situation of immigrant workers – both male and female – from Southeast Asia has not been ameliorated much over the review period. They lack substantial legal protection and live in the shadows of Taiwan's affluent society. Concerning Taiwan's indigenous peoples, who account for about 2% of the total population, a

Equal opportunity

number of social welfare programs and affirmative-action measures have been implemented. These include low-interest housing loans, access to senior high schools and universities, employment in Taiwan's Civil Service, and the protection of language and culture. The social gap between these native groups and the Taiwanese Han-majority has narrowed over the last 10-15 years, but inequality still exists.

11 | Economic Performance

In spite of difficult political circumstances caused by the deadlock in the legislature and considerable polarization in Taiwan's party system, the economy has done well. GDP growth was 4% in 2005 and 4.6% in 2006. Export growth was healthy throughout the review period (2006: +7.3%). The island republic's overall trade surplus stood at \$21.3 billion at the end of 2006 and is significantly less than its trade surplus with mainland China (2006: + \$66.4 billion). Taiwan's strong economic performance also entails continuous investment growth since 2002, reflecting the optimism of Taiwan's export industries (especially with respect to mainland China). Inflation has been moderate (2006: 0.6%), and unemployment has been in constant decline over the last years (2006: 3.91%). Tax revenues are sound, totaling 13% of GDP at the end of 2006. The biggest problems are the fiscal deficit (2006: 2.4%) and –from the perspective of the current DPP government – Taiwan's growing trade dependency on mainland China. In 2006, trade with China amounted to over 20% of Taiwan's worldwide trade according to – usually conservative - official Taiwanese figures. Measures to lure Taiwanese investors away from China to Southeast Asia and other regions have not been completely unsuccessful, but they cannot stop the “China fever” of most companies on the island.

Output strength

12 | Sustainability

Environmental awareness has been on the rise in Taiwan since the 1980s, mainly because of a strong social movement that pushed the government to make environmental protection a major concern in economic policy-planning. Today, environmental protection is institutionally integrated at the government level, both independently (by the Environmental Protection Administration or EPA) and at the sub-divisional level within different government entities, resulting in systematic environmental policy planning and a relatively low externalization of costs over the years.

Environmental policy

Taiwan has a very well-developed education system with high-quality secondary and tertiary education as well as vocational training, reflecting the importance given to education in a society still heavily imbued with Confucian values. In

Education policy / R&D

2005, gross enrolment in higher education stood at 82%, while growth in university and college enrolment was 5.8%. School curricula undergo continuous reform to keep the education system in line with international developments. Education amounted to over 19% of all government expenditure throughout the entire review period and to 4.28% of total GDP in 2005. Launched in 2002, the Challenge 2008 National Development Plan aims at making Taiwan the leading R&D location in Asia and bringing about “digital Taiwan.” Consequently, public-sector research and official support for Taiwan’s various science parks are high on the government’s finance agenda; so does broad support for privately initiated R&D. Public expenditure for R&D stood at 2.5% of GDP in 2005 (the latest available figure), and will be extended to 3% by 2008 according to official announcements.

Transformation Management

I. Level of Difficulty

Taiwan enjoys few structural constraints on governance thanks to the following factors: its high level of socioeconomic development; its sound market economy and good economic performance; a well-developed education system and research environment; a well-qualified labor force; a capable bureaucratic apparatus; low social disparities in terms of income and status; a lack of serious ethno-religious conflicts; and an unchallenged state monopoly on the use of force. Social movements and social interest organizations of all sorts are firmly embedded within society and play an essential part in the daily exercise of democracy.

Structural
constraints

In light of Taiwan's historically authoritarian rule, there are only weak traditions of civic engagement, but social movements played a major role before and after the transition to democracy in the mid-1980s, contributing substantially to democratic consolidation. Today, Taiwan has one of the most vibrant – though small in numbers – civil societies in Asia, characterized by numerous NGOs engaged in all sorts of public activity and high degrees of social and institutional trust. Ideological polarization and division play a role, however, when issues of national identity are at stake.

Civil society
traditions

The old conflict between mainlanders and Taiwanese has evolved into a cleavage among the Taiwanese (now including the mainlanders) who disagree on the island republic's national identity and the most sensible policy approach to China in order to secure long-term security and prosperity for the island. While this has mitigated the sub-ethnic cleavage to some extent, it has resulted in high-level political polarization that limits institutional efficiency in the government. Undoubtedly, the Chinese claim to Taiwan and the related standoff between pro-independence and pro-unification forces – with the broad majority of the populace opting for the so-called status quo – are the biggest obstacles facing Taiwan against the background of an otherwise positive assessment of its level of difficulty.

Conflict intensity

II. Management Performance

14 | Steering Capability

Since Taiwan's domestic political arena is very polarized on the issues of national identity and cross-strait policy, the current DPP minority government finds it hard to carry through most of its legislative initiatives. The inconsistent government system does not provide for institutional levers to overcome the current stalemate. Moreover, a series of corruption scandals involving close advisers and relatives of President Chen Shui-bian (and himself) have hampered his administration and undermined its legitimacy. Chen's project for a new constitution to assure Taiwan's sovereignty has met with harsh "blue-camp" hostility and a hesitant public opinion, pointing to the huge majority of status-quo supporters who do not want to rock the boat of Sino-Taiwanese relations. Since he cannot run in the 2008 presidential election, the president is now in danger of becoming a "lame duck." Although the DPP still stands firm behind Chen when it faces the opposition and fights the latter's attempts of ousting the president, the struggle over Chen's succession has already begun. This will further curtail the leadership's steering capability in the coming months and make long-term policy initiatives, such as social welfare reform, capital market restructuring and cross-strait economic liberalization, complicated endeavors at best. The same is true for the establishment of consistent strategic priorities, as the DPP's minority government is constantly forced to compromise its political agenda in the Legislative Yuan. This is not likely to change very much after the next legislative election scheduled for December 2007. With Taiwan's political landscape almost evenly split between the "pan-blue" and "pan-green" camps, any government would face serious limitations to its steering capability. However, there is a strong consensus among the political elites that constitutional democracy and a socially responsible market economy must not be jeopardized by the conflict on Taiwanese independence. This consensus helps to prevent government policy from becoming too volatile and election-oriented.

Prioritization

As Taiwan's market economy and democratic order are already well-developed, any assessment concerning the implementation efficiency of the government's reform policies starts from an advanced vantage point. This said, the current government has been unable to realize its most important reform project during the review period - constitutional revision. A new constitution, which President Chen wants to see implemented before he has to step down in 2008, is fiercely

Implementation

opposed by the “pan-blue” opposition in the legislature, although even in its own ranks nobody questions the need to streamline the current government system and do away with long-time inconsistencies concerning the triangular relationship between the president, executive and legislature. However, cross-party camp cooperation was possible in the case of a controversial referendum law passed in late 2003 and important revisions of the Additional Articles in the Taiwanese constitution in mid-2005, which resulted in a sharp reduction of seats in the Legislative Yuan. Moreover, the DPP and KMT agreed on a new electoral law that introduces a Japanese-style proportional voting system, soon to be applied in the Legislative Yuan elections of December 2007.

Generally speaking, political learning in Taiwan often takes place in economic and social policy-making, thanks to the leadership’s close-knit relations to well-established social organizations and interest groups who keep it informed of the need for policy adjustments and new initiatives. In fact, the current DPP Administration has become increasingly sophisticated and professional in these matters since coming to power in mid-2000. However, little learning and policy innovation has occurred in the realm of cross-strait relations and the dealings with the “one China-principle,” as these are core issues of DPP ideology. The current leadership has remained immovable concerning the rejection of the “one China-principle” as Beijing’s fundamental precondition for holding any bilateral talks. Although economic reason and a great deal of pressure from Taiwan’s business community and the “pan-blue” camp push for opening up direct trade with the Chinese mainland, the Chen Administration has been clinging to a conservative approach of liberalizing cross-strait trade. When China is involved, political learning is profoundly confined by ideology.

Policy learning

15 | Resource Efficiency

In comparison with most other countries in the Asia-Pacific region, the government makes efficient use of available economic and human resources to pursue its transformation policies and implement further administrative reforms. While the top positions in Taiwan’s administrative bodies are filled with political figures who may or may not be experts in the relevant field, the rank-and-file is recruited according to established rules and qualification levels. For example, Taiwan’s Examination Yuan, a constitutional organ responsible for the education, recruitment and evaluation of the country’s public officials, organizes multi-stage exams. Consequently, Taiwan’s public service is professional and non-politicized, although there have been some cases of corruption (involving high- and mid-level officials within the administration of Taipei’s and Kaohsiung’s mass railway transit systems). Public service is mostly reliable, though it has come under attack repeatedly during the typhoon season when

Efficient use of assets

heavy rainfalls and landslides plague the island and put pressure on local administrations. However, its cost efficiency is contested in Taiwan. Therefore, administrative reform has been written large by the DPP government since 2000 with the objective of making government services more effective, transparent and cost-efficient. Some corresponding laws were passed, others initiated, but their long-term effects remain to be seen. A special organization, the Council of Organizational Reform, was established at the government level in May 2002 for driving forward administrative reform, particularly focusing on deregulation, decentralization and outsourcing. Taiwan has also made progress in its efforts to set up comprehensive e-government services at all administrative levels.

Since the president nominates the premier without requiring parliamentary consent, there is a relatively high degree of like-mindedness between the presidential and prime ministerial offices. Moreover, the current DPP caucus in the Legislative Yuan shows considerable loyalty to the president and his government, so that legislative initiatives passed down by the Executive Yuan are not usually contested. However, party cohesiveness has suffered from the DPP's factions; five premiers have been nominated in six years in order to maintain political equilibrium between the different groupings and ensure political unity. The decision to ban all party factions, initiated by President Chen and DDP party chief Yu Shyi-kun as a measure to further streamline the policy-making process and make it more efficient, was only narrowly accepted by a DPP congress in July 2006. Whether that was a good decision remains to be seen. Although factional struggles made it quick changes in the top personnel necessary, they also presented a mechanism for effectively balancing the different interests and ideological stances that have characterized the DPP since it was founded in 1986. Due to a series of corruption scandals involving close associates and members of his family, Chen Shui-bian has lost much esteem and intra-party authority during the review period. Party unity has suffered a lot and may deteriorate further over 2007, when the nomination of the next presidential candidate is fought out. Policy coherence may also face serious challenges from the modification of the DPP's cross-strait approach in the post-Chen era, which will be necessary to attract more status-quo supporters.

Policy coordination

Taiwan ranked 35th (out of 159) and 34th (out of 163) respectively in Transparency International's 2005 and 2006 Corruption Perceptions Index, making it a so-called "middle integrity" country. This is an acceptable result by international comparison, though it also suggests that little progress has been made over the last ten years in the fight against corruption. A series of "sunshine bills" have been passed since the early 1990s to combat political corruption, the latest of which was the Political Contribution Act of 2004, which limits political donations and makes campaign financing more transparent. Most important for the containment of political corruption is the Public Functionary Assets

Anti-corruption
policy

Disclosure Act of 1993, which requires the declaration of all income and assets by high-ranking officials and elected representatives. Party financing is regulated by law. Taiwan's public and media are very sensitive to political corruption, having a fair share in exposing officeholders who have come under charges of misbehavior. Taiwan's anti-corruption policies are very strict, which is not really reflected in its current CPI ranking. This may point at a gap between factual and perceived corruption caused by a feeling of general disdain for party politics and the political elites and very much nurtured by the incapacitation of the Control Yuan, which is a result of the current standoff between Taiwan's party camps.

16 | Consensus-Building

All major political actors agree on building and strengthening Taiwan's market-based democracy. No veto power has survived the democratic transition and consolidation process of the late 1980s and 1990s. However, there is considerable disagreement on the issue of economic integration with the Chinese mainland, which is critical for the sustainability of Taiwan's economic success.

Consensus on goals

There are no anti-democratic veto actors in Taiwan.

Anti-democratic veto actors

The most serious domestic cleavage between advocates of Taiwanese independence and Chinese unification is reflected in the current division of the party system into two rival ("pan-blue" and "pan-green") camps. In recent years, however, this ideological confrontation has turned into a conflict on realistic and helpful cross-strait policies and their strategic timing, making independence and unification future options that can only be realized with the democratic consent of the Taiwanese people anyway. In that sense, the "identity cleavage" is less serious in Taiwan than it appears from the outside. However, the DPP government under Chen Shui-bian has polarized Taiwanese society with its pro-independence policies and outright call for building a Taiwanese nation. It is therefore unable to develop a meaningful consensus with the political opposition, which rejects any policy that jeopardizes the status quo in the Taiwan Strait and rejects the "one China-principle" as the starting point to negotiate with Chinese authorities.

Cleavage / conflict management

Civil society in Taiwan has meaningful access to political decision-making and is considered an important contributor to the formulation and evaluation of policies. The government sponsors regular meetings with civil society leaders and invites them to national conferences on particular problems regarding economic and social development, environmental protection or educational reform. Since the DPP is itself very much a result of civic engagement during the authoritarian era, it strongly appreciates civil society input into the governing process.

Civil society participation

The most important cleavage in post-war Taiwanese society, the conflict between mainlanders and Taiwanese, has already been addressed by the former KMT government under Lee Teng-hui.

Reconciliation

In 1992, the Executive Yuan published the “February 28 Incident Research Report,” which was the first ever official account of the tragedy based on solid academic research. In 1995, KMT party chief and Taiwan’s President Lee made a formal apology on behalf of the government and declared February 28th a national holiday to commemorate the victims. Among other memorials erected, Taipei New Park was renamed 228 Memorial Park, and the 228 Incident Memorial Foundation was established to compensate the victims and their families. However, in Taiwan’s highly politicized society, “228” remains a sensitive issue often invoked by the “pan-green” camp to remind the populace of the KMT’s authoritarian past and to mobilize it against China’s claim to sovereignty over the island.

17 | International Cooperation

Taiwan has been internationally oriented since its turn to export-led industrialization in the early 1960s. At the time, it made efficient use of U.S. economic aid, and later on, it reacted positively to U.S. pressure for democratization and for the appreciation of the new Taiwan dollar in the mid-1980s (which was a major step to push Taiwan to become a world center of computer technology). Taiwan’s reputation for adapting to new circumstances and to learn from its international environment is well-known and explains much of the “Taiwan miracle.” Within the international community, it has earned a reputation of high credibility and reliability to continuously implement necessary market reforms – perhaps with the single exception of the banking system, which still faces strong “traditional” forces resisting full-scale liberalization and transparency.

Effective use of support

Since China prevents Taiwan’s entry into international and regional organizations and bodies in a state capacity, it is particularly important for Taiwan to demonstrate credibility, reliability and generosity in the international arena. By convincing the world’s public that the degradation of its sovereignty is unfair and that its diplomatic isolation deprives the international community of fully making use of Taiwan’s expertise and financial might, Taiwan enjoys a good reputation as political partner and engaged donor of development aid and humanitarian assistance.– However, this is often linked to political expectations of raising Taiwan’s international recognition or even gaining diplomatic status, which is also known as “dollar diplomacy.”

Credibility

Taiwan cooperates actively and successfully in regional and international organizations like the Asian Development Bank (ADB), Asia-Pacific Economic Cooperation (APEC) and the WTO (though not under its official state name “Republic of China”) and, generally speaking, is a strong advocate of regional integration and cooperation. The only exception is cross-strait integration, which the current DPP government intentionally limits for political reasons.

Regional cooperation

Strategic Outlook

Starting in the 1950s, Taiwan successfully pursued transformation toward a market-based economy and in the 1990s, it evolved peacefully into a consolidated democracy. The historic transfer of power in 2000, when the Democratic Progressive Party (DPP) won the presidency and took charge of the government for the first time, has put the country's political institutions to a test. In spite of ongoing party infighting and legislative paralysis that spiraled into a regime crisis in 2005 – 2006 during Chen Shui-bian's second administration, Taiwanese democracy proved strong enough to cope with these problems. Awaiting the March 2008 presidential elections, Taiwanese politics will soon be "back to normal" with fierce campaigning, ruthless political divisions, a revival of the national identity issue, emotional debates on the validity of the "one China-principle" and few substantial policy outcomes.

However, at the end of the second Chen Administration, there seems to be some change as well; since the people have grown increasingly weary of party infighting and the mobilization of nationalist sentiments. As unofficial cross-strait economic and social integration proceeds, Taiwan's rival party camps will have to come up with new cross-strait policies to attract voters. This may soon induce a "post-Chen" DPP to take new steps in liberalizing cross-strait trade and even accept full-scale economic integration, though it will certainly uphold its claim to Taiwanese sovereignty and eventual independence. As the era of Chen Shui-bian comes to an end, a new chapter of cross-strait relations is imaginable. A new generation of DPP politicians may prove to be more pragmatic, resulting in a positive posture towards further trade liberalization across the Taiwan Strait. This will not make Taiwan embrace the Chinese mainland in political terms, but may reduce tensions across the strait after eight years of mistrust and "cold peace". The scenario also depends on developments in China, where a "fifth generation" of party leaders prepares for taking over in 2012. It remains to be seen what is on their Taiwan policy agenda.

Taiwan's market economy will remain sound, and it will further flourish thanks to ongoing cross-strait economic integration. Taiwan's increasing interaction with the Chinese mainland should not only be assessed by taking stock of outbound investment and trade figures, but also by factoring in the growing numbers of Taiwanese students and professionals "emigrating to the motherland" for study, new job opportunities and profitable careers. Notwithstanding the high gear of political confrontation in Taiwan over the best policy approach towards China and in spite of a "deep green" orientation of many of Taiwan's lower strata in the central and southern parts of the island,

increasing segments of Taiwan's middle class look across the Taiwan Strait and are open to closer ties. This may soon affect the official level of cross-strait relations and pave the way for new dialogue. Should this happen and results in even more cross-strait interaction and the eventual installation of direct trade links, Taiwan's economic future looks bright.

However, without an accompanying and credible statement from Beijing that the interpretation of the "one China-principle" is open for discussion and unification not an urgent matter, cross-strait relations can hardly improve, and a political consensus in Taiwan on the best policy vis-à-vis China is next to impossible.