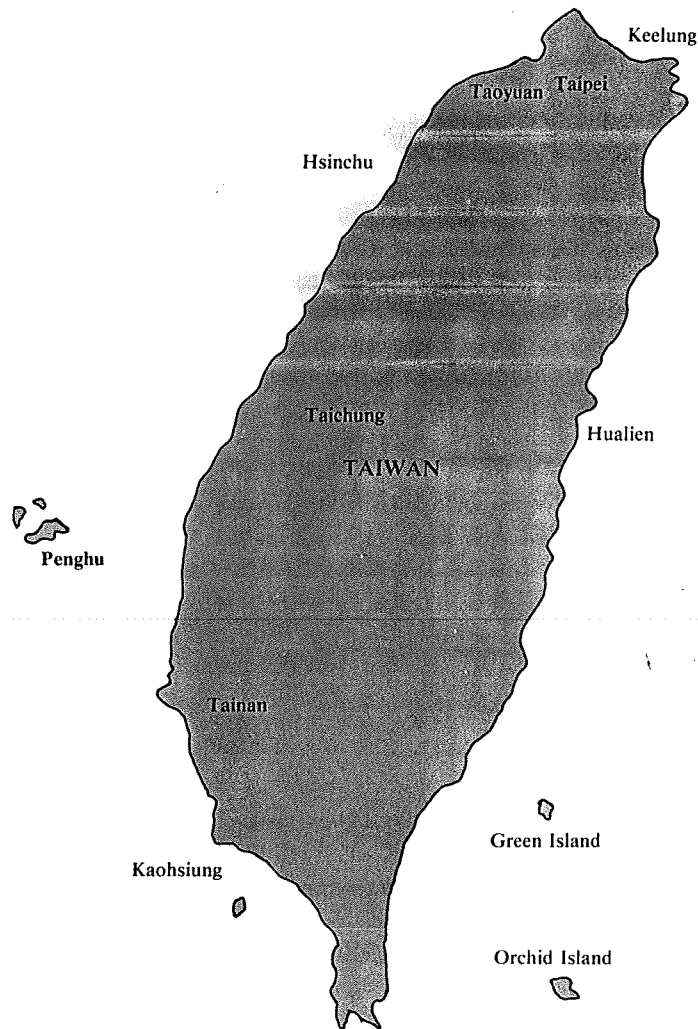


# TAIWAN AFTER CHIANG CHING-KUO

---

TAIWAN



---

Hong Kong : BT Brokerage (HK) Ltd, 30/F Admiralty Centre, Tower I, 18 Harcourt Road, Hong Kong

Telephone: (5)8618300 Facsimile: (5)8656732 Telex: 73046 BTRUS HX

Singapore : BT Brokerage & Associates Pte, Ltd, 50 Raffles Place # 21-03/04, Shell Tower, Singapore 0104

Telephone: 2249233 Facsimile: 2249180 Telex: RS 26413 BTSEC

Sydney : BT Stockbroking Pty, Ltd, 38/F Australia Square, NSW 2000

Telephone: (02)2511622 Facsimile: (02)2217028 Telex: AA123426 DX: 10267

The death of Taiwan's President, Chiang Ching-kuo, has raised questions in the eyes of many investors about the prospects for Taiwan's successful economy and for Chiang Ching-kuo's program of economic and political reforms. Press reports have carried contradictory headlines, with the *South China Morning Post* arguing that his passing will damage the prospects of reform and the *Asian Wall Street Journal* arguing the opposite.

### The Real Transition Process

The formal transition will be relatively smooth. Taiwan's leaders have long emphasized the creation of institutional mechanisms for leadership transition, so that at any time in the last generation a succession in Taiwan was much less likely to lead to a crisis than in South Korea or in most of the Third World. The Vice President automatically moves into the presidency when the President dies. The Kuomintang Party, which really runs the country, also has established processes for leadership transition.

Real power lies with the Kuomintang Party, and secondarily with the military and with the government institutions that manage the economy. The continuity and competence of these institutions is the strongest guarantee of economic and political stability. Personalities matter less in Taiwan than in the Philippines or Indonesia.

Chiang Ching-kuo had taken further actions over many years to smooth the transition of power to his successors. He broadened the base of the regime away from the mainlander refugees to include a very large number of indigenous Taiwanese, including his successor, Lee Teng-hui — while ensuring that ultimate power always lay with people opposed to Taiwan independence. He had promised that no member of his family would move to succeed him. He had given the political opposition an increasingly significant, although still very limited, role. All these contributed to the calmness of Lee Teng-hui's accession to the presidency.

The smooth formal transition of the presidency gives Taiwan time to adjust the leadership of the institutions that really count. Ultimate power is not conferred by the title of President. Neither Chiang Kai-shek's vice president and successor, C. K. Yen, nor Chiang Ching-kuo's vice president and successor, Lee Teng-hui, possessed firm control of the power bases that really count, namely the Party, the army, and the government. This second, informal, succession in the real power bases is more important. Real power is divided among new President Lee Teng-hui, Premier Yu Kuo-hwa, Party Secretary General Lee Huan, armed forces Chief of Staff Hau Pei-tsun, National Security Council head Chiang Wego, who is Chiang Ching-kuo's younger brother, and possibly Madame Chiang Kai-shek. The power game is managed by the Kuomintang Central Committee, which could well eventually put power in the hands of a less well-known figure.

There is a third form of succession that is even more important than the second. This is the generational succession. Taiwan's ruling Party, its executive agencies, and its legislature are still dominated by elderly men of Chiang Ching-kuo's generation. They are dying or becoming enfeebled at a rate reminiscent of what happened in Beijing during 1975-'77. But Taiwan is likely to experience a much more rapid generational transition than China did a decade ago. Although Taiwan has numerous experienced and respected managers of the older generation, it has no political leadership of that generation with the clout of Deng Xiaoping or even Hua Guofeng.

### The Ongoing Reforms

The 1980s have been years of vital economic and political reform, led by Chiang Ching-kuo. The reforms were an ongoing process rather than a fixed set of goals. Under Chiang Ching-kuo, the economy was upgraded and diversified, its fruits were equitably distributed, and its internal and external finances were further consolidated. The political transition was further institutionalized, the role of the Taiwanese was greatly enhanced, and the quality of administration was upgraded to very high standards. These reforms were largely completed.

Several reforms were not completed. Chiang Ching-kuo's administration was pursuing a gradual financial and economic liberalization that was necessary to cope with the growing complexity of Taiwan's economy, with the huge costs of tight Central Bank control of foreign exchange, and with trade pressures from the U.S. It was also liberalizing Taiwan's politics by permitting overt opposition political organization, more

competitive elections, and greater freedom of speech. And it was beginning a process of hitherto prohibited exchange with the Chinese mainland by allowing some personal visits to the PRC, by encouraging indirect trade, and by engaging in more public, albeit indirect and adversarial, dialogue with Beijing.

While these reforms were taking place, and while Chiang Ching-kuo was more forthright and determined to move in the direction of liberalization than many Third World leaders, the reforms were not being implemented swiftly; indeed, the economy was paying a substantial price for slow financial liberalization and the country's diplomacy was paying a high price for failure to compete imaginatively with Beijing.

What will happen to these reforms after the political transition?

For a short period, while leaders adjust to new roles, new initiatives either for or against Chiang Ching-kuo's reforms are unlikely. This period could last from a few weeks to a few months.

There will then be a second period when the older generation is still in control, but there is no single central leader. During this period economic reforms will probably go forward very slowly as they have been. Economic, especially financial, reforms are being forced by overwhelming pressures such as huge Central Bank losses caused by the current system of managing foreign exchange. The government will have to respond grudgingly but steadily to these pressures, but the leadership is too divided to move swiftly and Chiang Ching-kuo's passing will not change the balance of views.

There would almost certainly be no new movement during this second period with regard to domestic political reform or in relations with Beijing. These issues are simply too dangerous for any leader to tackle when he is part of a divided leadership.

During a third period, it is possible that a single leader of the older generation will take firm command. This period may not occur at all, but if it does, and if the new leader is an advocate of economic reforms, then economic liberalization might speed up.

The most important period, which is unlikely to be long delayed, is the fourth. The timing of the emergence of the fourth period, when the older generation departs from the scene, is difficult to predict. When it occurs, it will probably happen quickly, because the younger generation is anxious for power, and the new generation will likely be a great deal younger than the current leadership. To repeat, Taiwan has no elderly Deng Xiaoping. And below the current generation, for historical reasons, there is a "missing generation." Thus Taiwan's next generation should be more than a decade younger on average than its counterparts in Beijing.

What will this younger generation do?

On economic and financial reforms, it is correctly convinced that Taiwan has been paying a huge price for slow liberalization. It will move very swiftly indeed.

On relations with Beijing, it will not move precipitously, but contacts with the mainland will multiply very quickly and indirect dialogue will gradually become more direct. Under Chiang Ching-kuo, a small hole was created in the dam preventing contacts with Beijing; the younger generation will encourage this hole to enlarge in a controlled but rapid fashion.

On political reform, the weight of the younger generation understands the necessity for proceeding in the basic directions of Chiang Ching-kuo's reform program and is enthusiastic to do what is needed. But there is a problem. The political opposition has overtly advocated a policy amounting to Taiwan independence. Such a policy is anathema to the Kuomintang. Moreover, a chance that a group with such views could take power in Taipei is the one thing that could cause Beijing to abandon its present peaceful entreaties to Taiwan and choose military invasion instead. Therefore, no conceivable leadership in Taiwan will permit political reforms that would give the opposition any chance of achieving power. That means there will be a pause in Taiwan's political reform, just as the mainland students' questioning of Communist Party rule inevitably caused a pause in Beijing's political reforms. Taiwan's pause coincides with Chiang Ching-kuo's death but is not caused by it.

What does this mean for financial markets?

It implies a continuation of Taiwan's fabulously successful economic growth and slow continuation of financial reforms, together with stability in other areas -- with the promise of more innovative and even more successful policies sometime in the not too distant future. This should buoy all financial markets.

Are there any risks to this optimistic forecast? There are always risks to any forecast, but we have considerable confidence in this one. The principal risk arises from the chance that the army would not accept some major leadership or policy decisions taken by the Kuomintang Party. Both the Party and the military were dominated by Chiang Ching-kuo. The Party is supposed to command the military; any sign that its command was threatened would be extremely negative for Taiwan and for its financial markets.

The proper strategy therefore is to take advantage of the current period of panic selling in order to obtain quick profits. While severe Party-Army dissension is low probability, any indication of it should trigger urgent sell orders.

**William H. Overholt**  
*Director of Economic Research*

15 January 1988

BT Brokerage research products are based on diverse sources. We endeavor to ensure the accuracy of all information provided, consistent with timely transmission of market influences, including market rumor. BT Brokerage accepts no responsibility for special, incidental, or consequential damages however caused.