CHAPTER 5

GLOBALIZATION AND ECONOMIC GOVERNANCE IN TAIWAN

YUN-HAN CHU AND PEI-SHAN LEE

Introduction: The Development Model in Crisis

The Newly Industrializing Economies (NIEs) of East Asia, including Taiwan, South Korea, Hong Kong and Singapore, have presented their brand of economic development as a paragon for other developing economies. These so-called "developmental states" had sustained impressive growth and survived external economic shocks until the onset of the 1997-98 Asian financial crisis. However, the financial storm blew the lid off the structural weakness of South Korea and ASEAN countries. Japan's sluggish reactions to its financial sector woes also discredited the economic governance capacity of the East Asian developmental state.

Some scholars[1] began to suggest that this economic model was in the decline, pointing to its failure to cope with the demands and pressure of globalization. Others[2] demystified the model, stating that there was no "miracle" in East Asia; it was just very high levels of factor inputs that were supplied by high domestic savings and an abundant labor force. Doubts emerged regarding the prospect of sustained growth under this model.[3] In addition to the skepticism of foreign observers and advisors from international lending institutions, neo-liberal advocates within these countries repudiated the developmental state, urging a rolling back of the government and a reduction of market-distorting intervention.

All of this has raised some vexing questions. Does the dawn of the twenty-first century foreordain the triumph of "neo-liberalism" and the demise of East Asian developmentalism?[4] Is an alternative set of models and ideas for national economic management needed for East Asian countries to enter and excel in the age of globalization? Would the "lost decade" of the 1980s in Latin America be duplicated in East Asia?[5] Could the East Asian NIEs re-engineer their governance model to fully

[1] Meredith Woo-Cumings, "Introduction: Chalmers Johnson and the Politics of Nationalism and Development," in Meredith Woo-Cumings, ed., *The Developmental State* (Cornell: Cornell University Press, 1999), pp.1-31.
[2] Paul Krugman, "The Myth of Asia's Miracle," *Foreign Affairs*, 73(1994): 63-75.
[3] Nicholas Kristof, "Asian-style Capitalism Giving Way to the Free Market," *New York Times*, 17 January 1998.
[4] Lee, Pei-shan, "Regime Transition and Economic Governance: The End of Developmental State in Taiwan?" Paper presented at the 7th Annual Meeting of the Taiwanese Political Science Association, National Sun Yat-sen University, Kaohsiung, Taiwan, 9-10 December 2000.
[5] Paul Hirst and Grahame Thompson, *Globalization in Question* (London: Polity Press, 1999), p.241.

globalization? Would the "lost decade" of the 1980s in Latin America be duplicated in East Asia?[5] Could the East Asian NIEs re-engineer their governance model to fully reap the benefits of globalization, while smoothly executing concurrent domestic adjustments? Taiwan, which weathered the regional crisis relatively unscathed, has shown that the clash between globalization and the East Asian economic model need not be a zero-sum game. In the face of a tremendous global transformation, Taiwan has shown its economic resilience and made a successful leap into high-technology industries. The Kuomintang (KMT), Taiwan's ruling party for decades until it lost the presidency in 2000, has taken an unorthodox approach mitigating adverse external influences and cushioning the distributive impacts of globalization. It has taken advantage of opportunities provided by the formation of transnational production networks, while proceeding with financial deregulation and economic liberalization at its own pace.[6] Economic governance in Taiwan by and large maintains a state-led but market-friendly approach whose policy implications may be of some help in reorienting the oversimplified polemics in the "globalization versus developmental states" debate.

Challenges of Globalization since the 1985 Plaza Accord

The Plaza Accord in 1985 can be viewed as a milestone in the globalization process. Through the accord, the U.S. government set an implicit target zone of currency fluctuation for East Asian countries in a bid to bring down what was seen as an overvalued dollar. This stirred a wave of monetary realignments in the region. Taiwan was compelled to drastically appreciate its currency in a short period of time. In 1987-89, the New Taiwan Dollar appreciated about 50 percent. This triggered a set of structural changes that broke with the established mode of capital accumulation and economic governance.

First, the monetary realignment propelled a sharp increase in land prices and manufacturing costs. The rising costs afflicted labor-intensive industries and further weakened their international export competitiveness. Second, the United States demanded that Taiwan liberalize its trade polices and open up its domestic markets in banking, securities, equities and futures. From 1985 to 1988, Taiwan was incessantly pressured to lower tariffs and dismantle non-tariffs barriers such as import restrictions and export subsidies in a series of trade negotiations with the United States. Third, Taiwanese firms, particularly those in traditional industries, had to opt for overseas outsourcing and relocation via foreign investment to reduce their costs. This precipitated a massive wave of capital outflows from Japan, Taiwan, and South Korea. According to a survey,[7] cumulative outward foreign direct investment (FDI) from

[5] Paul Hirst and Grahame Thompson, *Globalization in Question* (London: Polity Press, 1999), p.241.
[6] Elizabeth Thurbon, "Two Paths to Financial Liberalization: South Korea and Taiwan," *The Pacific Review* 14(2001): 241-68.
[7] Peter Dicken and Henry Wai-chung Yeung, "Investing in the Future: East and Southeast Asian Firms in the Global Economy," in Kris Olds et al., eds., *Globalization and the Asia-Pacific: Contested Territories* (London: Routledge, 1999), pp. 111-22.

South Korea and Taiwan largely concentrated on Asia. By 1995, 43 percent of South Korea's FDI and 39 percent of Taiwan's went to other Asian countries.[8]

Developmental states in the region were thus not only preoccupied with attracting FDI from industrialized countries, but more importantly, with helping their own firms map out strategies for securing a position in global (or regional) production chains. The formation of the global commodity chain not only presented fresh opportunities and challenges to firms, but also acted as a crucible for the long-entrenched neo-mercantilist practices that developmental states had adopted throughout most of the post-war era. Meanwhile, the requirements for entry into GATT and later, the WTO, forced Taiwan to abandon established policy instruments in the name of trade liberalization. On the financial front, the state's control of the financial sector, another important policy regime buttressing national development, came under threat. Under U.S. pressure, the Kuomintang government began taking steps to liberalize the banking sector beginning in the mid-1980s. In order to join the WTO, Taiwan agreed to liberalize its banking and security industries and allowed foreign participation in domestic markets in the 1990s. Foreign exchange controls and restrictions on capital mobility were also relaxed. The imposition of such financial liberalization measures has made East Asian economies more exposed to external shocks in today's integrated global financial market. Although its causes have been hotly disputed, the 1997-1998 Asian financial crisis exposed this structural vulnerability as countries embraced the volatile mobility of short-term capital.

Under these drastically shifting circumstances, Taiwan faced several key challenges:

- Adapting its traditional export-oriented industrialization strategy quickly and flexibly.
- Enabling domestic firms to carve out a niche in the new global division of labor.
- Coping with further liberalization pressure from pro-global forces.

Taiwan's Unorthodox Approach to Economic Governance

Despite the current of economic neo-liberalism from the early 1980s on,[9] Taiwan's economic bureaucracy did not rush to wholly dismantle its governance model. Instead, it has carried out a complex yet steady adaptation to the challenges and opportunities of a highly international economy.[10] Through a constant upgrading and renewal of its industrial portfolio throughout the 1980s and 1990s, Taiwan has maintained its export competitiveness by leaping into high-tech industries. In addition, through a cautious and developmental-oriented approach to financial liberalization, Taiwan's financial sector remained under sound governance and more

---

[8] Ibid, p.113.

[9] See Thomas Biersteker, "The 'Triumph' of Liberal Economic Ideas in the Developing World," in Barbara Stallings, ed., *Global Change, Regional Response* (New York: Cambridge University Press, 1995).

[10] Yun-han Chu, "Re-engineering the Developmental State in an Age of Globalization," Paper delivered at a conference on "Taiwan as a Developmental Model for the 21st Century," School of Oriental and African Studies, University of London, London, September 21-22, 2000.

insulated from the sudden external shocks derived from capital mobility and the regional currency crisis compared to other economies in the region, such as South Korea and Thailand.

Industrial Governance and the Quest for High-Tech Success

Despite a sharp currency appreciation during the late 1980s and the resulting rise in labor and land costs, as well as growing environmental concerns and competition from ASEAN and China in labor-intensive industries, Taiwan has managed to maintain its international competitiveness through human resource development, technological upgrading and overseas outsourcing.[11] Taiwan's high-tech industries grew substantially from 27.4 percent of manufacturing production in 1986 to 43.4 percent in 1997. In 1995, Taiwan surpassed Germany to become the world's third-largest exporter of information technology (IT) products, including semi-conductors, computers, telecommunications equipment, and computer software. The state has played a critical role in pushing and enabling traditional labor-intensive industries to invest, upgrade, innovate and internationalize through long-term policy guidelines designed and implemented by its economic bureaucracy. In response to the intense hi-tech competition, the state has acted as the guiding force in a national effort to identify trajectories of technological diffusion in order to better link the domestic production with the global market demands.

What made this round of adjustments different from previous industrial upgrading stems from the changing nature and dynamics of the global production regime. On one hand, the increased fragmentation of the production process across borders complicated the design and implementation of national industrial policy. On the other hand, the IT revolution enhanced the predictability and reliability of the division of labor across the firms, further facilitated the globalization process and gave birth to new forms of collaboration, integration, and collective action. Under the globalization of the supply chains, it became clear that firms must exploit their location-specific advantages[12] and focus on moving upward into more complex segments of the global value chain. The economic bureaucracy was pressured to close the digital divide that would determine who will leap forward or be left behind in the new game of global competition.

In the 1990s, the new transnational production network and the IT revolution prompted the planning technocrats in Taiwan to incubate a new generation of firms for the fast-paced world of high-technology production. The essence of this game of catch-up is to upgrade in the subcontracting system from original equipment manufacturing (OEM) supply to own-design manufacturing (ODM), and even to own-brand manufacture (OBM), in order to internalize the imported technologies and build on them. In a first step, planning officials undertook vigorous measures to mobilize the overseas Chinese science and engineering community. The government sponsored the Chinese Institute of Engineers in USA, which was originally created in 1917 and renamed to CIE/USA in 1977, under which Chinese Americans who work

[11] Ibid.

[12] See David G. McKendrick et al., *From Silicon Valley to Singapore* (Stanford: Stanford University Press, 2000).

at national laboratories, NASA, top universities and leading industrial groups such as Bell Labs, Dupont and IBM were brought together for regular meetings and workshops to solicit policy suggestions for Taiwan's industrial development. Through the network, the government appointed prominent senior executives and scientists to the "Science and Technology Advisory Group" (STAG), founded in 1979, directly under the premier. Members of STAG advise on science and technology policy and help planning officials formulate long-term development plans.[13] In addition, the Institute for Information Industry (III), a public think tank established in 1979, has specialized in policies on the development of Taiwan's information infrastructure.

Beginning in 1979, the National Science Council (NSC) was entrusted with the development and management of the Hsinchu Science-based Industrial Park and other science park projects. Foreign investors and high-tech startups were invited to set up shop with easy access to the parks' R&D facilities, brainpower, and the financing of state-owned development banks. Tax deductions, duty-free import of key equipment and exemption from commodity taxes for exports were also provided. By the end of 1999, the park hosted 292 high-tech firms with gross revenue of NT$651 annually. The government also made heavy investments in basic scientific research relating to the targeted industries. The most notable fruits of this investment are seven large-scale science projects launched since 1986, including the National Space Project; the National Nano Device Laboratory, involving the research and development of semiconductor devices and materials; the National Synchrotron Radiation Research Center, dealing with R&D in high-energy physics; and the National Super Computer Center.[14]

Moreover, since the late 1980s, the government has relaxed restrictions on investment outflows to foster business expansion abroad, particularly in ASEAN countries. In addition to private investment, an official development assistance program emulating that of Japan was set up in the late 1980s to encourage trade and investment in the Asia-Pacific region. A "Southward Policy" was adopted to help Taiwanese companies set up operations in ASEAN countries to lower labor and environmental costs, instead of investing in mainland China, due to the security concern in a deeper integration with the latter. Taiwan also has hammered out a range of measures to attract foreign investment into strategic sectors and to incubate strategic alliances between local and transnational firms in a bid to obtain foreign technological know-how. The Steering Committee of the Industrial Cooperation Program under the Ministry of Economic Affairs (MOEA) identifies technology transfer opportunities for domestic industries and then makes decisions on big-ticket public-sector procurement projects in areas such as electric power, waste incineration, aerospace and national defense based on the prospects for technology transfer or technological cooperation. Through these efforts, global firms such as Hewlett-Packard, Boeing, General Electric, Lockheed Martin, Northrop Grumman, Raytheon, Dassault, and Thomson-CSF, have agreed to do business with the MOEA.[15]

[13] See Yun-han Chu, 2000.
[14] See Yun-han Chu, 2000.
[15] See Yun-han Chu, 2000.

Lastly, a policy network in high-tech industries was created to link up industrial planning agencies, state-owned industrial banks and investment funds, private capital, high-tech start-ups, public research organizations, universities, foreign consultants, and Chinese-American scientists and entrepreneurs. This consultative mechanism has laid a foundation for coherent industrial governance under which collective problems within industrial sectors are solved through coordination across agencies. The most prominent examples for the success of public-private coordination in the high-tech industry were the creation of United Microelectronics Corporation (UMC) in 1980 and Taiwan Semiconductor Company (TSMC) in 1987. The UMC has become the foundry technology leader in the 1990s, while TSMC is now the world's largest independent semiconductor foundry. Their creation and development was sponsored by government's direct financial inputs. Up until now, the government still owns 10% of TSMC's share. In addition to finance, in terms of technology, government commissioned Industrial Technology Research Institute (ITRI) to help purchase and transfer foreign technology, then transferring to private firms as technology matured for manufacturing. ITRI has also served to recruiting and training local scientists and engineers for the industry. The success of Taiwan's high-tech catch up is completely by design, not by chance.

From the above analysis, we can see that an intra-state policy coordination mechanism was in shape since the 1980s to promote strategic industries through fiscal incentives, the channeling of investment outflows, attraction of foreign investment and technology transfer, and by laying the foundations for infrastructure, R&D, funding, etc. During the 1990s, more sector-specific consultative bodies were set up and incorporated into the industrial policy apparatus under which officials from related agencies, research institutions and industrial representatives could work together to solve problems. This evolutionary institutional adjustment has created a coherent system of industrial governance for both traditional and high-tech industries.

Although many countries have tried to emulate this model of industrial governance for specific sectors, its success depends on the involvement of state institutions and institutionalized links between the public and the private sectors. As David G. McKendrick et al put it,[16] "many are called" to move along with technological changes, but "few are chosen" to succeed in the industrial upgrading.

Financial Regulatory Governance

The regional financial crisis of 1997-99 put the globalization of financial markets in the spotlight. It served as a warning: that the volatility of short-term transnational capital and the proliferation of new financial instruments, if not properly regulated, could hurt economies, stir political upheaval, and imperil regional stability. Taiwan weathered the crisis, however, and this puzzling exception merits scrutiny of Taiwan's financial governance.

From the mushrooming scholarship on this issue,[17] can be drawn some policy implications which suggest that the orthodox (neo-liberal) approach to financial

[16] See David G. McKendrick et al., p.252.

[17] See Yun-han Chu, 1999; Stephan Haggard, *The Political Economy of the Asian Financial Crisis* (Washington, D.C.: Institute for International Economics, 2000); Gregory Noble and John Ravenhill, "The Good, the Bad, and the Ugly?

liberalization is not the only way. Neo-liberal forces advocate removal of capital controls and exchange rate maneuvering in developing countries, as embodied in the "Washington consensus" shared by the United States, the International Monetary Fund (IMF) and the World Bank.[18] The prevailing perspective on financial liberalization suggests a set of standard procedures and rules for reform, including prudent regulation, transparent accounting and supervision, an orderly sequencing of capital account liberalization, and corporate restructuring.[19] Nevertheless, is this "one-size-fits-all" kind of institutional reform really a panacea for developing countries in the course of financial liberalization?

Taiwan's experience suggests not. First, despite the trend toward an integrated global financial market, the government has managed to control the volatility of cross-border short-term capital movements for the sake of monetary and financial stability. Moreover, Taiwan has had its own agenda and policy sequence for liberalization, which gave priority to the deregulation of domestic capital markets over internationalization. When the government decided to open up the stock market to foreign investors in 1991, it set a strict investment cap and raised it only gradually.[20] In this incremental approach to liberalization, the government has kept financial stability and industrial development as top priorities. Therefore, liberalization measures were taken only with the concurrent introduction of re-regulation to safeguard domestic financial and price stability, and insulate Taiwan from excessive external shocks.[21]

Second, as to the decision-making structure of its financial governance, the government has stressed the importance of strengthening financial supervision. Supervisory agencies include the Central Bank of China (CBC), Ministry of Finance (MOF) and the Central Deposit Insurance Corporation (CDIC). The autonomy and special status of the CBC is of particular importance. The CBC falls under the executive purview of the president and is entrusted with an extensive regulatory authority over the banking sector and capital market.[22] The CBC can overrule the MOF over the timetable and degree of financial deregulation and internationalization. Indeed, the CBC's conservative approach to capital account liberalization has sometimes been at odds with the MOF, which is generally more in favor of liberalization. But given its superior position in the state apparatus, the CBC has been able to overrule the MOF and maintain its extensive regulatory authority over the banking sector and capital markets. For example, although restrictions on private holdings of foreign exchange were removed in the late 1980s, the CBC soon set up

---

Korea, Taiwan and the Asian Financial Crisis," in Gregory Noble and John Ravenhill, eds., *The Asian Financial Crisis and the Architecture of Global Finance* (New York: Cambridge University Press, 2000); Jia-Dong Shea and David C.Y. Sun, "Financial Crisis and the Prudential Regulation of Financial Institutions," in Gordon de Brouwer and Wisarn Pupphavesa, eds., Asia-Pacific Financial Deregulation (London: Routledge, 1999); Elizabeth Thurbon, 2001, pp.241-68.

[18] Iyanatul Islam and Anis Chowdhury, *The Political Economy of East Asia: Post-crisis Debates* (Oxford: Oxford University Press, 2000), pp. 208-11.

[19] See Alison Harwood and Bruce L.R. Smith, eds., *Sequencing? Financial Strategies for Developing Countries* (Washington, D.C.: Brookings Institution Press, 1997).

[20] Yun-han Chu, "East Asia: Developmental Challenges in the 21st Century," Manuscript, 2001.

[21] See Elizabeth Thurbon, 2001, p. 251.

[22] See Yun-han Chu, 1999, pp. 189-93.

monitoring scheme and intervened in the spot market when necessary to prevent excessive short-term currency fluctuations.[23]

The CBC also monitors fluctuations in capital market from time to time by intervening to stabilize the exchange rate in its targeted zone. When the 1997 Asian crisis unfolded, the CBC initially tried to resist the market pressure of devaluation by spending more than US$7 billion. However, under the overwhelming speculation pressure and market expectation for depreciation, a high-level meeting among the president, premier, and the CBC governor was convened and decided to allow the NT dollar to float. The Taiwan currency fell steeply from 25:1 US dollar before the crisis down to 35:1 after it. After this drastic realignment, however, the practice of managed float has resumed.

Neo-liberals may disapprove, or even condemn this practice as a "dirty floating" currency regime.[24] However, it has helped maintain monetary stability and prevented a currency crisis from happening.

The lessons learned from the case of Taiwan attests to a different model of financial governance. Financial liberalization must proceed with concurrent efforts on re-regulation rather than wholesale deregulation. A country should choose a pace of financial opening in accordance with its tolerance for short-term fluctuation. The strengthening of Taiwan's financial governance involves the comprehensive functioning of regulation, supervision, examination, and enforcement on the part of regulatory agencies, as well as the internal governance of financial institutions on risk management. More importantly, financial governance has been conducted in a macro- and development-oriented style aiming for diverse policy goals.

Prospects for the Developmental State in Taiwan

Taiwan is an important case in the debate over national responses to the challenge of globalization. It has shown that the clash between globalization and national development need not be a winner-take-all contest. The engagement of states in the process of globalization is, in fact, critical to ensure proper overhaul of legal and regulatory systems, re-engineering of governance structures, and maintenance of national competitiveness. In the process of negotiating with the global economy, some components of the state apparatus may well be transformed. Finance ministries, central banks, or other institutions may be strengthened rather than weakened.[25] In the case of industrial policy—the core functioning ingredient of the developmental state, the Taiwanese government has managed to re-engineer the institutions of industrial governance while enacting gradual neo-liberal reforms. Globalization and state strength may not be mutually exclusive. Depending on national orientations and institutional capabilities, globalization may prompt developmental states to move on to different trajectories of adjustment or transformation.

As the corollary, the demise thesis regarding the future of developmental states

---

[23] See Yun-han Chu, 2001.

[24] Jeffrey A. Frankel, "No Single Currency Regime Is Right for All Countries or at All Times," Working Paper 7338, National Bureau of Economic Research, 1999.

[25] Saskia Sassen, "Embedding the Global in the National," in David A. Smith, Dorothy J. Solinger and Steven C. Topik, eds., *States and Sovereignty in the Global Economy* (London: Routledge, 1999).

may not be tenable as globalization per se is not in antagonism to the functioning of the state, and as shown from Taiwanese state's successful negotiation with the trend of globalization. State may continue to intervene in the market, not to shield the country from global market forces, but to link it to the global market on a favorable term. This is exactly an option some experts promote: selective globalization rather than de-globalization.[26] The model of developmental states should not be jettisoned for wrong reasons.

Even if a developmental state shows a capacity to foster national development by selectively and gradually coping with the challenges of globalization, threats to governance may come from elsewhere. They may stem from a lack of institutional flexibility and political responsiveness, or permeation of structural corruption from within.[27] In other words, the prospects for developmental states will be largely contingent on domestic politics and institutional arrangements. In the case of Taiwan, to be more specific, it faces challenges on two fronts: how to restructure democratic governance and build up a social safety net system to accommodate those left at a disadvantage by global competition.

Taiwan's democratization since the mid-1980s has undermined its solid foundation of economic governance. The open competition for votes in democratic Taiwan often results in politicians attempting to ingratiate themselves with specific constituencies by supporting short-term expansionary and distributive policies. This short-sightedness can lead to fiscal deficit, financial rot, and pork-barrel legislation. In the worse case, the insulated economic bureaucracy could be sandbagged by the politics of distribution.

Constructing a new institutional foundation for sustained growth under democracy is therefore an impending challenge for Taiwan. The task involves maintaining a delicate balance between developmental logic and distributive politics; between policy responsiveness and democratic accountability.[28] The prospects for the maintenance of sound economic governance in Taiwan depend on how well it copes with the challenges of democratic governance.

An interesting and vital question concerns whether the Democratic Progressive Party (DPP), which came to power in May 2000, will fundamentally change the essence and structure of economic governance in Taiwan. As a longtime opposition party, the DPP is founded on an intrinsic distrust of the established bureaucracy and hostility to the developmental model. Will it abandon the developmentalist approach and carry out a protracted and politically motivated neo-liberal restructuring to eradicate Kuomintang influence in the economy? It remains to be seen.

---

[26] See Islam and Chowdhury, 2000, pp. 211-5.
[27] Stephan Haggard, "Governance and Growth: Lessons from the Asian Economic Crisis," *Asian Pacific Economic Literature*, 13(1999): 30-42.
[28] Pei-shan Lee, "Political Institutions and Economic Governance," *Journal of Social Sciences and Philosophy,* 14(2002): 1-31.