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**FROM ISLAND FACTORY TO
ASIAN CENTRE: DEMOCRACY AND
DEREGULATION IN TAIWAN**

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ABSTRACT

How have the capitalist powerhouses of East Asia reacted to the economic, demographic and international pressures to liberalise policies and structures that once brought growth but are now assailed as obstacles to further development? The record of Taiwan's attempts to satisfy stiff demands by trade partners in preparation to join the World Trade Organization (WTO) and to turn Taiwan into an 'Asian Pacific Regional Operating Center' (APROC) for local and foreign multinational corporations shows that neither democratic institutions nor the process of democratisation have posed insurmountable obstacles to liberalisation in the trade-dependent East Asian economies. The major impediments to reform emanated not from newly emboldened economic interest groups or particularistic legislators, but from the remnants of the old statist coalition, including, surprisingly, public sector labor unions. When the top leadership of the ruling party made economic reform a major priority, it managed to overcome both forms of opposition to liberalisation. The remaining dilemma is not so much how to deregulate, as how to administer necessary regulations efficiently.

FROM ISLAND FACTORY TO ASIAN CENTRE: DEMOCRACY AND DEREGULATION IN TAIWAN

*Gregory W. Noble**

Introduction

In the course of economic development the shift to an economy dominated by services and technology is virtually universal, and gains in productivity and thus incomes cannot be sought in manufacturing alone. As capital and information flow ever more smoothly across countries and continents, and direct labour accounts for a declining share of production costs, developing countries that have specialised in exports of natural resources or labour-intensive manufactured goods find themselves under increasing pressure to provide a more open and efficient environment for the high value-added activities of local and international investors. If they fail, not only will foreign multinationals desert them in favour of cheaper, more convenient sites, but their own large companies may transfer more sophisticated activities abroad.

Despite the economic rationale for economic opening and improvement of infrastructure, the domestic political opposition to liberalisation is often deep-seated. The challenge of wider opening is especially acute in Asia, where many previously successful middle-level countries find themselves squeezed between developed countries with technologically advanced manufacturing skills and sophisticated service sectors, and an ever-expanding list of developing countries able to compete for the provision of low-wage labour. In Asia, the most rapidly growing region in the world, Singapore and Hong Kong have made great progress in the transition out of cheap-labour production. However, the jury is still out on Korea and Taiwan, and Malaysia and Thailand are beginning to face similar pressures. Even Japan, for all its manufacturing prowess and financial muscle, faces tremendous pressures to deregulate services and prevent the 'hollowing out' of the manufacturing sector and

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‘Japan passing’ as both Western and Japanese multinationals concentrate their investments in more congenial locations.

One of the most interesting cases is Taiwan, a major ‘newly industrialising country’ and newly emerged power in Asian trade and investment. Taiwan’s economic accomplishments are well known. Beginning in the early 1960s, a combination of export-led growth, heavy investments in education and infrastructure, macro-economic stability, and state guidance, particularly in electronics, resulted in a combination of economic growth, equity and structural transformation that gained attention throughout the world.¹ Taiwan then entered a smooth, evolutionary transition to democracy that culminated in the dismantlement of most of the old authoritarian political structure and democratic elections of both legislators and executives.²

Despite its many economic and political successes, by the early 1990s Taiwan faced increasing pressures to change its economic strategy. First, the very success of the labour-intensive strategy paved the way for its eventual exhaustion. Under the pressure of full employment, wages escalated, while the cost of land in densely populated Taiwan skyrocketed. Environmental protests, a product of both democratisation and environmental degradation caused by years of unrestrained growth, made investments in heavy industry increasingly difficult. With rising incomes, the focus of demand shifted to services, but the service sector lacked the intense competitive pressures that had led to efficiency in manufacturing. The dark side of Taiwan’s combination of export-led growth and statism was a service sector subject to pervasive impediments to the free flow of money, information and people, and widespread favouritism and petty corruption in public works and many public services. In addition to the natural exhaustion of the old strategy, the international economic environment also shifted. Chronic trade surpluses, long concentrated on the United States, led the American government to pressure Taiwan to open its markets and allow the New Taiwan Dollar to appreciate. The success of countries like Taiwan and Korea also encouraged a host of new competitors. China adopted an outward-looking economic strategy, as did many of the countries in Southeast Asia. The combination of low wages, economic liberalisation and waves of direct foreign

¹ Shirley W.Y. Kuo, Gustav Ranis and John C.H. Fei, *The Taiwan Success Story*, Westview Press, Boulder, CO, 1981; Robert Wade, *Governing the Market*, Princeton University Press, Princeton NJ, 1990; Stephan Haggard, *Pathways from the Periphery*, Cornell University Press, Ithaca NY, 1990.

² Hung-mao Tien, ed., *Taiwan’s Electoral Politics and Democratic Transition*, M.E. Sharpe, Armonk NY, 1996.

investment from Japan, Hong Korea, the West and not least Taiwan created a whole new crop of competitors for investment in Asia.

The pressing need for new economic policies to deal with this increasingly stringent environment collided with formidable political obstacles to change, including the remains of the old statist coalition and a fractious and often particularistic Legislature, many of whose members represented not just narrow local interests but specific business groups and even gangsters. The 1995 Legislative elections exacerbated the situation by leaving the ruling Kuomintang (KMT) with only a slim majority of three to four seats, some of whose occupants displayed dubious loyalty to the party centre. Many feared that Taiwan faced the worst of all possible worlds: neither efficient authoritarianism nor thoroughgoing liberalising reform.

In this increasingly difficult economic and political environment, the government in Taiwan adopted two major initiatives. First, it embarked on a concerted campaign to gain entrance to the new and expanded World Trade Organisation (WTO). The government hoped to retain access to foreign markets, and to use the new organisation as partial protection against attempts by the United States or others to impose unilateral restrictions on Taiwan's vital exports. In addition, government planners hoped to use the WTO entry to force rationalisation of the domestic economy. At least as important as these economic goals were foreign policy considerations: the government hoped to use entry into WTO and other international organisations as a way of enhancing its international stature in face of unrelenting pressure from the People's Republic of China (PRC).

The second major initiative aimed to entice multinational corporations, including emerging multinationals from the island itself, to make Taiwan home to their 'Asia Pacific Regional Operating Centres' (APROC—echoing Taiwan's official title of Republic of China). The APROC plan aimed to establish centres in six key functional areas: manufacturing, finance, telecommunications, shipping, air cargo and passengers, and media. Taiwan brought several strengths to this plan: a central location; a well-integrated manufacturing sector, particularly in electronics; a strong higher educational system and a deeper and more dynamic high technology system than anywhere else in Asia outside Japan; a larger market than Hong Kong or Singapore; and the ability to serve as a cultural and linguistic link between Japan, China and Southeast Asia. Offsetting these assets were serious liabilities: Taiwan was far less open or efficient than Hong Kong or Singapore, and levied much stiffer taxes on multinationals. With little experience in developing the service sector,

it lacked the experienced personnel and excellent English-language skills available in Hong Kong or Singapore. Finally, the natural market for its high-tech manufactures and services was China, a difficult and volatile place to do business in the best of circumstances, but much more tricky for Taiwan given the continual struggle over its international identity. The government attacked these weaknesses on two fronts. First, and foremost, it embarked on a campaign to deregulate both the overall economy and the six centres, in order to raise Taiwan's place in the international value-added chain and make up for the loss of labour-intensive manufacturing industries. Second, it oriented infrastructure development to the six centres, building both special zones for manufacturing and media, and improved transportation facilities such as harbours and airports.

To many, the 'APROC' initiative sounded like nothing but a faddish theme out of a marketing textbook. As analysts observed, even the key concept of a 'regional operations centre' remained ambiguous: did it involve the regional headquarters for an entire company? a division? or even a product? And what about the many companies that were abandoning the entire practice of establishing regional headquarters? In fact, however, the real import of the APROC plan far exceeded regional headquarters. It was a clever way to measure domestic inefficiencies against the best practices of competing economies, a lever and benchmark to overcome political obstacles to implementing a massive scheme to dismantle the old statist system erected during the period of authoritarianism. Deregulation in the guise of APROC, in combination with the reforms to secure acceptance into the WTO, represented potentially the biggest transformation in Taiwan's political economy since the shift toward externally-oriented growth in the early 1960s.

Prospects for success of the type of liberalisation and deregulation represented by the WTO and APROC initiatives were mixed. From a purely economic perspective, the outlook was fairly positive. The Stolper–Samuelson theorem predicts that bountiful factors of production (labour in China, capital in the United States, land in Australia) will support trade liberalisation (since they will gain access to larger markets), while scarce factors will tend to oppose liberalisation (since they will be priced out of their own markets). However, opposition need not equal paralysis, since neo-classical trade theory highlights the mutual gains from trade and the opportunity to use pay-offs from

efficiency gains to compensate potential losers, such as scarce factors.³ Analysts who focus more on sectors than factors see countries with strong light industrial sectors as enjoying a distinct advantage, since they have developed a tradition of reacting flexibly to market shifts.⁴ Others emphasise the degree of trade dependence. Small, open economies that depend on exports cannot afford to resist liberalisation.⁵ Thus, these economic approaches would predict that the biggest obstacles to trade reform and liberalisation would come from rigid sectors based on scarce factors of production. In the Taiwan case, likely opponents would include agriculture, low-skilled labour and high-technology industries (except computers and semiconductors), while supporters would include skilled labour and moderately capital and technology intensive industries. Since Taiwan has one of the most trade-dependent economies in the world, we would expect it to take strenuous steps to maintain access to foreign markets.

Political approaches, which examine in more detail the crucial process of offering side payments to potential losers, offer decidedly mixed predictions. Many analysts are flatly pessimistic about the failings of democratic institutions. Potential losers from liberalisation are often better organised and have more at stake. Domestic firms that stand to gain from liberalisation may be poorly organised, or not even in existence yet. Foreigner producers cannot vote and are usually forbidden from contributing to political campaigns. Consumers, the ultimate beneficiaries, are typically ill-organised, both because they are far more numerous and because the per capita gains from each individual effort at reform are often small.⁶ Nor is the problem limited to private interests. The bureaucrats in charge of regulations and trade barriers often derive much of their power from those regulations, and normally develop a sense of mission and a set of specific skills and operating procedures centred on controlling economic activity. They often form the heart of 'iron triangles' (industries,

³ David A. Lake, ed., *The Political Economy of Trade*, Elgar, Aldershot Hants, 1993.

⁴ D. Michael Shafer, *Winners and Losers*, Cornell University Press, Ithaca NY, 1994.

⁵ Peter J. Katzenstein, *Small States in World Markets*, Cornell University Press, Ithaca NY, 1985; Helen V. Milner, *Resisting Protectionism: Global Industries and the Politics of International Trade*, Princeton University Press, Princeton NJ, 1988.

⁶ Mancur Olson, *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities*, Yale University Press, New Haven Conn, 1982.

their regulators, and relevant legislative committees) committed to maintaining the status quo. For bureaucrats, liberalisation is threatening, and compensation schemes are unlikely to include them. Bureaucratic resistance is often credited for the slow progress of deregulation in Japan.⁷ Finally, legislators often come to the defence of threatened private interests and their regulators, for the political market is not always perfect, and compensation by no means automatic and efficient. Legislators typically have short time horizons and imperfect information. Assigning responsibility (and thus credit) for policy formation and implementation is difficult for both voters and legislators. Overseeing the bureaucracy to ensure the complete implementation of reform is difficult. Similarly, the political transaction costs of cutting deals in the legislature may be substantial. Moreover, legislators may not even want efficient economic markets, since they often reap political advantage from providing access to protected but inefficient bastions.⁸ ‘Democratic pessimism’ certainly characterised the public in Taiwan. Polls revealed that ‘67.1% of respondents agreed that government policies were heavily influenced by big business conglomerates whose interests were being protected by legislators’.⁹ Both the foreign and local business communities strongly supported WTO and APROC, but expressed grave doubts that the government would succeed in carrying out fundamental liberalisation.¹⁰

In contrast, some researchers argue that the possibilities for political entrepreneurship and the dynamics of opening formerly authoritarian regimes justify more optimistic predictions. In the transition to democracy, the biggest opponents to economic reform are often the beneficiaries of the old state system rather than the mass of private firms. New political parties and business firms that hope to gain access to formerly protected or monopolised markets can

⁷ Yayama Taro, *Kanryo Bokokuron* [Bureaucrats are ruining the nation], Shinchosha, Tokyo, 1993.

⁸ David C. Colander, ed., *Neoclassical Political Economy: The Analysis of Rent-Seeking and DUP Activities*, Ballinger, Cambridge MA, 1984. For a critique of this approach, see Albert Breton, ‘Toward a Presumption of Efficiency in Politics’, vol. 77, no. 1, September 1993, pp. 53–65.

⁹ Lin Tse-min, et al., ‘Elections and Elite Convergence: The Consolidation of Democracy in Taiwan’, APSA Conference Group on Taiwan Studies, Working Papers in Taiwan Studies, no. 15, 1995, p. 22.

¹⁰ See, for example, the poll results cited in *Lienhe Bao*, 1 and 2 January 1996.

form a powerful coalition for reform.¹¹ Oversight of the bureaucratic implementation, while difficult and costly, is feasible if politicians assign it a high priority. The prospects for reform are relatively good, assuming a certain degree of political entrepreneurship (speaking for groups that are not yet powerful or well organised) and party discipline. Thus, economic approaches to liberalisation are generally optimistic; key issues involve the degree of dependence on international trade, the organisation of the competing factors and sectors, and the degree to which the political system can organise 'side payments' to compensate the losers from liberalisation. Politically-oriented approaches are more cautious. Legislators, businesses and bureaucrats are often fearful and short-sighted and political markets imperfect. Reform is often easier to block than implement, since the old system provides a focal point, and bureaucratic and other interests form around it. The two accounts agree, however, that two of the most crucial factors are the presence or absence of political entrepreneurship and leadership—perhaps stimulated by the emergence and growth of new parties—to propel reform and organise side payments that grease the way for efficiency-enhancing reforms.

Applying to the World Trade Organisation: players and preferences

Both economic and political goals motivated Taiwan's application to join the World Trade Organisation, which includes not only trade in manufactured goods, but also new areas such as agriculture, textiles, services, and intellectual property rights. The government feared that local firms would lose to competitors from Korea and elsewhere if they were precluded from taking advantage of lower tariffs and equal access to the markets of member countries. Economic planners also believed that important gains in efficiency would accrue from the forced structural transformation of the Taiwan economy brought about by the entry of new foreign competitors and the relaxation of regulations on both foreign and domestic firms. The Ministry of Economic Affairs (MOEA) and the Executive Yuan's Council for Economic Planning and Development (CEPD) estimated that GDP growth could be boosted as much as one or two percentage points a year.¹² Of course, even these optimistic

¹¹ Karen L. Remmer, 'New Theoretical Perspectives on Democratisation', *Comparative Politics*, vol. 28, no. 1, October 1995, pp. 103–22; Barbara Geddes, *Politician's Dilemma: Building State Capacity in Latin America*, University of California Press, Berkeley CA, 1994.

¹² *Far Eastern Economic Review*, 6 April 1995, pp. 66–7.

simulations included many APROC reforms that were not necessary for accession to the WTO. In reality, diplomatic concerns were at least as important. Taiwan was determined not to let the PRC block it from entering As President Lee Teng-hui (Li Denghui) told the *Wall Street Journal* shortly after his (re)election: 'We can't wait on this [WTO membership]. The U.S. must...not wait for the PRC to say OK'.¹³

The agency with direct responsibility for the WTO negotiations was the Board of Foreign Trade of the Ministry of Foreign Affairs (*Jingjibu Guomaoju*), a key element of one of Taiwan's most important ministries. The Board represented other ministries and agencies, such as agriculture, and other divisions within the Economics Ministry, notably the Industrial Development Bureau, but it enjoyed sole responsibility for negotiations with other countries. The Board tended to take a pragmatic approach to its work and its officials came from a variety of professional backgrounds; few were professional economists. The Board generally supported free trade, because Taiwan is dependent on exports, but was not averse to some protection, since many sectors, such as agriculture (virtually absent in Hong Kong and Singapore) were not competitive in world markets. Moreover, the very job of negotiation pushed the Board to take a practical approach, since even countries such as the United States, which constantly urged Taiwan to open its markets, maintained quotas on textiles and other imports from Taiwan, and also sought special access for their own industries. Also pragmatic was the powerful Ministry of Finance (MOF), which generally supported freer trade but worried about the loss of tariff revenue. For thirty years, Taiwan was a model of fiscal probity, but with democratisation the government budget sank deeply into the red. Tariffs provided almost 10 per cent of total revenues, an unusually high share for a country at Taiwan's level of development.¹⁴ Thus, while the MOF did not oppose the WTO bid in principle, it preferred to minimise tariff cuts.

While crucial ministries cautiously supported the WTO bid, President Lee Teng-hui pushed aggressively. The President, an economist trained at Kyoto and Cornell, was well aware of Taiwan's dependence on trade. More important, he was vitally interested in the WTO because of Taiwan's weak diplomatic position. He saw participation in international economic organisations as a crucial supplement to Taiwan's dwindling formal diplomatic representation, and few economic organisations could compare to the WTO.

¹³ *Wall Street Journal*, 26 March 1996.

¹⁴ *Monthly Bulletin of Statistics of the Republic of China*, November 1996, p. 45.

Lee was also concerned about maintaining the support of the United States, the major force pushing for a strong WTO. Last but not least, he worried that China would enter the WTO first, and delay or block Taiwan's application.

For most producers in the private sector, WTO entry represented neither a major opportunity for new gains nor a serious threat. Most industries were already either competitive (computers and semiconductors), in the process of moving most production abroad (garments, toys, footwear), or busily moving upstream to supply overseas assembly operations (artificial fibres, consumer electronics). A few industries or sectors that depended mainly on the domestic market, notably agriculture and automobiles, did stand to lose. Overall, the private sector did not adopt an aggressive stance on the WTO. Though better organised than during the authoritarian period, peak business organisations remained divided and personalistic, no match for organisations like Japan's Keidanren. Business offered neither strong support for liberalisation, nor a coherent rationale for support of vulnerable industries. Instead, threatened firms and industries appealed directly to individual legislators.

Taiwan's legislature was potentially highly susceptible to protectionist appeals. After the December 1995 elections, the KMT barely managed to hold a majority of seats in the Legislative Yuan. More important was the impact of the electoral system, which combined a single, non-transferable ballot for the voter with multiple seats in one district (plus a smaller number of national seats, allotted in proportion to the votes won in multiple-seat districts). Like Japan's old electoral system, from which it descended, the multi-member system created strong incentives for legislators to shuck off party discipline and cultivate a personal vote and opportunities to seek credit, since they could not rely on party or ideological labels when forced to campaign in the same district with candidates from their own parties.¹⁵ The situation was even more dire than in Japan, since district magnitude (the number of seats per district) was roughly twice as great, with the largest districts returning almost a dozen members to a much smaller legislature. The result was horrifically expensive and corrupt elections, as legislators competed to prove to voters that they could bring home the goodies. Taiwan legislators not only engaged in pork barrelling for the district, many of them represented specific business groups, and a few were convicted criminals known for their association with gangsters. As in Japan, the legislature had but weak capabilities to research and draft comprehensive policy bills. Both bureaucrats and representatives themselves

¹⁵ Kobayashi Yoshiaki, *Senkyo Seido* [Electoral systems], Maruzen, Tokyo, 1994.

estimated that only about one-third of legislators made a serious commitment to policy and legislation, while one-third were primarily interested in putting on a show, and one-third were out to make profits for themselves and their backers.¹⁶ Japan repudiated its multi-member system in 1993, and many called for electoral reform in Taiwan as well.

In one way, however, Taiwan differed fundamentally from Japan's Westminster-style system: like France, it featured both a Premier and a President. Given the KMT's quasi-Leninist heritage and extensive business holdings, the President, as head of the ruling party and namer of the Premier, was in a good position to exert party discipline and exercise influence over potentially recalcitrant back benchers of his party. At the same time, the very existence of the President and the traditional predominance of the Executive Yuan (Cabinet and executive branch) created a dilemma for legislators. They could differentiate themselves and claim credit with voters by blocking or revising bills, but not by passing them, for the voters would simply attribute them to the executive. From the President's perspective, there was also a danger that the Legislature would revise bills along populist lines. The leadership's countermeasure was to parachute star technocrat Vincent Siew (Xiao Wanchang), a former head of the Ministry of Economic Affairs, Planning Council and Mainland Affairs Council into the legislature. After emerging victorious in a tough election campaign against the Democratic Progressive Party in his home district of Jiayi in 1995, Siew then formed a cross-party group (*Caijing Liwei Cujinhui*), to smooth passage of crucial economic and financial bills.

Despite the existence of likely losers from trade liberalisation, and an electoral system prone to particularism, no strong opposition to the WTO emerged: virtually everyone accepted that Taiwan had to do whatever it took to preserve access to foreign markets and major international organisations. Both the greatest support and the most obvious opposition came from the KMT, the largest and most diverse party. Some KMT legislators relied upon technocratic backgrounds or reformist images; those with more particularistic orientations occasionally called for tougher stances or higher tariffs, but generally went along with the party leadership. The DPP was even more committed than the KMT to Taiwan's participation in international organisations. DPP representatives were also more likely than KMT legislators to hail from urban

¹⁶ Interviews with élite bureaucrats in Taipei, January 1997; presentation in Canberra by Democratic Progressive Party (DPP) and KMT representatives, February 1997.

districts; though they asserted an ideological affinity with agriculture as a repository of Taiwan's culture, they would not fight for it. Instead, they were more dependent on the export-dependent small and medium-sized business sector. In addition, as analysts of democratic transition would predict, the DPP, though generally more sympathetic to social welfare than the KMT, favoured a liberal economic policy on trade and industrial issues. As in the ex-Soviet empire, the opposition criticised the ruling party's unfair use of the apparatus of statism. When pressed to help local industries, the DPP tended to advocate promotion rather than protection. Finally, the New Party, while bitterly opposed to the DPP's support of Taiwan independence, also favoured Taiwan's active participation in international organisations. It, too, was largely urban, and was heavily dependent on new middle-class professionals who neither needed nor supported protectionism. Thus, for both economic and political reasons, the WTO initiative faced little organised or principled opposition. The real problems in the legislature revolved around isolated outbreaks of protectionism, particularly from the back benches of the KMT, and conflicts over priorities—for instance, the opposition parties tied up the legislature for much of 1996 in protest of President Lee's decision to name Premier Lien Chan (Lian Zhan) as his running mate—that exacerbated the general inefficiency of the Legislature.

Applying to the World Trade Organisation: negotiations

The Republic of China had been a founding member of the WTO's predecessor (the General Agreement on Tariffs and Trade—GATT) in 1948, but withdrew in 1950 following its retreat to Taiwan.¹⁷ In January 1990, Taiwan formally applied for re-entry into the GATT under the name of the Taiwan tariff area. After delays caused both by American opposition to entry by China and Taiwan's reluctance to make major concessions in areas such as agriculture, Taiwan acquired Observer status in February 1995. In July, many of the necessary legal revisions passed the legislature in Taiwan. Taiwan easily satisfied the basic GATT/WTO criteria. The real test was to conclude an exhausting series of bilateral negotiations with countries dissatisfied with Taiwan's trading practices, totalling about two dozen, and then persuade two-thirds of the WTO membership to support its application. At first, Taiwan

¹⁷ For a timetable detailing Taiwan's campaign to enter the WTO see *1996 Shijie Nianjian* [1996 World Almanac], Zhongyang Tongxunshe, Taipei, 1995, pp. 200–3.

presented a tough posture on a number of issues. However, once the United States made it clear that it would actively support China's entry, the pace of Taiwan's negotiations and concessions suddenly accelerated. Well aware of Taiwan's anxiety, the United States made demands far in excess of those mandated by the WTO. The Legislature proved surprisingly stubborn at first, but once President Lee exerted direct leadership, it reluctantly acceded.

Negotiations covered five areas: agriculture, manufacturing, intellectual property rights, services, and government procurement and monopolies. The toughest negotiations focused on agriculture (as in most countries) and, tellingly, the government itself. Other areas were relatively straightforward, even where domestic interests stood to suffer significant losses. In manufacturing the major controversy involved automobiles. The combination of limited market size, high tariffs, stiff local content requirements and a ban on direct imports from Japan fostered the development of a large but inefficient auto industry in Taiwan. Even with the tariffs, foreign cars, including imports of 'half-breed' Japanese models from the United States, captured one third of the market. Tariff reductions and elimination of the ban on imports from Japan pressured the local assemblers, while the elimination of local content requirements threatened to devastate local parts producers. Both assemblers and parts makers vigorously lobbied the bureaucracy and the legislature. Despite the widespread scepticism about the Legislature's favouritism toward big business, in the late 1980s it forced the Economics Ministry to accelerate tariff cuts. And despite the new entreaties, the Taiwan government made it clear to local firms that a major opening of the market could only be delayed, not postponed. In mid-1995, the economics ministry announced that it would eliminate the crucial local content requirement immediately upon Taiwan's accession to the WTO, even though the trade organisation's rules allowed a two-year grace period after entry.¹⁸ The more difficult problem came in crafting a specific proposal on imports that would satisfy the conflicting demands of Taiwan's trade partners. The government proposed to soften the blow by cutting tariffs as slowly as possible, and by implementing a variable 'tariff quota' system, under which Taiwan would assign each country an initial quota, and increase tariffs in proportion to the number of cars imported from that country. This proposal implied severe limits on imports from Japan, which vigorously opposed the idea as 'unfair trade'. The Koreans and the Japanese jockeyed for relative advantage, eventually winning quotas of 7700 units each, rising to 10 000 units

¹⁸ *Free China Journal* (hereafter *FCJ*), 22 September 1995.

the first year after Taiwan's entry into the WTO, followed by annual increases of 10 per cent. The United States and the European Union received far larger quotas on the basis of their past export records and concentrated on increasing the tariff cuts.¹⁹ While Taiwan's market opening for autos was not complete—tariffs remained fairly high, and Japanese and Korean cars were still subject to discriminatory treatment—the concessions in tariff rates and local content requirements were significant, and taken in the face of stiff domestic opposition. In the end, diplomatic concerns and struggles among Taiwan's trade partners for relative advantage proved more of an obstacle to liberalisation than did interest group liberalism.

Nor did domestic interests prevent revision of laws protecting intellectual property rights. Developing countries rarely excel at protecting patents, copyrights and trademarks. The issues are technically and legally complex, and developing countries have little incentive to prosecute violations vigorously, since they are virtually always big net importers of products rich in intellectual property rights, such as textbooks, computer software, movie videos, CD recordings, pharmaceuticals, Rolex watches and anything with the word Disney on it. Indeed, some economists have argued that developing countries should be allowed to provide a laxer standard of enforcement.²⁰ Even by the standard of developing countries, however, Taiwan, with its myriad of ingenious small firms and its enforced isolation from international legal frameworks, was a stand out. Well into the 1980s, frustrated Western businesses denounced Taiwan as the pirate island and the king of the knockoffs. Within a decade, American pressure and the desire to enter the WTO transformed the scene. In the early 1990s, Taiwan cracked down on pirated books, videos and cable TV providers, and enacted a major revision to the patent law. The passage in mid-1995 of a law protecting the designs of integrated circuits largely completed the legal framework. According to officials at the Planning Council, the key to reform was American pressure and the fear of trade sanctions. Despite the emergence of local firms with significant patent portfolios and valuable trademarks, the domestic balance of power still opposed

¹⁹ Central News Agency (in Chinese; hereafter CNA), 4 February 1997. The Koreans signed a bilateral accord earlier, and received an initial quota of 7000 units, with a 10 per cent increase for the second year. The Japanese were thus given an equivalent quota.

²⁰ Julio J. Nogues, 'Social Costs and Benefits of Introducing Patent Protection for Pharmaceutical Drugs in Developing Countries', *Developing Economies*, vol. 31, no. 1, March 1993, pp. 24–53.

enforcement. When the United States threatened to impose trade sanctions, however, bills flew through the Legislature. The Americans still occasionally expressed concern about enforcement, but intellectual property rights were effectively removed as an obstacle to WTO membership.

Similarly, in alcohol and tobacco manufacture and numerous service sectors, the biggest problem was not demands for protection by local producers, but reluctance of the government itself to reform. The production of beer, alcohol and tobacco was long a highly lucrative government monopoly. As with autos, entry into the WTO would cause the local industry to lose much of the market to more prestigious foreign brands. The government vowed to privatise the alcohol and tobacco monopoly, but opposition from the union slowed progress. In finance, American pressure to provide greater access to foreign banks, insurance companies and securities houses resulted in some liberalisation, but the government was reluctant to cede control in a crucial sector long subject to tight regulation and dominated by government and party-owned firms.

As in other countries, agriculture was particularly contentious. Taiwan sided with Japan and South Korea in seeking to delay the effective opening of rice markets as long as possible. In the end, despite the enormous practical and symbolic importance of rice production, Taiwan agreed to adopt the extremely gradual Japanese formula for opening the rice market rather than the agonisingly slow approach granted to Korea (six years after entry rice imports would total 8 per cent of the market, as opposed to just 4 per cent after ten years in Korea). Taiwan renounced price supports for corn and soy beans, and entered tough negotiations over frozen chicken, milk, and other agricultural products. Particularly important and revealing were the negotiations over beef. The existing two-sector tariff scheme not only protected local beef producers, it also gave a special advantage to American exporters of cattle fed in feed lots. Representatives from Canada, Australia and New Zealand demanded removal of the bias against range-fed beef.²¹ Clearly, interest group lobbying and political pressure were important considerations in the agriculture negotiations. Yet even in agriculture the Taiwan government made fundamental concessions at the expense of private local producers, and found many of its trickiest problems to involve conflicts of interests among its trade partners. If agriculture received wide coverage, almost no media attention was paid to government procurement, an area in which the Taiwan government proved surprisingly

²¹ *Free China Review*, February 1995, pp. 54–4.

stubborn. Taiwan sought to restrict the scope of agreements over government procurement, and fought attempts to lower the minimum value of government construction contracts subject to international bids.

The combination of the PRC's unwillingness to see Taiwan precede it into the WTO, and the US government's exceedingly tough demands of the PRC made it impossible for Taiwan to attain its goal of entering the WTO as a founding member. Notwithstanding these delays, Taipei remained committed to joining the WTO, and it announced major concessions in such areas as rice and autos. By Spring 1997, it succeeded in reaching agreement with all but a handful of trade partners. Apart from the PRC, the biggest barriers to Taiwan's entry were not local firms and their political supporters, but opposition from protected parts of the government itself and, ironically, conflicts among Taiwan's trade partners.

The Asia Pacific Regional Operating Centres initiative: players and preferences

The plan to develop Taiwan into a base for the headquarters activities of multinational corporations operating in East Asia implicated a greater variety of actors and objectives than did the negotiations to enter the WTO. The Ministries and agencies involved fell along a spectrum defined by their core tasks, from planning to promotion, protection and regulation. The lead agency for APROC was Taiwan's premier planning agency, the Executive Yuan's Council for Economic Planning and Development. The CEPD was a direct descendent of the agencies entrusted with managing US aid in the 1950s and 1960s. In the early years its central task, American connections and elite status allowed it to hire specialists at salaries far above those available in the regular bureaucracy. It actively participated in designing specific projects, and adopted a pragmatic approach to its job. Its influence on policy fluctuated somewhat depending upon its relation to top leaders such as the Chiangs, their retainer Yu Guohua and leading technocrat K.T. Li (Li Guoding), but its staff was increasingly dominated by American-trained economists and its orientation increasingly liberal (it is ironic that while American economists regularly denounce economic planning, in East Asia planners such as the CEPD, Korea's Economic Planning Bureau and Japan's Economic Planning Agency are among their most loyal followers). While the Planning Council enjoyed the greatest prestige, it was directly responsible for the actual implementation only of overall planning and macro-level deregulation. Implementation of the six centre plans fell under the jurisdiction of line agencies such as Economics and

Transportation. This made the CEPD's job of coordination more difficult, but it also vested overall authority in the hands of an agency with few links to vested interests. The earliest and most vigorous advocate of the notion that Taiwan had to encourage multinational corporations to conduct headquarters activities in Taiwan, and that deregulation was the key to attracting and retaining them, was Dr. Chi Schive (Xue Qi), Chairman of the Department of Economics at National Taiwan University. Born in the mainland, raised in Taiwan and trained in the United States, Schive was brought in as Vice-Chairman of CEPD to spearhead the APROC initiative, to which he brought enormous drive and a sense of mission that quickly pervaded the ranks of the CEPD.

The agency most dedicated to promotion was the Ministry of Economic Affairs, particularly its Industrial Development Bureau. Responsibility for the welfare of local industries and a more varied set of career patterns—many of its leading officials had backgrounds in engineering rather than economics—made the Ministry less inclined than the CEPD to defer to the market on all occasions. However, it was less closely tied to local industry than Japan's Ministry of International Trade and Industry or even the Ministry of Trade, Industry and Energy in Korea. Taiwan's export dependence and the Ministry's control over large budgets and formidable quasi-state research agencies rendered it more oriented to promotion than protection. The lack of a hard and fast 'up or out' rule and the opportunity to move into a variety of other agencies or state-related companies made MOEA officials much less reliant on securing *amakudari* (descent from heaven) posts in the private sector for retiring officials than was the case in Japan. The Economics Ministry viewed APROC as an opportunity to increase Taiwan's already successful high-tech manufacturing sector. The Ministry promoted strategic alliances with foreign multinationals, and developed new high-tech industrial parks modelled on the phenomenally successful Hsinchu (Xinzhu) Science-based Industrial Park. For the MOEA, the fruits of liberalisation in service sectors would accrue to its major clients in manufacturing, but the costs and disruption would fall largely on other ministries. If not as zealous as the Planning Council, the Economics Ministry viewed APROC as a positive development.

Further down the spectrum toward protection and regulation lay the Ministry of Transportation and Communications (MOTC) and the Government Information Office (GIO), largely because the industries they oversaw were oriented to the domestic market. They, too, were basically positive, but they took a more cautious approach. APROC represented an opportunity to upgrade the facilities and competitiveness of their sectors, and thus justified larger budgets, and allowed them to claim credit for any improvements. On the other

hand, APROC looked likely to impose painful and disruptive effects on some local firms and workers, while much of the direct gain of APROC, especially at first, was likely to accrue to foreign firms or other sectors. To the extent that bureaucrats care about ease of regulation, it behooved the GIO and the MOTC to tread carefully. The telecommunications monopoly, in particular, was overstaffed, overpaid and uncompetitive, and any attempt to open it up was sure to face resistance. The Transport Ministry, which had a major role in almost all of the infrastructure projects in the APROC initiative, also faced constant pressure to cave in to particularistic demands from politicians and local construction companies. MOTC officials thus faced a painful dilemma: acquiesce, either from greed or impatience to get the projects rolling, and face possible accusations of corruption and incompetence, or resist, and take the blame for delays in implementation of projects vital to the success of the APROC venture. In all, the MOTC and GIO were less resistant to change and deregulation than ministries in Japan or Korea, but they faced strong pressures to move slowly and cautiously, and they were not primarily oriented to international competitiveness.

Most cautious of all were the regulatory agencies. The Ministry of Finance and the Central Bank of China faced many of the same pressures as the MOTC, but were also responsible for the financial stability of the entire economy. The Ministry of Foreign Affairs and the security and labour agencies also stood to gain little from APROC, while liberalisation of the movement of people raised concerns about a possible influx of illegal workers and communist spies and inability to catch economic criminals fleeing for foreign havens. The security agencies also worried that even legitimate liberalisations would lead to excessive reliance on the mainland. The motivations and attitudes of the Ministries and Agencies thus varied from the zeal of the planners at the CEPD to the caution of the regulators at the Central Bank and the security agencies. Actual implementation, especially in finance and telecommunications, the areas most in need of reform, lay in the hands of agencies whose motivations were mixed. As a result, the need for coordination and policy drive from the top was especially pressing.

Unfortunately for the reform effort, the top political leadership was less committed to APROC than to the WTO. President Lee's main concern was foreign policy, and while the APROC initiative had a definite foreign policy component, it was not linked to any specific international organisation, nor did it garner any clear recognition of Taiwan's position on the international stage. Moreover, it highlighted and threatened to exacerbate one of the greatest obstacles to Taiwan's attempts to gain greater autonomy and security: the

island's increasing economic dependence on the mainland.²² The mainland market had already become crucial for some companies, and the rapid increase in indirect trade and investment led to fears that Taiwan's economy was becoming 'hollowed out'. The way a huge influx of PRC capital had swayed the business community in Hong Kong well before 1 July 1997 was an ominous portent to many in Taiwan. These fears had led to the incorporation of the policy of 'three nos' in Taiwan's national unification guidelines: Taiwan would not open direct trade, transportation and communication links until the PRC stopped treating Taiwan as a renegade province and recognised it as an 'equivalent political entity', and renounced the use of force as a means to reunification.²³

Of course, the guidelines left considerable room for interpretation of 'direct' ties. President Lee, the Foreign Ministry, the Mainland Affairs Council and the Central Bank all tended toward the most conservative possible construction. Officials at most of the line agencies, particularly the Planning Council and Economics Ministry were privately impatient with what they regarded as unrealistic and unprofitable approaches, and they constantly pushed more aggressive policies to smooth the division of labour with the mainland and maintain Taiwan's attractiveness as a centre of headquarters operations. Nonetheless, they were unable to challenge the President directly. They were occasionally forced to back pedal, particularly after August 1996, when the President called on large Taiwan companies to exercise restraint in their mainland investments. Lee's campaign blocked (or at least delayed) a number of large projects in the mainland, and led to tighter scrutiny of investments in Taiwan by Hong Kong firms in which the PRC had even a small capital share.²⁴

Timing was also less favourable to APROC than to the WTO. APROC lacked a specific and pressing deadline, and was intended to stretch over a decade or more. This left it vulnerable to policy fatigue and changes in personnel. In Taiwan, unlike the case in Japan, new ministers generally try to

²² Heather Smith and Stuart Harris, 'Economic Relations Across the Taiwan Strait: Interdependence or Dependence?' in Greg Austin, ed., *Missile Diplomacy and Taiwan's Future: Innovations in Politics and Military Power*, Strategic and Defence Studies Centre, Research School of Pacific and Asian Studies, The Australian National University, 1997.

²³ The relevant documents are collected in 1996 *Shijie Nianjian*, pp. 713–59.

²⁴ CNA, 14 August, 14 September 1996; *Gongshang Shibao* (hereafter *GSSB*), 22 October, 12 November 1996.

make a mark by impressing their own agendas on the agencies they are chosen to lead. Only a year after the initiation of APROC, leadership of the Planning Council was taken out of the hands of Xu Lide, the mainlander bureaucrat who was concurrently serving as assistant head of the Cabinet, and placed in the hands of Jiang Bingkun, a Japanese-trained Taiwanese who had previously headed the Economics Ministry, and showed less zeal in his enthusiasm for the inherited task of promoting APROC.

Business and the public were generally supportive of APROC, if hazy on the exact details and the underlying conception. APROC grabbed the popular imagination as a plan for Taiwan to replace Hong Kong as a home for multinationals after the colony reverted to China in 1997. Public excitement helped legitimate and energise the plan, but also paved the way for disillusionment, since few multinationals were about to depart Hong Kong, and the handful that left headed for Singapore rather than Taiwan. Despite diffuse support for the idea of APROC, neither the public nor the business community was as *laissez-faire* as the CEPD. Both viewed the government as responsible for economic performance, and were sceptical about the government's ability to implement the bold APROC agenda. The business community became increasingly impatient with the government's insistence on sticking to the 'three policy limiting direct contact with the mainland'.²⁵

Unlike WTO, the APROC plan engendered a clear opposition force: public sector agencies and their workers. The telephone monopoly, the three dominant commercial banks owned by the Provincial Government, ports and airports, quasi-public construction agencies, even the post office all faced the prospect of new competition, corporatisation and eventual privatisation. Few stood to gain from APROC: the manufacturing sector, focus of the plan, contained but a handful of publicly-owned enterprises, and many of them, including China Steel, were already well on the road to privatisation. At first glance, the public sector unions seemed unlikely dragon-slayers. They were neither numerous nor radical, nor did they enjoy particularly close organisational links with any of the parties. The largest, the telecommunications monopoly, boasted only 36 000 workers. However, the workers were well organised and well educated, and they had plenty at stake. They were used to high salaries, absolute job security, relatively pressure-free jobs, and the status accruing to public sector positions that had been won on the basis of stiff examinations. A minority of workers believed that the new firms and technological innovation encouraged

²⁵ Lianhe Bao, 1–3 January, 1996.

by APROC would bid up the price of experienced personnel, particularly in telecommunications and finance. However, with flexibility came vulnerability, and most workers looked to the legislature to help protect their jobs, or at least win better concessions.

In principle legislators, like the public and business community, were favourably disposed to the APROC plan, though it was not always their top priority. As always, the prospect of infrastructure spending appealed to representatives, and they generally agreed that some deregulation was necessary. In practice, the legislators wanted to show their responsiveness to affected constituents, and to claim some credit. During the Presidential election of 1995 and early 1996 the DPP criticised the APROC plan as biased against local industry and culture, particularly small firms, and for deliberately increasing Taiwan's dependence on the mainland.²⁶ After the election it became more positive, seeing APROC as a valuable tool for liberalisation. Still, APROC was never at the top of the party's agenda. More severe opposition came from the Provincial Assembly, long infamous in Taiwan for its corruption and particularism. In most countries, the more local the assembly, the less weight carried by party labels and ideology, and the members of the Provincial Assembly were no exception. If Provincial agencies were corporatised, privatised or just reformed, the members of the Assembly had little to gain, and plenty to lose in the form of patronage and opportunities to help constituents (and themselves) .

The Asia Pacific Regional Operating Centres initiative: implementation

In its broadest sense, the APROC plan dated back to orders issued in 1984 by President Chiang Ching-kuo (Jiang Jingguo) and Premier Yu Kuo-hua (Yu Guohua) to 'internationalise, liberalise, and institutionalise'. More immediate influences were the success of Singapore's 1986 plan to use a low tax rate of 10 per cent to attract 'operational headquarters' of multinational companies, the Economics Ministry's strategic alliance program, and the writings of academic economists such as Schive. The first major political figure to take the initiative was Vincent Siew, then head of the Economics Ministry, who presented the broad outlines of the plan to the Central Committee of the KMT in February of 1993. The Planning Council hired the American consulting firm McKinsey to

²⁶ *Gei Taiwan yi ge Jihui* [Give Taiwan a chance], Minzhu Jinbudang, Taipei, 1995, pp. 104-6.

draft a strategic focus that would appeal to multinationals. In January 1995, the Executive Yuan formally endorsed the plan. In April, Premier Lien Chan announced five guiding principles:

...focusing primarily on competition policy instead of industrial policy; relying on facilitative and constructive rather than regulatory and constrictive policies; redefining government's role as an umpire instead of a player to maximise private participation; adopting the reporting system in lieu of approval system; ensuring policy transparency to delimit the purview of government responsibility.²⁷

The Planning Council took responsibility for overall deregulation. In the first two years, it made significant headway. Of a total of 110 regulations (*xingzheng mingling, cuoshi*) listed for revision, 94 (85 per cent) were completed by September 1996. This fell behind the original (and perhaps deliberately optimistic) target of complete revision by December 1995, but represented impressive progress nonetheless. Passage of new or revised laws proceeded rather more slowly: by September, 1996 only fifteen of 40 laws had passed the legislature.²⁸ Many of the revisions fell under the ambit of specific centres, but several important revisions was pushed directly by the CEPD. Among them were relaxing restrictions on direct foreign investment in many service industries, including telecommunications, travel and electricity generation, and liberalisation of visa and exit procedures for foreign white-collar workers. For decades, foreign business people were required to register with the police and present tax records every single time they left the island. Those cumbersome regulations alone were enough to deter many foreign companies from establishing headquarters functions in Taiwan, and their elimination marked a major breakthrough.²⁹

²⁷ *Nation's Business*, October 1995, p. 59.

²⁸ Xingzhengyuan Jingjijianshe Weiyuanhui, 'Fazhan Taiwan Chengwei Yatai Yingyun Zhongxin: Banli Qingxing yu Chengguo' [CEPD, Developing Taiwan into an Asia-Pacific Regional Operations Centre: The State of Implementation and Results], December 1996, p. 23. This document is also the source for much of the discussion of implementation for the six centres below. For the original targets, see Council for Economic Planning and Development, Executive Yuan, 'The Plan for Developing Taiwan as an Asia-Pacific Regional Operations Center', 5 January 1995, p. 46.

²⁹ CEPD, 'Entry and Exit Requirements Eased', *Industry of Free China*, August 1996, pp. 123–6.

Development of the manufacturing centre proceeded relatively smoothly. The Economics Ministry continued its campaign to form international strategic alliances with major foreign high tech firms. In Korea, the giant *chaebol* conglomerates were able to enter into direct alliances with foreign multinationals, particularly from Japan. In electronics, Samsung paired up with NEC and LG (Lucky Goldstar) with Hitachi, while Samsung used a new alliance with Nissan to enter the auto industry. Taiwan's smaller firms brought less to the negotiating table, so the Economics Ministry took the initiative itself, offering tax breaks to offset partially rates of taxation on foreign corporations that were far higher than those of Hong Kong and Singapore. In return, the foreign companies agreed to engage in major investments in Taiwan, particularly in research. Many, but by no means all, established some sort of regional operating centre in Taiwan: General Motors, Motorola, Dupont, Texas Instruments and Philips were among the best known. The CEPD was not entirely comfortable with the concept of discretionary tax cuts, but they gave the Economics Ministry flexibility, and engendered less opposition from the Finance Ministry than major cuts across the board would have. One important guest was missing from the party, however: out of dozens of strategic alliances signed by the Economics Ministry, not one involved a Japanese partner. In reality, a number of Japanese companies entered into *de facto* alliances with individual Taiwan companies. The increasingly interdependent relationship between Japan's giant electronics and machinery company Hitachi and Taiwan's leading computer firm Acer was a prominent example. However, fear of mainland retribution prevented Japanese companies from entering into formal alliances with the Economics Ministry.³⁰ Nor were locals entirely happy with the breaks given to foreign multinationals. Stan Shih (Shi Zhenrong), Chairman of Acer, asked why the government did not sign similar agreements with local firms that wanted to go global.³¹

In addition to the strategic alliance program, the Economics Ministry accelerated support for local research and development, and began work on a series of 'intelligent industrial parks'. In the mid-1960s, Taiwan pioneered in the development of labour-intensive export processing zones. In the 1980s, following the experience of Silicon Valley in California, it established a Science-based Industrial Park near the university town of Hsinchu, creating

³⁰ *Shangye Zhoukan*, 23 December 1996. On Acer–Hitachi, see *Nikkei Weekly*, 23 December 1996.

³¹ *China Post*, 4 June 1996.

perhaps the most successful planned science park in the world. By the 1990s, Hsinchu was packed with a mix of venture start ups and giant factories, and the government began work on a clone in the southern university town of Tainan. Then with the advent of the APROC program, the Economics Ministry planned a series of twenty to 30 industrial parks sprinkled across the island and linked with the latest telecommunications hardware. The MOEA assumed responsibility for overall planning and provided assistance in acquiring land-use permits, but actual development of the parks was delegated to the private sector. Acer led the way with a multi-billion dollar development focused on computers and semiconductors, but including housing for workers and other amenities.

In electronics, Taiwan's future appeared very bright indeed. By the mid-1990s, Taiwan emerged as the premier site for the design and production of notebook computers, while the semiconductor industry grew at extraordinary rates. Even software, starting from a small base, made impressive strides. Moreover, more and more Taiwan firms developed their own brands, and even production on consignment from Western or Japanese firms increasingly depended upon local designs. Few other high technology industries were able to match this dynamic growth. For example, despite the government's attempts to promote biotechnology, the modest size of Taiwan's market and its limited pool of biologists, combined with the lack of a link to labour and skill-intensive assembly operations, led multinational pharmaceutical companies to move away from Taiwan rather than locate regional centres there.³² More generally, the spread of liberalisation and direct foreign investment in Asia led to an increasingly specialised division of labour. No longer could Taiwan produce all but the highest tech items at home. This specialisation made sense to economists: if Taiwan is good at electronics, let it produce electronics. To locals, however, it seemed that most industries were stagnant or declining, while their fortunes were increasingly tied to a handful of cyclical industries (and the volatile mainland market). Moreover, as Taiwan moved away from labour-intensive production, the first signs of structural unemployment began to emerge. Manufacturing was Taiwan's star, but as the island emerged as a developed economy, no longer could it guarantee perpetually rapid growth and zero unemployment. Improvement in services was also crucial.

Reform in Taiwan's conservative financial sector was more pressing but slow and difficult. Financial regulators everywhere fear instability, capital

³² GSSB, 8 January 1997.

flight and inflation, but historical experiences and international vulnerability made authorities in Taiwan especially apprehensive. In the 1940s, the KMT lost the mainland in good measure because it was unable to conquer hyperinflation, and in the extraordinarily flexible global financial environment of the 1990s the government feared that Taiwan could be subject to devastating outflows of capital. The spectre of PRC manipulation of the Taiwan economy haunted local regulators. Financial regulators were also well aware of widespread corruption at the local level. They knew that the Provincial Assembly used its control over the budgets of the three major commercial banks to obtain illicit influence over loans, personnel and procurement. For decades the solution to possible instability and corruption was to insist upon public ownership of banks, and to regulate every aspect of the financial industry, from loan rates to the number of branch offices. Ubiquitous regulation reduced opportunities for corruption and maintained comfortable profits and payments to the Provincial Government. Unfortunately, it also made the banks rigid and insensitive to costs, and obviated the need to learn to balance risks and returns. Collateral, not business plans and cash flow, became the basis for loans. Local wags referred to banks as 'pawnshops'. The strategy of limiting competition and innovation so as to maintain the profits of all banks was carried out even more strictly than in Japan. As a result, the effect of the 'bubble economy' was less severe, but the costs in reduced flexibility and efficiency even greater. Taiwan businesses faced one of the most sclerotic financial systems in Asia. With democratisation and the growing sophistication of the Taiwan economy, the pressure to break this regulatory stranglehold grew. Reforms began in the mid-1980s. In the early 1990s, the government allowed the entry of a slew of new private banks, and relaxed restrictions on establishment of branches by foreign banks. These measures eased the situation somewhat, but as long as regulation remained pervasive, the new private and foreign banks had a difficult time luring clients from their accustomed banks.³³

APROC financial reforms thus had two components. First, they aimed to loosen regulations of all types, easing new entry and provision of new financial instruments. Eventually, the Planning Council hoped to privatise the three leading Provincial banks. The government also recognised that reduced regulation would create the need for greatly enhanced monitoring systems to ensure the stability and honesty of the financial system. The CEPD pushed for the

³³ Hugh T. Patrick and Yung Chul Park, eds, *The Financial Development of Japan, Korea, and Taiwan: Growth, Repression and Liberalization*, Oxford University Press, New York, 1994.

establishment of private credit rating agencies to facilitate evaluation of both would-be borrowers and the financial institutions themselves. Stronger monitoring by the government also seemed necessary, but the CEPD's emphasis on deregulation made this a lower priority, and the Ministry of Finance and the Central Bank of China remained reluctant to undertake the task, pushing responsibility off on each other even as scandals broke out at increasing numbers of local cooperatives.

The two financial agencies also clashed over the pace and focus of reform. The initial APROC plan placed overall responsibility for financial reform in the hands of the Central Bank of China. The Central Bank placed priority on the development of offshore banking and foreign exchange trading and the need to allow Taiwan to compete with Hong Kong and Singapore for regional financial trading. President Lee, Premier Lien and the CEPD worried that this approach was unrealistic and risked delay of reform of the crucial domestic banking and securities industries, a concern forcefully articulated by the foreign banking community.³⁴ Eventually the Central Bank accepted that Taiwan needed domestic reform and not just offshore services, and announced that it would strive for full capital convertibility 'in principle' by the year 2000, a goal not mentioned even in the original APROC timetable for 2005. To help implement the change in emphasis, the Ministry of Finance was assigned an equal role in deregulation, and the Deputy Governor of the Central Bank moved over to assume the post of Minister of Finance.³⁵

As the Planning Council and the financial authorities moved to a more aggressive posture on liberalisation, they also carried out a number of specific reforms. The Ministry of Finance agreed to stop taxing financial transactions not subject to taxation in other countries. Restrictions on foreign exchange holdings and trading were relaxed, as were regulations on futures, gold and currency markets. Review periods for issuance of corporate bonds were reduced

³⁴ The Banking Committees of The American Chamber of Commerce and The European Council for Commerce and Trade, 'Taipei as a Regional Financial and Funding Center', Taipei, 9 June 1995.

³⁵ Christopher Fruean, 'Banking on Finance', *Free China Review*, October 1996, pp. 34–41. The original APROC plan assigned primary responsibility for financial deregulation to the Central Bank of China (*Yatai Yingun Zhongxin Jihua*, Diyiufen, 58 ye). By the December 1996 review, both agencies were listed, with the Ministry of Finance in Front. 'Banli Qingxing', p. 18. Where the financial authorities talked of 'freedom as the principle, approval as the exception', the CEPD's review also listed the goal of financial

Fruean, 'Banking', p. 36; 'Banli Qingxing', p. 84.

by more than half. The monopoly once held by a KMT-owned company on bills financing was broken, and three new firms entered the market. The number of foreign securities firms increased sharply, as did the number of foreign bank branches. For example, the four leading Japanese securities companies all entered the Taiwan market. The Ministry of Finance relaxed a number of restrictions on the local operation of foreign insurance companies, and significantly liberalised and accelerated approvals of the rates and instruments available to insurance companies. Limits on foreign investment of local stocks were effectively doubled, to 10 per cent for holdings by one foreign investor in one local firm, and up to 25 per cent for aggregate holdings by foreign investors in the entire stock market.

In a few cases, particularly regarding financial relations with the mainland, the Central Bank of China effectively blocked reforms. Relaxation of restrictions was common, but radical deregulation almost unknown. Reform of the critical banking sector was especially slow. Banks were not allowed to establish branches on the mainland to service the direct foreign investments of their Taiwan-based customers, and privatisation of the three main commercial banks made little progress. In other cases, reform came too slowly to aid in the development of local markets. A bill to allow development of a stock futures exchange was bottled up in the Legislature. When exchanges in Chicago and Singapore took the lead in creating a Taiwan index, the financial authorities initially refused to cooperate with them, only to cave in when it became clear that the foreign indexes could not be blocked.³⁶

In sum, progress in financial deregulation was slow and painful, and little progress was made in improving monitoring. Few outside analysts believed that Taipei would take any business away from Hong Kong or Singapore. Nonetheless, progress there was. In the words of a prominent foreign banker in Taipei:

It seems to be government practice that for every loosening in the industry, there is a corresponding tightening somewhere else. It's one step forward, a half step back, and one sideways...Nevertheless, considering what the market was like five years ago, there has been significant progress.³⁷

³⁶ *FCJ*, 7 March 1997.

³⁷ Fruean, 'Banking', p. 41.

Indeed, in some cases, notably capital liberalisation, the goals became more ambitious over time. The irony of financial reform was that in many ways internationalisation was easier than domestic reform. Real liberalisation required deregulation or even privatisation, but it threatened the public banks that controlled over two-thirds of the assets in Taiwan's banking system.³⁸ While some of the managers of the public banks welcomed the prospect of liberalisation from the Provincial Assembly and its rapacious politicians, most employees did not.

Major reform, including corporatisation, did take place in another crucial sector, telecommunications. Traditionally, Taiwan's telecommunications system excelled at hardware and provision of basic services, but trailed in software and business development. The telecommunications monopoly's accounting system was so primitive that it could not even determine the share of profits coming from each of its operations. By the early 1990s, the island was one of the last places in Asia with a telecommunications monopoly and no independent regulatory apparatus. In January 1996, after two years in the bureaucracy and three years in the legislature, a package of three bills to reform telecommunications finally passed. Umpire and player were finally separated: the Directorate General of Telecommunications, the old monopoly provider, was turned into the Zhonghua [China] Telecommunications Company, while the Ministry of Transportation and Communications retained responsibility for oversight. The new framework created two levels of service. While the government retained tight control over basic telecommunications providers, it almost completely deregulated value-added services. Private investors were allowed to provide value-added services such as data communications and mobile communications, including cellular phones and paging services. Under the stimulus of the APROC plan, long-distance and international phone rates were reduced significantly. New internet services were introduced and rates on international data transmission dropped dramatically. Almost immediately business and household customers reported an improvement in Zhonghua Telecommunications' service, flexibility and marketing skills. Zhonghua Telecommunications began to develop sorely-needed accounting and monitoring systems to determine its own costs, improve productivity, and meet the coming age of competition.

Despite this progress, both the Legislature and the new phone monopoly posed obstacles to further reform. The long delay in passing the telecom-

³⁸ Central Bank of China, *Annual Report 1995*, p. 43.

munications laws resulted mainly from opposition by the telecommunications union, which organised numerous rallies and raucously encircled the Legislature Yuan for days on end. The compromise that finally paved the way for passage of the laws provided complete job security for all existing employees. However, the union opposed the government's plans to open up all voice services to competition by 2001, and eventually to privatise Zhonghua Telecommunications. Even though their jobs were secure, the majority of workers feared that their high wages and easy working conditions might suffer in a more competitive environment. The Legislature changed the plans submitted by the executive branch in several other ways as well. First, where the Executive Yuan had suggested limiting foreign ownership of Type I basic telecommunications providers such as cellular phone companies to 30 per cent, the Legislative Yuan reduced the limit to 20 per cent. The United States protested vigorously, and the Executive Yuan sought a compromise by providing a controversial interpretation of the law that effectively allowed foreign companies to control 50 to 60 per cent of companies. Second, while the new telecommunications laws specifically outlawed cross-subsidisation, all three parties adopted a populist line and blocked any increase in the long-frozen and heavily subsidised local telephone rates. Third, while reviewing the budget of Zhonghua Telecommunications, the Legislature introduced an unprecedented number of resolutions, most calling for increases in workers' benefits.³⁹

Saddled with a large and highly paid workforce, and with little experience maximising profits, the new telecommunications company tried to tilt the playing field in its own favour. The Ministry of Transportation and Communications, well aware that the Zhonghua was not productive, and that weaknesses in the company could imperil the whole sector, tended to go along. Zhonghua tried to limit the spectrum available to wireless communications operators, and charged high fees for access to its local lines. While private firms had to compete for cellular licenses, Zhonghua was simply given a license. The Communications Ministry used privatisation as an excuse to proceed slowly on reforms, even though regulators in Australia and (ironically) *laissez-faire* Hong Kong had successfully used bench-marking of rates to force monopoly operators to improve operating efficiency.⁴⁰ In general, though, complaints from new operators gradually pushed in the direction of a more level playing field.

³⁹ GSSB, 3 December 1996.

⁴⁰ *Free China Review*, 'Crossed Lines and Missed Connections', April 1996, p. 34.

Thus, while telecommunications was among the most important and most backward service sectors in Taiwan when the APROC initiative began, passage of the three telecommunications bills paved the way for far-reaching reforms in service, competition and rates. The complaints of private firms mostly served to increase competition rather than decrease it. The telecommunications union managed to pry a guarantee of job security out of the Legislative Yuan, though concerns about pay and productivity remained. Finally, tense relations with the mainland constituted but a minor impediment to telecommunications reform. The ban on direct calls prevented the deployment of telecommunications cables linking the two sides of the Taiwan straits, but calls to the mainland—the single largest destination for outbound calls from Taiwan—were simply switched by third parties such as Japan for a modest fee.

In contrast, marine shipping began the APROC process in a stronger competitive position, but was more hampered by relations with the mainland—as well as labour problems. Marine shipping in Taiwan enjoyed several advantages, including Taiwan's central location in Asia, one of the world's great natural harbours at Kaohsiung (Gaoxiong), and the business generated by a large and trade-dependent manufacturing sector. Indeed, Taiwan's leading shipping company, Evergreen, grew to be the largest and most profitable container line in the world. Nevertheless, over the early 1990s, Gaoxiong lost ground to Hong Kong and Singapore in container shipping. They enjoyed access to large and rapidly growing hinterlands in southern China and Southeast Asia, respectively, while Gaoxiong suffered from restrictions on direct shipping to the mainland. At least as important were the inefficiency and high costs in Gaoxiong, particularly the inability of shipping companies to own and manage their own operations and hire workers directly. Gaoxiong Harbour was hamstrung by conflicting jurisdictions, as Gaoxiong City and the Provincial Government were used to treating the Harbour as an easy source of revenue and patronage.

The Transport Ministry and the CEPD took a number of steps to ameliorate conditions for shippers, but fundamental breakthroughs proved more elusive. They poured considerable effort into automating customs procedures and electronic links to the international airport at Taoyuan. They strove to reduce paperwork and simplify safety procedures. They opened up some wharf and container operations to foreigners, and both Hyundai and Maersk established new operations in Gaoxiong. The CEPD persuaded the Executive Yuan to establishment a retirement and compensation fund for longshoremen, but implementation proved elusive, and in the meantime shippers were forced to work with aging and cosseted workers. Partly for that

reason, there was no fundamental breakthrough on the privatisation of operations. Similarly, some progress was made in construction, particularly the completion of the first stage of a new container facility in Gaoxiong, but upgrading of the vital inland transport links remained elusive.

In contrast, while relations with the mainland suffered periodic setbacks over Taiwan's efforts to enter the United Nations, the mainland's intimidating missile exercises near Taiwan, and other issues, the two sides edged nearer to direct shipping links. Taiwan had three major goals: it wanted to avoid granting the mainland direct shipping ties, maintain its image as an independent international entity, and uphold competitive and efficient shipping practices. The definition of 'direct links' became muddy, but Taiwan's bottom line was to avoid allowing goods to or from the mainland to pass through customs in Taiwan. The PRC's goals, in contrast, were to uphold the principle of one China, allow two-way direct shipping and secure mutual benefits. In practice, this meant getting as close to full direct shipping as possible, portraying shipping across the straits as strictly domestic, and managing and protecting its own large and complex shipping industry by forcing Taiwan and foreign shippers to enter into joint ventures with mainland shipping companies, and by exercising control over market entry and rates. Faced with this prolonged conflict of principles and interest, the Taiwan government tried three approaches. The initial APROC plans called for establishing 'off-shore transshipment centres', beginning with Gaoxiong. This vision called for Gaoxiong to compete with Hong Kong; the port would serve ships originating in or destined for third areas; it would not handle outbound cargo from Taiwan, nor would goods pass through customs. When the mainland boycotted this conception, authorities in Taiwan considered other options, such as allowing goods to pass through customs if they were carried by foreign ships (including those flying flags of convenience) which stopped at third ports before or after sailing to the mainland. The CEPD and the Industrial Development Bureau pushed for the establishment of special economic zones, which would include manufacturing, finance, trade and other services, but technically would not involve the passage of goods through Taiwan's customs.⁴¹

After a long delay, the PRC finally responded to the APROC transshipment plan with an alternative plan in August 1996, and implementing regulations in November. After extended 'unofficial' talks in Hong Kong, the two sides

⁴¹ *FCJ*, 19 July 1996; *GSSB*, 24 January 1997.

reached agreement on specific arrangements using flags of convenience in early 1997. The Hong Kong agreement called for commencement of shipping between Gaoxiong and Xiamen and Fuzhou, two ports north of Hong Kong in Fujian Province. Shippers were to apply to their own 'unofficial' associations first, then to the other side. Taiwan announced that it would impose no restrictions on entry or pricing, but the mainland exerted controls over both. The two sides pledged that they would not make rigid demands on flags, nomenclature and the like, and claimed that exact reciprocity was not necessary.⁴² The next day, Taiwan's Transport Ministry announced that it would allow 'simple processing' up to 35 per cent of the value of transhipped goods.⁴³ It also worked on plans to help local shippers in compensation for the possible losses suffered by Taiwan shippers not flying flags of convenience.⁴⁴ By April 1997, the first cargo ships crossed the Straits of Taiwan. In shipping, as elsewhere, the looming retrocession of Hong Kong exerted increasing pressure on Taiwan to reach a *modus vivendi* with the mainland. The chief obstacle to progress was clearly ideological and political rather than economic, and the government in Taiwan seemed capable of developing techniques to pay necessary side payments to the few losers from liberalisation.

The key issue in developing an air centre hinged not on relations with the mainland, but on tensions between local and global shipping companies.⁴⁵ Like marine shipping, air shipping enjoyed the advantage of Taiwan's central location and strong manufacturing sector. In addition, express cargo benefited from the increasing tendency for Taiwan's electronics companies to work on a 'just in time' basis, as well as the 'fifth freedom' rights granted by the Taiwan government (but not by Hong Kong and many other countries) to foreign airlines to pick up passengers and cargo at other airports and then fly them beyond to other destinations. The government was intent upon luring global shippers to establish service centres in Taiwan, even if it meant exposing local shippers and freight forwarders to intense competitive pressure. The initial stage of deregulation and development was oriented primarily to the handful of Western carriers capable of providing fully integrated pickup, processing and delivery operations using their own fleets of cargo planes: Federal Express (FedEx), United Parcel Service (UPS), TNT and DHL. Unlike Singapore,

⁴² *Zhongguo Shibao*, 23 January 1997.

⁴³ *GSSB*, 24 January 1997.

⁴⁴ *GSSB*, 5 December 1996, 9 January 1997.

⁴⁵ *Free China Review*, July 1996, pp. 46–55.

Taiwan was unable to provide 24 hour customs service for all express cargo, much less regular cargo. Thus, the Transport Ministry moved first to create a 24-hour Express Handling Unit to expedite customs clearance for parcels. Firms were required to use sophisticated Electronic Data Interchange (EDI) systems that few local firms possessed, and a special fee was imposed to pay for the 24-hour service. As a result of remaining paperwork, including 32 approval seals, and stiff limits on weight and value imposed because of the lack of customs officers, the new zone operated far under capacity. Next, the Ministry opened an integrated cargo zone that allowed freight companies to operate their own ground crews and bonded warehouses and provided 24-hour customs services right at the international airport. Due to space limitations, only integrated firms were allowed to bid for the space, which gave rise to bitter accusations from local firms that the foreigners were being given special privileges. After extensive negotiations, UPS won, largely because it accepted Taiwan's rate structures and the requirement, imposed to protect local air-freight forwarders, that 75 per cent of its business be devoted to transshipment. FedEx then protested to the US government, which used its control over access to routes to the United States to pressure the Transport Ministry to carve space out of the facilities used by local firms for FedEx to establish another integrated cargo area.⁴⁶ Thus, the government won the international recognition it craved, but at the cost of great bitterness from local air shippers. To complement the opening of UPS's new facility, the government eliminated the previous restrictions at both zones on the value of express parcels and increased the maximum weight to 70 kg from 45 kg, again in face of opposition from local companies.⁴⁷ The air cargo transport and warehousing union, with about 500 workers, opposed both the UPS deal and the possibility of privatisation. Labour protests delayed the signing of the UPS agreements, and periodic slowdowns plagued the processing of air cargo.⁴⁸ A cross-party group of legislators promised to take up the union's case and call the Minister of Transportation and Communications on the carpet.⁴⁹

The long-term solution to many of the complaints of unfairness lay in the expansion of infrastructure. The Transport Ministry hurried development of a new and much larger express cargo area, large enough at 40 000 square metres

⁴⁶ *Zhongguo Shibao*, October 26, 1996; GSSB January 8, 1997

⁴⁷ GSSB, 28 September 1996, 10 October 1996.

⁴⁸ GSSB, 24 and 25 October 1996; CNA, 17 June 1996, 4 February 1997.

⁴⁹ CNA, 5 February 1997.

to accommodate all possible shippers. It also continued work on a new passenger terminal and regular cargo zone, though both were plagued by the usual accusations of delay and improper bidding.⁵⁰ Finally, it worked on the grand plan to turn the entire district around the airport into an 'air city'. As before, the major problems remained land acquisition and inland transportation links.⁵¹

In contrast to air cargo, considerable progress was made in passenger services. Significant deregulation began in 1987. By early 1996, there were no fewer than ten airlines in Taiwan, four of which offered regular international service. Eva Air, a subsidiary of the leading shipper Evergreen, was so successful that Northwestern and Delta were forced to reduce service to Taiwan's rapidly growing market. In 1996, Taiwan reached new five-year agreements with both Hong Kong and Macao that safely transcended 1997 and 1999, when the two colonies would revert to Chinese rule. These agreements allowed essentially direct flights to mainland cities by PRC-invested airlines Dragon Air and Macao Airlines, with only a stop for change of flight numbers in Hong Kong or Macao (of course, this provided only modest advantage for passengers headed north to Shanghai or Beijing).⁵²

Air cargo represented perhaps the most successful case of luring foreign multinationals to establish regional headquarters operations in Taiwan. Taiwan strove desperately to attract big, high profile investments by UPS and FedEx, and its campaign was successful. Indeed, the government did not just provide the foreign 'integrated shippers', with national treatment but gave them advantages not available—at least at first—to local shippers, who complained strenuously but to little avail. The government focused early attention on creation of the integrated cargo zone used by UPS and FedEx, despite the fact that most academics and industry leaders argued that it was economically more important for Taiwan to streamline ordinary import and export procedures than attract transshipment operations. Nor were the remaining obstacles to progress in the air centre the protectionist measures highlighted by the democratic pessimists. Rather, they involved still creaking customs procedures, difficulties

⁵⁰ CNA, 21 January 1997.

⁵¹ For a comprehensive overview of developments in the area of the airport, see the special section in GSSB, 9 January 1997.

⁵² Earl Wieman, 'Turbulent Market', *Free China Review*, April 1996, pp. 38–42; GSSB, 11 January 1997.

in land acquisition and zoning, tense relations with Hong Kong and China, and continuing opposition from labour unions.

The one area that conformed to some of the predictions of the democratic pessimist model was the media centre. Development of the media centre was obstructed by the protectionist attitude of local private businesses and their representatives in the Legislature. From the start, the media centre was the poor step-sister in the APROC plan. Unlike finance or transportation, it was neither closely related to the central task of strengthening high-tech manufacturing nor a huge focus for investment in its own right. Even Planning Council officials expressed puzzlement about McKinsey's inclusion of media in the APROC plan. Since it was less central to the overall plan and received almost no attention from the top leadership, the media centre proved vulnerable to the kinds of particularistic interventions highlighted by the democratic pessimists.

Though the media centre was not a key component of the APROC plan, there was certainly a large and rapidly growing market for news and entertainment in East Asia, to which Taiwan brought significant strengths. In addition to a well-educated, prosperous population of 21 million, the vast majority of whom were literate, native speakers of Mandarin (along with Hokkien), Taiwan possessed a significant base of talent and experience in movies, television commercials and East Asian popular music. The government also assumed that Hong Kong was likely to lose some of its attractiveness as a centre for news gathering and dissemination once it reverted to Chinese rule, and that Taipei could become a substitute, at least for the Mandarin-speaking world. In the drive to turn Taiwan into a media centre, the government also faced a number of serious obstacles. Given the political tensions between the two sides of the straits and the possibility of direct pressure applied against news organisations based in Taipei, and the cultural and economic gap with the PRC, and even overseas Chinese, it was not clear that there was really a single, unified 'Mandarin'⁵³ market, or that Taiwan was

⁵³ It is worthy of note that the CEPD's planning documents avoid reference to the 'Chinese' language. There is no exact equivalent in Chinese to the Western term 'Mandarin'. Under the Empire, the official language used in Beijing and national administration was known as *guan hua* (the language of officials). Under the Republic and in Taiwan it was long referred to as *guoyu* (the national language), while the PRC preferred the term *putonghua* (the common language). Colloquially, Chinese is often referred to as *Zhongguo hua* or *Zhong wen* (spoken and written Chinese). The CEPD avoided all of these in favour of *Huayu* (*wen*)—a less prevalent term referring to the language used by people of Chinese descent, with

best suited to serve it. More tangible disincentives included the shortage of qualified technicians, high tariffs on cameras, film and other media equipment, and the numerous impediments to the participation of foreigners, including high taxes, restrictions on foreign investments, and restrictions against the use of foreign personnel.

While the economic bureaucracy could do little in the short run to solve the larger political and cultural gaps with the mainland, it took action to remove specific obstacles. The Planning Council convinced other agencies to drop a 10 per cent limit on use of foreign personnel in media industries, and eased entry procedures and time limits for foreign workers. The Government Information Office pushed for targeted tax breaks to reduce the heavy tax burden. Together, they persuaded the Finance Ministry to make deep cuts in the steep tariffs on cameras, film and other imported media equipment. The Legislative Yuan, however, blocked reduction of protection for domestic producers. The executive branch then counterattacked with a special provision in the tariff laws that allowed it to cut tariffs in half for one year, and drafted plans to eliminate completely all tariffs on media equipment.⁵⁴

The two branches also clashed over limits on foreign investment in satellite broadcasting and cable television. The GIO initially proposed limiting foreign investment in satellite channels to 51 per cent, so as to leave some room for participation by local firms. The Planning Council then convinced the Cabinet to eliminate restrictions on foreign investment, but in response to protests from local cable operators and television producers, the Legislative Yuan turned around and inserted even stricter restrictions. Foreigners were limited to a 20 per cent share and were not allowed to sit on the board of a satellite company. PRC capital was completely banned from Taiwan's satellite business.⁵⁵ The GIO then drafted new laws to relax restrictions on foreign ownership, but for at least the first couple of years of the APROC plan, the Legislature prevailed.

no implications as to nationality. 'Banli Qingxing', pp. 121, 123, 125. A single slip-up referring to *zhongwen* (written Chinese) appears on page 127, presumably reflecting the fact that while *huayu* is reasonably common, *huawen* is not.

⁵⁴ CEPD, 'Banli Qingxing,' pp. 122–32; *East Asian Executive Reports*, 15 August 1995; GSSB, 21 December 1995.

⁵⁵ *FCJ*, 15 September 1995; *Free China Review*, February 1996, pp. 4–15; GSSB, 19 December 1995.

Similar tensions pervaded cable television. Taiwan had one of the highest diffusion rates of cable television in Asia, and indeed the entire world: almost three-quarters of households were wired for cable. Cable grew popular during the transition to democracy when it became known as ‘the fourth channel’ for its role in providing an alternative to the three government-controlled terrestrial broadcasters; it also provided cheap entertainment in the days before the United States forced Taiwan to strengthen its intellectual property laws. Despite this promising start, cable did not develop smoothly in Taiwan, in part because the regulatory structure divided Taiwan into 51 districts and allowed as many as five providers per district. Economies of scale proved elusive, and local oligopolies emerged in many districts. Conflicts between cable channels and systems operators sometimes led to blackouts that infuriated viewers. Not surprisingly, given the distorted markets and political influence of cable, dozens of politicians invested, directly or indirectly, in local cable networks.⁵⁶

With revision of copyright laws and announcement of the APROC plan, foreign firms were attracted to the Taiwan market. Media giant Time–Warner invested almost \$50 million dollars to acquire a 49 per cent stake in a joint venture to develop eighteen cable networks in Taiwan. Even though Time–Warner, the third largest cable operator in the United States, was precisely the kind of sophisticated global operator that the government had hoped to attract, regulators rejected the joint venture’s first four applications on the remarkable grounds that they lacked subscribers. The ruling seemed to imply that only the former cable pirates in the waiting-to-be legalised grey market were qualified to receive cable licenses. Time–Warner withdrew in disgust, leaving the APROC media plan with a giant black eye.⁵⁷

Nor did the plan to develop four media parks proceed smoothly. Three of the parks were new and the owners would have had to donate 35 per cent of the land to local governments in return for receiving permission for development. Faced with uncertain demand and high costs, the developers stalled. The fourth was proposed by Philips of Holland, one of the few multinationals which had long used Taiwan as an East Asian base. The Philips project faced fewer problems with zoning, since it already had land available from a disused electronics factory, but its plans did not proceed smoothly either. Instead, the City of Taipei (controlled by a mayor from the DPP) and the GIO took the lead in developing yet another park. The ideal of letting private firms develop parks

⁵⁶ GSSB, 11 January 1997.

⁵⁷ GSSB, 22 December 1995.

proved less effective in media than in manufacturing.⁵⁸ All in all, media and the media park represented the one case among the six centres that clearly manifested some of the dangers highlighted by the democratic pessimists.

Conclusion

The outcome of Taiwan's twin initiatives to liberalise its economy and seek a higher and more tightly integrated position in the division of labour in East Asia can be summarised simply. After a slow start, the campaign to gain admission to the World Trade Organisation rushed toward a successful conclusion, despite opposition from vulnerable local industries, pressures from China, and stiff demands by the United States. For trade-dependent Taiwan, insuring access to foreign markets was crucial. President Lee placed top priority on securing and expanding Taiwan's participation in quasi-formal international organisations, and few were more important than the WTO. In contrast, the results of the more ambitious initiative to develop Taiwan into a centre for the regional operations of companies in the Asia-Pacific (APROC) were more mixed. The Planning Council and line ministries made considerable progress in reducing regulatory burdens, and began improving government efficiency and strengthening critical transportation links. Progress was slow, leading some participants to fear that the program would gradually lose steam. Nonetheless, local and foreign businesses acknowledged that Taiwan became a more attractive location to conduct high-end activities. Of the two, the APROC initiative was clearly the more important, and provided a good illustration that the key to understanding the international division of labour is not just openness to the outside world in the form of low tariffs or national treatment, but beyond-the-borders reforms that make it easier for both foreign and local firms to communicate and compete freely with the outside world.

Taiwan's WTO and APROC initiatives provide revealing tests of the sources of opposition to economic liberalisation and the prospects for overcoming them. The WTO case clearly indicates that those sectors that stood to lose from liberalisation were not capable of stopping change. The Stolper-Samuelson approach provides little guidance, both because the key predictor of effective opposition was political organisation (public unions) rather than relative abundance of factors, and because in a natural resource-scarce environment like that of Taiwan, the key economic factor is labour, and

⁵⁸ GSSB, 2 January 1997.

measuring differences between ‘moderately skilled’ and ‘highly skilled’ labour becomes analytically difficult and politically irrelevant. Trade dependence, in contrast, proved to be a crucial factor in the Taiwan case. Virtually everyone in Taiwan agreed that the island had no choice but to export; those who lost out, such as unskilled labourers and farmers, sometimes managed to get side payments to ease their transitional pain, but they were never under any illusion that the government could sustain their export-competitiveness against countries with dramatically lower wages or higher productivity. Fortunately, in the context of continued economic growth and trade liberalisation in Taiwan, China and Southeast Asia, diversification and direct foreign investment were reasonable options for most economic actors. Workers found employment in the service sector, owners of low-tech assembly operations moved to the mainland, auto assemblers increasingly focused on importing foreign cars.

The proposition that the key source of opposition to economic change in democratising countries is the remnants of the old statist system also receives some support from the Taiwan case. State-owned enterprises and regulators were reluctant to give up their special privileges and powers, though bureaucrats proved less resistant to deregulation than did their counterparts in Japan, largely because of differences in career patterns that left Taiwan’s bureaucrats less dependent on individual ministries and *amakudari*. More surprising was the consistent and tenacious opposition to reform from public-sector unions. Labour had never been part of government in Taiwan, nor was it closely identified with any one party during the transition to democracy. Indeed, during the authoritarian period an independent labour movement was not allowed, and preservation of a docile, mobile and inexpensive work force was a crucial part of the export-led growth strategy. The authoritarian government was not able to repeal the law of supply and demand—as full employment took hold wage increases closely tracked productivity improvements—but it did manage to avoid the kind of high-wage agreements negotiated by an aristocracy of urban manufacturing workers in so many developing countries. The key to this puzzle is that public enterprises were actually quite numerous during the rapid growth period, particularly in services, where for a long time they did not much constrain the growth of productivity in manufacturing. The peaks of the labour market were incorporated in an implicit statist coalition. Workers in public enterprises (and to a lesser extent in the largest private enterprises) were given a degree of job protection and an array of non-salary benefits far above workers in all other companies. Workers had no direct say in the policies of the KMT regime, but

workers in public organisations received benefits from it.⁵⁹ Moreover, the public sector unions formed after democratisation, while not particularly large, were well organised, and their members relatively well educated and accustomed to a respected status as public servants by virtue of having passed competitive written tests. Taiwan's route to democracy was gradual and moderate, and many elements of the old statist coalition were left in place. With democratisation, public sector workers were well placed to oppose changes in their special status. In Taiwan, as elsewhere, the key was not simply economic class or the relative abundance of various factors of production, but political organisation.⁶⁰ One of the greatest challenges of the APROC plan was to satisfy the public sector workers without undermining the whole process of deregulation and reorganisation.

The group most commonly identified in Taiwan with opposition to reform and liberalisation was legislators. The problems highlighted by the democratic pessimists certainly did exist. In fact, they were especially severe because of Taiwan's highly particularistic electoral system, the lack of conflict of interest legislation, and the ineffectiveness of public disclosure laws. The particularistic and protectionist tendency of the Legislature could be observed in the struggle to retain high tariffs and restrictive cable licensing in the non-critical media case, and the severe restrictions on foreign ownership shares for telecommunications. In sharp contrast to the case in Japan, where bureaucratic resistance to deregulatory efforts is infamous, in Taiwan revision of restrictive regulations proved much easier, or at least far more rapid, than passage of new or revised legislation. Moreover, the members of the Provincial Assembly were even more governed by particularistic concerns. They stalled reform of the banking and shipping sectors because they wanted to retain control over Gaoxiong Harbour and the Provincial banks.

If the legislators, like legislators elsewhere, often were influenced by particularistic concerns, it is important to point out that the biggest obstacles to reform were actually not particularistic in nature. Delays in the Legislature resulted more often from disputes over ideology, such as the heated conflict over the Number Four nuclear power plant, and struggles for institutional and

⁵⁹ Frederic C. Deyo, *Beneath the Miracle: Labor Subordination in the New Asian Industrialism*, University of California Press, Berkeley CA, 1989.

⁶⁰ Compare the political composition and maintenance of the 'traditional' middle classes in France: Suzanne Berger, 'Regime and Interest Representation: The French Traditional Middle Classes', in Suzanne D. Berger, ed., *Organizing Interests in Western Europe*, Cambridge University Press, New York, 1981.

partisan advantage, personified by the lengthy battle over President Lee's decision to name Premier Lien Chan as his Vice-President. In other cases, the legislators focused on a different set of priorities from the Executive Yuan and the Planning Council—foreign policy, defence, budgets, social welfare, law and order, and so forth. Both bureaucrats and the public assailed the Legislative Yuan for its inefficiency, but that 'inefficiency' needs to be placed in a broader democratic perspective, and not just assessed relative to technocratic goals, however well-intended and economically pressing. The open contestation of values and priorities may be messy and protracted, but it is a critical element of democracy.⁶¹

Nor was the Legislature always obstructive or inefficient. The three critical telecommunications bills may have been delayed, but they passed early in the APROC program, and largely along the lines set out by the economic planners. Planning Council officials reported that the opposition Democratic Progressive Party proved quite agreeable to the APROC plan once the presidential election had passed and the Planning Council had opportunity to report at length on its plans and activities:

Even though we completely disagreed on issues of foreign policy and national identity, to my surprise we saw eye to eye on almost all economic reform issues except nuclear power [which the opposition opposed as much on economic as ecological grounds]. We've actually had far more trouble with some of the back bench representatives from the KMT than with the DPP [or the smaller New Party].

Even when the Legislature insisted on special consideration for those harmed by the transition to a more open and competitive market, its actions were not always obstructive. The reluctance to lower tariffs on video equipment and limits on foreign ownership of cable television posed a serious impediment to the development of the media centre, but moves to satisfy the telecommunications and air cargo workers were probably justified as a way to minimise opposition to reforms that would greatly increase overall efficiency and flexibility. That is, there is often a real distinction between 'kowtowing to special interests' when the kowtow preserves a monopoly or a rigid and

⁶¹ Hu Fu and Yun-han Chu, 'Neo-Authoritarianism, Polarized Conflict and Populism in a Newly Democratizing Regime: Taiwan's Emerging Mass Politics', *Journal of Contemporary China*, vol. 5, no. 11, March 1996, pp. 23–41.

inefficient regulatory system, and providing 'side payments' to smooth the transition to a more open and efficient system.

Finally, even if there was some justice to the complaints that the Legislature was inefficient and particularistic, it did not operate in a vacuum. The attitude of the President was crucial. The Legislature responded when the head of the majority party made reform a top priority, as the concessions made in Taiwan's pell-mell drive to enter the WTO at almost any cost vividly demonstrated. Similarly, in December 1995, with relatively little preparation or publicity, the President convened a 'National Development Seminar' that proposed several important constitutional revisions (not least strengthening the position of the President) and effective elimination of the Taiwan Provincial Government. While Lee's motivation was probably less domestic than international (down playing the traditional conception that Taiwan was merely a province of China), elimination of the Provincial Government would almost certainly simplify the progress of the APROC initiative. In contrast, Lee's relative neglect of APROC, and his strictures against 'excessive' trade and investment with the mainland, clearly took some of the steam out of APROC. Planning Council Vice-Chairman Chi Schive pursued the APROC initiative with conviction, persistence and energy, and superstar legislator Vincent Siew worked to smooth relations in the Legislature. On occasion, even Vice-Premier Xu Lide and Premier Lien Chan emphasised the need for economic reform, but none was in a position to substitute for the President. Soon after the President finally placed top priority on the APROC initiative in early 1997, a raft of WTO and APROC legislation quickly passed 'with an unusual display of

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The progress of Taiwan's twin initiatives for economic liberalisation highlight the need to place trade reform and deregulation in a broader context. Clearly, all of Taiwan's plans were heavily influenced by considerations of diplomacy and security. Taiwan's obsessive concern with China energised its WTO bid, but had a mixed impact on the APROC initiative. Of course, the case of Taiwan is unusually intense, since the PRC is simultaneously a mortal threat to Taiwan and its largest export market. The necessity of linking trade and investment liberalisation to security and diplomacy is hardly limited to Taiwan, however, as the cases of Eastern Europe, central America and other countries demonstrate. In addition, all of Taiwan's economic initiatives were heavily swayed by the United States. The advent of the WTO notwithstanding,

⁶² *FCJ*, 28 February 1997; *CNA*, 15 April 1997.

bilateralism lives. Indeed, it flourishes. The United States exerted a major impact on almost every aspect of Taiwan's economic reforms, from liberalisation of finance, telecommunications and agriculture, to enhanced protection of intellectual property rights and access rights for airlines and cargo companies. In contrast, the European Union played only a minor role, and Japan was almost quiescent on all issues except autos, where it received a quota far below that of the United States and the European Union. Nor did Asia-Pacific Economic Cooperation (APEC) make much of a difference: tariff cuts and improved protection of intellectual property rights promised to APEC were quickly subsumed by larger concessions made to the United States. Even the WTO, hailed as avatar of multilateralism, took on a distinctly bilateral cast. For Taiwan, the key to entering WTO was not the promise to abide by universal rules, but the ability to satisfy key member states in a series of bilateral negotiations. Far and away the most demanding and important of these was the United States, crucial guarantor of Taiwan's security and international autonomy. Discussions of the decline of the United States and its lack of interest in East Asia are premature, to say the least.

The implications of the WTO entry and the APROC plan for the Taiwan economy were generally positive. Taiwan retained equal access to foreign markets, and it began to address many of the obstacles to placing or keeping higher value-added activities in Taiwan by slashing telecommunications charges, freeing up a conservative financial sector, and speeding up antiquated customs procedures. The high profile APROC plan was the subject of searching public debate and criticism. The most common complaint, particularly in Taiwan itself, was that the government did not push liberalisation hard enough. The public tended to take the goal of APROC as matching or even replacing Hong Kong and Singapore as an attractive home to foreign multinationals, and no leading multinationals switched headquarters operations from Hong Kong or Singapore to Taipei (though a few did move responsibility for specific products or functions to Taiwan, often on a global rather than regional basis). However, replacing Hong Kong was never a major goal of the APROC plan. It was neither possible, not least because Hong Kong and Singapore served different markets and possessed English-dominated educational systems, nor necessary, since the real goal was deregulation to support high technology manufacturing, and to ensure that *Taiwan* firms could keep their major headquarters activities in Taiwan without losing international competitiveness. By these criteria, the first few years of the APROC plan must be judged a solid success.

The opposite concern, voiced more often abroad than in Taiwan, was that even if the WTO and APROC efforts succeeded, the cost would be excessive liberalisation and a loss of the state capacity that had helped make the Taiwan such an economic success in the first place. To many, a Singapore-like strategy of appealing to footloose multinationals seemed dangerous. This argument missed three facts: first, Taiwan had little choice but to change, for the shift of labour-intensive manufacturing to China and Southeast Asia had already rendered Taiwan's traditional strategy inoperable. Second, the APROC plan was at least as oriented to Taiwan companies as foreign ones: the government's emphasis on expanding unofficial foreign ties sometimes created a bias toward foreign firms, but it was usually temporary. The crucial constituency was large local firms that were rapidly increasing overseas activities, particularly in China. Finally, APROC did not mark the triumph of a completely libertarian approach in Taiwan. Far from it. At the same time that the Executive Yuan and the Economics Ministry reduced protection for many industries to assure entrance into the WTO, they continued and expanded programs to encourage local research, development and design. Some of the programs were clearly of the 'picking winners' variety (or, more accurately, selecting for promotion products and technologies that the United States and Japan had already demonstrated to be winners), such as a program to encourage development of some five dozen key parts and components currently imported, mostly from Japan.⁶³ And, of course, the APROC program included considerable spending on training and transportation infrastructure. In addition, while the APROC initiative aimed at elimination or relaxation of unnecessary or inefficient regulations, the new technologies that it stimulated and the horde of new producers that it encouraged ironically increased the need for oversight and monitoring. With dozens of new financial and telecommunications firms and products, a slew of new electricity producers, and a group of new private developers of manufacturing and media parks, the government often found itself forced to develop new regulations and oversight capabilities. And at the same time that the government pushed the APROC program, it was also rapidly implementing a very different kind of 'liberal' agenda, including national health care and national pensions. Thus, the task facing Taiwan was not simply how to deregulate, but how to regulate in an economically efficient manner, and to make major investments to complement the increasingly sophisticated economy, particularly in education and physical infrastructure. The APROC program, by providing a rationale and an objective external

⁶³ Jingjibu, *Jishu Jianbing*, no. 20, August 1996, pp. 1–8.

yardstick, clearly made a contribution to both improving the quality of regulation and increasing the volume and effectiveness of investment. The role of government in Taiwan certainly changed, as the uneasy combination of developmental state, stifling regulations and petty corruption lost political and economic viability, but on balance it tended to grow rather than shrink.

As the Taiwan case illustrates, the issues raised by democratic pessimism are not entirely without foundation. Both cosy old statist arrangements and new private ones can impede reform. Some firms and workers stand to lose from reforms, and legislators, particularly in Taiwan, do have incentives to engage in particularistic politics, while coalition or weak majority governments may become inefficient (though they may also impede tyranny). Efficiency-enhancing side payments do not proceed automatically. At the same time, it is important to note the powerful countervailing forces that may come into play. Political leaders can provide direction and energy and broker necessary concessions to smooth the way for reform. Global economic pressures often undermine local monopolies and oligopolies. And finally, economic liberalisation is always carried out in the context of concerns for security and diplomacy.

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