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Taiwan's Foreign Economic Policy: The 'Liberalization Plus' Approach of an Evolving Developmental State

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I. Introduction

Globalization has compelled state governments to embrace economic liberalization as a means to participate purposely in an increasingly 'borderless' world economy. At a general level, this is seen to enable the economies in their charge to engage more effectively in the integrated international linkages of production, finance, distribution and investment being created by transnational business activities. Economic liberalization refers to an opening up of markets to greater competition, which had previously been constricted by various forms of state regulation or intervention, e.g. import tariffs. Hence, liberalization can under many circumstances lead to a general retreat of the state's position in matters of economic governance. However, it is argued here that smart approaches to economic liberalization do not necessarily require a weakening of state capacity but rather its upgrading. As such, questions about 'how much' state involvement or economic liberalization is required to meet the challenges posed by globalization need to be replaced with those of 'what kind'.

Recent developments in technical aspects of Taiwan's foreign economic policy (FEP) present a very useful case example of where economic liberalization has been implemented in a strong state institutional context. This 'liberalization plus' approach is closely associated with Taiwan's evolving developmental statism, that itself demonstrates a path by which states are adapting rather than surrendering their managerial roles in the era of economic globalization. In Taiwan's trade-industry policy nexus, we show how trade policy liberalization has been accompanied by industrial policy measures designed to enhance the competitiveness of Taiwan's strategic industries. Meanwhile, in Taiwan's international finance policy, it is

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revealed how liberalization has proceeded in a gradual and cautious manner whereby state institutions have retained various capacities to ensure that liberalization is effectively implemented and, moreover, that the scope for ensuing 'free' market volatility is contained. Before we examine these aspects of Taiwan's FEP in closer detail, we first consider more general perspectives on the relationship between the state and economic liberalization.

II. Economic Liberalization and the State–Market Nexus

The analysis that follows makes a number of general arguments with respect to economic liberalization and the state. First, it is now clear that a far more *pluralistic* approach to understanding economic liberalization is required, as there are manifestly different paths and different goals associated with the liberalization process in both theory and practice. Second, liberalization does not necessarily imply the retreat of the state's role in matters of economic governance. As Lee (2000) has argued, a strong regulatory state is a prerequisite for effective market liberalization. Moreover, markets do not operate in a political, institutional or social vacuum, and hence there is a vital function for the state to perform in ensuring they yield optimal welfare outcomes. Third, many state governments that embark on economic liberalization policies would not necessarily prescribe to the wider neo-liberal approach to economic policy management. As our case study on Taiwan's FEP reveals, liberalization may be commensurate with an evolving developmental statist approach whereby it is combined with parallel state activist measures. This forms the basis of Taiwan's 'liberalization plus' approach.

Let us begin by examining the emergence of different theories on the state–market nexus. Weber (1947), for instance, was interested in what kind of internal organization best offers states the capacity to construct effective markets and promote growth. He posited that capitalist development was dependent upon degrees of social, economic and political order that only a modern bureaucratic state could provide, and that an important purpose of the state was to support market development and capitalist accumulation. In a similar vein, Polanyi (1944) contended that markets are socially and institutionally embedded, and that the development of markets and market relations depended on various forms of state action. As he

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commented in specific relation to capitalist market development, 'the road to the free market was opened and kept open by an enormous increase in continuous, centrally organised and controlled interventionism' (p. 140).

The developmental relationship between the state and market was also the focus of Gershenkron's (1962) thesis on 'late industrialization'—usually cited as the earliest proto-theory of the developmental state. In his historical study on economic backwardness, Gerschenkron stressed the key developmental role of the state in mobilizing the necessary resources to reduce the techno-industrial gap between 'late industrializers' and the advanced industrial powers. Drawing mainly upon the experiences of nineteenth-century continental Europe and the early twentieth-century Soviet Union, Gershenkron demonstrated the importance of the state's industrial and mercantile policies in gradually strengthening an initially weak domestic business sector in the pursuit of techno-industrial catch up. Moreover, the bigger the gap, the stronger the state-based ideology required to mobilize resources for development. Gershenkron's typology, however, also suggested that the market will eventually supersede the role of the state as industrialization proceeds, and consequently mercantilism gives way to liberalism as an increasingly independent domestic business sector gradually weans itself from the state.

While Schumpeter (1950) had argued before Gershenkron that the uncertainties and costs of techno-industrial catch-up legitimized a role for the state in socializing risk and arranging entrepreneurial profits, he also contended that market capitalism can often undermine the very social foundations that sustain the market. This, he maintained, required a continual role for the state of safeguarding the institutional and social frameworks that cultivated market development—thus, a departure from Gershenkron's 'withering state' scenario. Schumpeter further argued that innovation often requires complex institutional arrangements that cannot be adequately provided by arms-length market relationships and maximum price competition, which if unchecked could lead to trade-offs between static and dynamic efficiencies. More recent studies from the new institutional economics school have further stressed the importance of institutionalizing market order before embarking on economic liberalization programmes (Block 1994, North 1990, Vogel 1996, Williamson 1985). In addition, Block (1994) makes the more specific point that states and markets cannot be easily disaggregated from

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one another, as they are naturally entwined within the same economic domain, and hence should not be separately compartmentalized.

In counter-position to these arguments is the orthodox neo-liberal approach, which prescribes that unfettered, 'free' markets are best able to generate optimum welfare gains. Liberalization forms an integral element of this approach, with others being deregulation, privatization, strict fiscal and monetary discipline, and the reduction of state economic intervention *per se* (Biersteker 1995). In the neo-liberal view, the minimalist of 'night watchman' state is the ideal type, whose actions were 'restricted largely, if not entirely, to protecting individual rights, persons, property, and enforcing voluntarily negotiated private contracts' (Buchanan *et al.*, 1980: 9). The rise of the neo-liberal orthodoxy occurred within the context of the coupled breakdown of the Fordist capital accumulation regime and Keynesian mode of social regulation. According to Jessop (1993), neo-liberalism is a political project that is 'primarily concerned with promoting a market-led transition toward the new economic regime' (p. 29). This was spearheaded by Thatcherism in the UK and Reagonomics in the US from the late 1970s/early 1980s onwards. Both rejected the Keynesian ideas of social partnership and welfarism in favour of free market economics, which implied a vigorous policy agenda of privatization, liberalization and deregulation.[1] This trend was closely aligned to the deepening embodiment of neo-liberal ideals within international economic organizations (IEOs), such as the World Trade Organization (WTO), International Monetary Fund (IMF) and the World Bank. These IEOs act as powerful sources of neo-liberal advocacy, promoting and pressuring governments around the world to administer continued doses of market opening into their economies. This is often referred to as the 'Washington consensus', the ideational and political power platform for a global neo-liberal agenda that became even stronger after the end of the Cold War.[2]

[1] It is perhaps helpful at this point to distinguish between liberalization from deregulation. While liberalization generally refers to opening up markets to greater competition, deregulation concerns the reducing or eliminating government regulations.

[2] This, in turn, is closely associated with Gill's (1995) concept of 'disciplinary neo-liberalism', which he contends 'is institutionalized at the macro-level of power in the quasi-legal restructuring of state and international political forms: the "new constitutionalism". This discourse of global economic governance is reflected in the conditionality policies of the Bretton Woods organisations, quasi-constitutional

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Yet as the 1990s progressed, many came to question the neo-liberal economic paradigm's ability to deliver the sustained market welfare gains (Tickell and Peck 1995). In states such as the US and UK, which had most comprehensively adopted this paradigm, the associated problems of social polarization, macroeconomic disequilibria (as exemplified by their early 1990s recessions) and flagging competitiveness compelled a re-evaluation of the neo-liberal approach to domestic and foreign economic policy. The move towards a more centrist, social democratic interpretation of neo-liberalism was carried forward by Bill Clinton in the US and Tony Blair's 'Third Way' policy agenda in the UK, where both attempted in their own ways to reconcile market economics with social inclusion policy objectives (Giddens 1998). A key axiom of the Third Way was to develop a stronger institutional framework in which markets could develop and *all* agents therein prosper. In contrast to the 'raw' neo-liberalism of the 1980s, it proposed that weaker market agents (e.g. unskilled workers) should be better empowered so as to improve their contribution to market development. Thus, economic liberalization would best induce welfare-enhancing market competition when the competitive potential of market agents was optimized.

Firms (capital) and workers (labour) under this 'social democratic' brand of liberalism were presented with greater opportunities to realize their potential with the state's assistance, which in turn dovetailed into a broad competitiveness strategy. Consequently, the choice of economic agents in the market economy was expanded from that of the 'sink' or 'swim' approach of the 1980s to that of 'what do you need to swim faster'. Similarly, this was a move beyond a blind faith in the market's ability to achieve optimum productive, allocative and distributional efficiencies—as embodied in Thatcherism—to at least a tacit acknowledgement that, left alone, market's often 'fail'. Thus, various policy and institutional measures were required to head-off market failure before it arose, but this too entailed an examination of 'government failure' that consequently required smarter state policies and re-regulation.

The East Asian neo-liberal experience has been markedly different to that of the West. Although many of the region's states introduced a wave of liberalization measures from the early 1980s onwards, these were broadly incorporated into a developmental statist model

regional arrangements such as NAFTA and Maastricht, and the multilateral regulatory framework of the new World Trade Organisation' (p. 412).

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of economic management—although this model itself varied greatly across the region in terms of coherence, integrity and application. As the 1990s progressed, so did various programmes of liberalization, deregulation and privatization in most East Asian economies. The whole debate on 'statism versus neo-liberalism' simmered in the region over these years, but the outbreak of the 1997–98 East Asian financial crisis brought it to boiling point. Broadly speaking, the neo-liberal camp claimed that various forms of 'government failure' were ultimately culpable for the crisis, while the statists argued that it was misconceived and poorly implemented liberalization of the economy prior to the crisis which was to blame (Feldstein 1998, Prakash 2001, Sachs 1998, Stiglitz 1998, Wade and Veneroso 1998). From this emerged a series of paradigmatic struggles pertaining to what future direction East Asian economic development should take. In the early post-crisis period, both the position and channels of domestic and external neo-liberal advocacy were much strengthened across the region. For domestic neo-liberal advocates, the crisis exposed the structural rigidities inherent in the (developmental) statist paradigm that had for too long constrained the market and entrepreneurial dynamics of the economy. External neo-liberal advocates, such as the US and the IEOs, pushed home similar arguments, and, moreover, opportunistically pressed the region's governments for improved foreign access to East Asia's markets (Belo 1998, Higgott 2000, Tsai 2001).

However, in the longer retrospective evaluation of the crisis came the view that it was not simply a question of *how much* liberalization or state involvement but rather *what kind*. In other words, a more nuanced and smart approach to economic governance was required that drew upon both the 'market failure' and 'government failure' lessons of the 1997–98 crisis (Bhagwati 1998, Mastanduno 2000). The wisdom underpinning this new synthesis also derived much from the work of the state-market theorists discussed earlier. Effective economic liberalization would be best implemented by a state with sufficient technocratic capacity to not only oversee its subsequent infusion within the economy but also introduce, where necessary, policy measures to further realize its success.

While many neo-liberals have been obliged to re-evaluate their blind faith in free markets, so have developmental state theorists had to adjust to new realities. In the traditional model of the developmental state, an authoritarian government guided the capitalist development of the economy through a combination of strict state

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controls and regulations, long-term corporate planning, a developmental alliance forged with the business sector (but led by the state), a mobilization of social resources (but often a simultaneous repression of social movements, such as labour), and a highly trained bureaucratic elite with impressive technocratic capabilities. Johnson's (1982, 1987) studies of Japanese economic development first formally introduced the notion of the 'developmental state', with a number of other theorists playing their part in further refining its conceptualization (Amsden 1989, Appelbaum and Henderson 1992, Chan *et al.*, 1998, Deyo 1987, Evans 1989, Haggard 1990, Wade 1998, Wade and White 1984, Weiss 1998, Woo-Cumings 1999).

However, two main forces have undermined the traditional developmental state paradigm, these being democratization and globalization. As democratization has deepened in East Asia, so has the emergence of a more pluralistic society and polycentric distribution of power that has challenged the authoritarian basis of the developmental state. This can be partly explained by the so called 'gravedigger' hypothesis, whereby the state's nurturing of the business sector creates an increasingly empowered bourgeoisie that in turn seeks greater political power and a more liberal policy agenda. In Taiwan, the onset of democratization from the late 1980s onwards saw the empowerment of its business sector's political influence over policy formation. Meanwhile, globalizing forces have brought compelling pressures upon East Asia's developmental states to liberalize. This has particularly occurred in the finance sector, where the region's governments have removed controls that hindered home firms' access to new global sources of capital. The growing engagement of these same firms in transnational business activity has further required the opening up of trade and other FEP regimes in order to minimize the associated transaction costs of such activity.

Huang (2001) argues that on the one hand, Taiwan is now a democratically contested state in which state policy formation has become increasingly susceptible to society-centric influences and pressures, thus shifting away from the authoritarian, state-centric approach. Yet on the other hand, state activism remains strongly evident within Taiwan's new democratic developmentalist paradigm. As Huang also contends in relation to Taiwan's evolving political economy, the 'state-centric authority structure and the state-preferred economic governance are not necessarily the same thing. While an active and engaging state may not necessarily entail an authoritarian structure, the function of the market and democratic institutions may well lead

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to such a state' (p. 173). More specifically, the Taiwanese political economy has shown that economic liberalization does not necessarily lead to the deconstruction of the developmental state, rather its evolution in response to changing domestic and international environments. Earlier questions pertaining to the manner in which liberalization is implemented are highly relevant to this evolutionary process, with particular respect to what re-regulatory measures accompany neo-liberal reform. As we later discuss, Taiwan's international finance policy regime provides a good example of this synchronous 'liberalization with re-regulation' approach, revealing the adaptive nature of the Taiwanese developmental state. Taiwan's trade-industry policy nexus further demonstrates the state's retention of transformative economic objectives, and the revolution rather than retraction of the state's role in economic governance. In other words, the Taiwanese developmental state has been re-engineered to meet the challenges of globalization (Chu 1999, 2000; Schive 1999), and forms an important underlying basis of Taiwan's 'liberalization plus' approach to foreign economic policy formation.[3]

III. Taiwan's Foreign Economic Policy in Perspective

3.1 The Cognitive-Ideological Dimension

Taiwan pursued a strong neo-mercantilist approach to its foreign economic policy for much of the last few decades, although this has softened in more recent years due to the inculcation of neo-liberal ideas. Such an issue relates to what I term the *cognitive-ideological* dimension of FEP formation, in that all policy is in some way determined by certain ideas, values or beliefs (Dent 2002). This may occur either through the formation of systematized ideological constructs, or by their development of more personalized or atomistic cognitive views and their respective influences over policy-making. In this con-

[3] Aspects of Taiwan's evolving developmental state are evident elsewhere. Developmentalist planning, albeit less dirigiste in tone and content, remains a central orientating factor in Taiwan's economic policy-making process. In the CEPD's 'Plan for National Development into the Next Century' introduced during the late 1990s, 'enhancing competitiveness' was one of three overarching goals, along with 'raising quality of life' and 'sustaining development'. This embodies Taiwan's transition to the new developmentalism, with new environment and welfare-focused developmental objectives co-existing with those of national economic advancement. Hence the state, though less interventionist, still provides the developmental vision and blueprint for other economic agents.

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text, we elaborate here on how a 'liberalization plus' approach has emerged as a prime cognitive-ideological fundament to Taiwan's FEP formation.

In general, Taiwan has adopted a controlled and gradual approach to economic liberalization with strong state mediation. Consequently, neo-liberal reform in the technical policy realms of Taiwan's FEP (e.g. the trade-industry nexus, international finance, foreign direct investment) has been accommodated within a firm institutional framework, with due attention to gradualistic sequencing that often entails the implementation of compensatory state policy measures. This, for instance, is later demonstrated in Taiwan's trade-industry policy nexus, where the Government has removed trade barriers while simultaneously augmenting its trade competitiveness-enhancing programmes. Such an approach has its roots in the Government's twin 'liberalization' and 'internationalization' policies that were formally introduced by Premier Yu Kuo-hua in 1984, and have contained the principal coterminous ideas orienting Taiwan's FEP ever since. Similarities can be drawn between the cognitive-ideological basis of this Taiwanese 'liberalization plus' approach with that underpinning the *Segyehwa* (globalization) policy pursued by South Korea's FEP protagonists during the 1990s. Just as *Segyehwa* constituted a policy means to advance South Korea's ultimately mercantilist commercial interests, especially in its first phase, Taiwan's economic liberalization programme has represented a vehicle to achieve comparable goals. Generally speaking, Taiwan's FEP protagonists have been willing to embrace neo-liberal ideas insofar as it helps Taiwanese firms exploit the growing commercial opportunities offered by globalization.

The proclivity of the Taiwanese state to liberalize within a strong institutional and regulatory framework is strongly connected to broader economic and other security imperatives. A prime reason for the state's extensive mediation in the liberalization process derives from various anxieties over potential developments in Cross-Strait economic relations, and this pervades every stratum of Taiwan's FEP bureaucratic cadres. These more specifically relate to how the opening up the Taiwan economy makes it ultimately susceptible to Beijing's attempts to undermine Taipei, through either direct or indirect means. For example, full economic liberalization would permit the Peoples Republic of China (PRC) to undertake the following: investments in Taiwan's strategically sensitive industries; foster Taiwans' dependency over time on key imports from mainland

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China; make substantial transactions in Taiwan's currency market, hold large reserves of the NT dollar, and hence be in a position to threaten its financial stability. Thus, the Taiwanese Government maintains a cautious regulatory approach on Cross-Strait economic relations.

This was recently illustrated by the decision made by the new Democratic Peoples Party (DPP) government, under Chen Shui-bian, to adjust its predecessor Kuomintang (KMT) administration's 'no haste, be patient' policy on Cross Strait commerce to one of 'active liberalization, effective management' in September 2001.[4] Just prior to the DPP government's declaration of a policy shift, there was significant expectation and hope amongst Taiwan's business community that greater emphasis would be placed upon 'active liberalization' rather than 'effective management', the latter relating to safeguard measures retained by the state aimed at upholding Taiwan's politico-military and economic security interests. However, the converse transpired, with various product and industry-specific bans on trade and investment projects remaining in place (although these would be annually reviewed), and the $50m investment project ceiling subjected to re-regulation rather than complete liberalization.[5] These policy changes are examined in closer detail later on, but this episode reveals continuity in the 'liberalization plus' approach during the transition in power from the KMT to the DPP.

3.2 Technical Policy Realms

In this section, we examine recent developments in technical policy practice within Taiwan FEP to demonstrate the applicability of the 'liberalization plus' approach. The trade-industry policy nexus and international finance policy are two of the main technical policy realms considered for this case study analysis.[6]

The Trade-Industry Policy Nexus In an increasingly integrated world economy, trade and industrial policies are best viewed as comple-

[4] This drew upon recommendations made at the new Economic Development Advisory Committee's (EDAC) inaugural meeting convened the month before and chaired by President Chen himself.

[5] *Financial Times*, 20.09.2001.

[6] In my macro-framework of FEP analysis I have developed elsewhere, foreign direct investment (FDI) and official development assistance and co-operation, or ODAC, from the other two main technical policy domains (Dent 2002).

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mentary (Hart and Prakash 1999), and recent developments in Taiwan's FEP present a good example of such complementarity. Over the past two decades Taiwan's trade policy regime has been gradually liberalized, yet the state has retained a well defined industrial policy aimed at continually upgrading the economy's export competitiveness. Thus, while trade liberalization has intensified foreign competitive pressures upon Taiwanese firms, their capability to respond to this challenge has been simultaneously fortified by the Taiwanese state as part of rearticulating its role in an era of deepening economic globalization. This aspect of Taiwan's 'liberalization plus' approach can be largely attributed to residual neomercantilism. Although the protectionist dimension of Taiwan's neomercantilism has withered over time, the promotive dimension (i.e. fostering strategic industry development) remains active.

Taiwan began to liberalize significantly its trade policy in the early-to-mid 1980s as part of the Government's twin 'liberalization' and 'internalization' drive. Particular national macroeconomic conditions arising in 1986 provided extra imperative to liberalize. In that year, the economy achieved very high financial surpluses, whereby both its internal and external balances experienced historic peaks of around 20% of GDP.[7] Although this helped Taiwan amass a substantial accumulation of foreign exchange reserves, it also applied significant upward pressure on the NT dollar in the currency markets, whilst high domestic liquidity and low interest rates risked creating an asset price 'bubble' within the economy at large. In the subsequent round of trade liberalization, tariff levels were significantly reduced, import and export procedures simplified, and trade licensing regulations relaxed. By 1988, a total of 3,467 items covering 45% of the Taiwan's trade item nomenclature saw tariff rate reductions of up to 41.3%, and in 1989 a further 4,700 items had their tariff rates lowered to a 20.2% average. In the same year, Taiwan's average nominal tariff rate was reduced to 9.7%, down from the 1984 figure of 30.8%. By 1995, this had fallen marginally to 8.6%, thus showing the significance of the late 1980s tariff-rate liberalization in perspective.[8]

[7] The internal balance equation: savings 37.3%, investment 17.5%. The external balance equation: exports 58.1%, imports 38.3%.

[8] By 2001, around 98% of Taiwan's domestic markets were open to trade in terms of official foreign access, whilst its average nominal tariff rate had fallen slightly further to 8.2%.

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Taiwan's WTO accession process, which began in the early 1990s, provided a further spur to trade policy liberalization. During a series of bilateral negotiations with incumbent WTO members, Taipei was obliged to comply with various WTO trade policy rules and norms, as well as make specific bilateral concessions to certain trade partners. Indeed, the accession process preoccupied much of Taiwan's economic diplomacy with the advanced industrial states and others for most of the decade. After formally acceding to the WTO in January 2002 Taiwan must also implement various liberalization measures over a 2 to 9 year phase period.[9] Consequently, Taiwan must exact an overall fall in the average tariff rate for its agricultural products from a pre-accession level of 15.5% to 12.9% after full implementation, and from 6.2% to 4.3% for industrial products. More specifically, average tariffs on automobiles are to fall to 16% after phase-in and on auto components to just over 10%, while for textiles these will fall from 12% to 10%, and for consumer electronics from low double-digit percentages to single figures. Taiwan is furthermore obliged to reduce non-tariff barrier 'equivalent' rates from an estimated 20% to 10%, reduce the number of import licences, and enter into negotiation of accession to the Agreement on Government Procurement with a view to also entering into accession to the Civil Aircraft Agreement.

There is, however, an increasingly important aspect of Taiwan's trade policy that remains subject to various restrictions, this being trade with mainland China. While the burgeoning expansion of Cross-Strait commerce has brought mounting pressure from Taiwan's business community to reduce significantly the level of regulation, both KMT and DPP governments have erred on the side of caution, as previously noted. Prior to amendments made to Cross-Strait commerce policy made in late 2001, the Foreign Trade Act of 1993 (subsequently amended in 1997 and 1999) had embodied the security-related sensitivities underlying this cautious approach. Over the 1990s there had, though, been some liberalization of Taiwan's Cross-Strait trade. In July 1996, the government introduced a 'negative list' of non-permissible imports from mainland China, replacing the more restrictive 'positive list' of permissible import items, and by April 2000 a total of 5,678 product lines (55.4% of the total

[9] Phased-in liberalization periods for individual sectors are: fruits and vegetables (2–5 years); meat products (4 years); automobiles (2–9 years); auto components (4 years); semiconductors (2 years); textiles and apparel (2–3 years).

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nomenclature) could be imported by Taiwanese firms across the Straits. As mentioned earlier, Taiwan's business community had been anticipating a far more extensive round of liberalization after the government's adoption of its new 'active liberalization, effective management' approach to Cross-Strait trade in late 2001. Although some further trade liberalization transpired, there was no substantive lifting of product-specific or industry-specific bans on Taiwan's 'strategic' exports to the PRC. In principle, Taipei is for the liberalization of Cross-Strait trade—as this greatly assists the economy's techno-industrial restructuring—but not to the extent that it compromises Taiwan's national security interests.

Analysing the development of Taiwan's industrial policy tells another story of where the state has run accompanying parallel measures alongside trade policy liberalization. Some of Taiwan's earliest and most extensive trade liberalization programmes were incorporated into the export processing zone (EPZ) policy that it pioneered in the 1960s. The first EPZ was established at Kaohsiung in 1966, with two more created at Nantze and Taichung in 1969. Firms located within these and other subsequently established EPZs have acquired imported inputs at low or zero-tariff rates, hence improving the cost competitiveness of their exports. As Gruen (1999) observed, this is constituent to what he calls the 'new' trade liberalization in that selective trade liberalization under such circumstances actually had an overt developmental or even a mercantilist purpose. Furthermore, selective liberalization measures are combined in these zones with a raft of supportive state measures (e.g. infrastructure provision, tax incentives) also intended to improve Taiwan's export competitiveness. The EPZs and their subsequent spin-offs continue to play a vital part of the Taiwanese state's competitiveness strategy, and moreover this zonal approach to 'enclave' economic liberalization has been emulated in China and elsewhere.

Other developments in Taiwan's industrial policy have accompanied the 'competitive-inducing' effects of the trade liberalization process. In other words, the state has sought to empower Taiwan's firms to take full advantage of the competitive discipline that trade policy liberalization brings. Much of Taiwan's industrial policy originates back to the 1960 Statute for the Encouragement of Investment—applied to domestic and foreign investment alike—and which first defined Taiwan's investment incentive and promotion system. This initially had a strong sectoral focus, with information technology, industrial machinery and other strategic industries receiving special

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attention by the 1980s. Industrial policy in Taiwan intensified during this decade in corresponding development to economic and trade liberalization as the state sought to develop a more competitive and technology-intensive economy (Amsden 1992). In 1982, the Executive Committee to Develop Strategic Industries was established under the Industrial Development Board (IDB), and was soon joined in 1984 by the Development of New Industrial Products programme. These were constituent to developing Taiwan's national innovation system and improve the technological competitiveness of its export production (Simon 1998).

Another important landmark in Taiwan's trade-industry policy nexus was the 1990 Statute for Upgrading Industries that offered provisions for tax benefits, the establishment and utilization of development funds, technical assistance, industrial district development, and venture capital towards the 'furtherance of industrial upgrading and betterment of economic development' (Article 1). This was allied to the government's Six Year National Plan for National Economic Development (1991–1996) that targeted Top Ten Emerging Industries for development, comprising aerospace, specialty chemicals and pharmaceuticals, information technologies, consumer electronics, pollution control technology and equipment, semiconductors, communications, precision instruments and automatic machinery, new materials and medical equipment. In addition, it selected 25 specific high-tech products for development, with state measures on tax credits, development loans, preferential access to innovation and R&D projects to realize these ends. The 1990 Statute was further amended in January 2000 with a ten-year extension, subsequently continuing to lay out a developmentalist vision for Taiwan and foster international competitiveness into the twenty-first century.

By the late 1990s, the government had also extended and upgraded Taiwan's R&D capacity via its expanding Industrial Technology Research Institute, an incubator centre designed to foster technological entrepreneurship and business growth, and which had made a significant contribution to boosting the technology-intensive exports of Taiwanese SMEs (Chu 2000, Lauridsen 2000). In addition, Taiwan's Board of Foreign Trade (BOFT) works assiduously to assist local companies enhance their international competitiveness through measures such as the Product Image Improvement Plan, various trade training schemes for company personnel, a large export promotion service unit, promoting Taiwan as a Worldwide Purchasing Centre, generous SMEs export credit, export insurance and

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export financing schemes.[10] More generally, Taiwan's trade-related ministries and their agencies currently preside over broad export-oriented industrialization (EOI) objectives and a 'strengthened export promotion plan' in alignment with a strategic trade agenda.[11]

Whilst Taiwan's main industrial policy agenda, the IDB, acknowledges the need for Taiwanese firms to embrace a more liberalized industrial environment, it continues to place generally great stress on EOI promotional strategies and measures. Interviewed IDB officials stated that the agency's main function is 'to improve Taiwan's technological upgrading so as to enhance competitiveness.'[12] This marks a neo-mercantilist continuity in Taiwan's trade-industry policy nexus, yet there has also been significant evolutionary change as well. The sector-specific emphasis in Taiwan's industrial policy has, however, gradually diminished in favour of horizontal measures, where economy-wide R&D incentives and tax credits on industrial investment are made available. Moreover, there has been a discernible shift from a directive to a more facilitative approach in industrial policy. However, these twin transitionary processes have been gradualistic, with the retention of many established forms of industrial policy. For instance, the IDB still maintains five offices for specific sector development, these being information industry, aerospace, biotechnology and pharmaceuticals, precision machinery, and digital video. In recent years, the IDB has even afforded more priority to improve the competitiveness of Taiwan's traditional industries, such as bicycle manufacture and textiles. Furthermore, a medium-to-long term planning framework remains evident in many sectoral or generic aspects of Taiwan's trade-industrial policy nexus. Examples include Five-Year Plans for Upgrading Product Design Capabilities (which began its third five-year phase in 2000), Training of Technical Personnel, National Quality Promotion Programme, and Promotion of Alliances and Competitiveness of Manufacturing Industry. The IDB also continues to set long-term development targets, for instance relating to R&D expenditure and skilled personnel development in key export industries.

International Finance Policy There are two useful initial points to note before examining Taiwan's international finance policy in closer

[10] *Trade Policies and Measures*, www.boft.gov.tw.

[11] As acknowledged in research interviews with government officials from the Ministry of Economic Affairs and their agencies (e.g. BOFT, IDB), April 1999 and April 2000.

[12] Interviews at IDB, April 2000.

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detail. These are that a gradualistic trend of liberalization has been evident in this technical policy realm over many years, and that the Taiwanese state's high prioritization of the finance-credit security objectives[13] has perpetuated its strong managerial and control capacities in this policy field. As Thurbon (2001) contends, financial liberalization in Taiwan has been implemented in a manner that has seen a simultaneous enhancement of state capacity to effectively intervene in the economy, and this is primarily vested in the institutional apparatus of the Central Bank of China (CBC). Recent CBC governors have commonly viewed the foreign opening of Taiwan's finance markets with considerable caution. For instance, according to an interviewed foreign banker in Taipei, 'the Taiwanese Government . . . don't like people speculating with the NT dollar, which explains why they maintain strong regulations between the NT dollar and foreign currencies, and also on foreign currency loans.'[14] This exemplifies Taiwan's cautious and strong institutional approach to international financial liberalization.

The Taiwanese Government liberalized international finance policy in an *ad hoc* and rather piecemeal manner from the 1950s to 1970s. For example, it liberalized certain foreign exchange controls as part of the 1960 Statute for the Encouragement of Investment. It was not until the late 1970s and early 1980s, though, that more substantive liberalization was implemented, in general alignment with the government's broader economic liberalization policy. In February 1979, Taiwan moved from a fixed exchange rate system to a floating system, and established the Taipei foreign exchange (forex) market. Nevertheless, the CBC frequently intervened in the currency markets up to and during the latter 1980s. This was not least because it wished to mediate the shock-adjustment effects on importers and exporters stemming from Taiwan's aforementioned 'twin surplus' predicament at the time, especially after its huge trade surplus of 1986 had precipitated a significant inflow of speculative capital, hence applying further upward pressure upon the NT dollar. The CBC also established open current account transactions in July 1987, and afterwards further liberalized Taiwan's capital account that in turn spurred foreign direct investment (FDI) inflows and outflows. By the late 1980s, the CBC had adopted a less interventionist

[13] The pursuit of finance-credit security broadly relates to ensuring the financial solvency of the FEP power in the international system, as well as its maintenance of access to, or influence or control over sources of international credit (Dent 2002).

[14] Interview with Japanese bank representative in Taipei, April 2000.

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approach in the forex market, with significant interventions only occurring in 1991 and 1994 up to the 1997–98 financial crisis.

As the 1990s progressed, Taiwan's WTO accession negotiations prompted the further liberalization of its international finance policy, especially with respect to capital markets. Consequently, restrictions on foreign banks establishing operations in Taiwan were lifted, and certain controls on Taiwan's foreign exchange revenues and expenses[15] were removed. Nevertheless, during the financial liberalization process of the 1980s and 1990s the CBC deliberately fortified Taiwan's shock-absorbing capacity to withstand international shocks to the economy, or perpetrated actions by China intended to compromise Taiwan's finance-credit security position. The Taiwanese state's retained strong managerial and control capacities within its foreign exchange policy are embodied within the Statute for Foreign Exchange Regulation and the Statute for the Administration of Foreign Exchange. These statutes, along with other institutional frameworks, empower the CBC with the robust supervisory and monitoring mechanisms that have ensured a relatively successful implementation of international financial liberalization.

This strong institutional framework could be starkly contrasted with its relatively weak counterparts in South Korea and most of Southeast Asia leading up to the 1997–98 East Asian financial crisis (Hsu 2000, Thurbon 2001, Wang 2000). Whereas financial liberalization had allowed South Korean and Southeast Asian banks and firms to run up enormous foreign debts within a free market climate where only limited institutionalized checks and balances were applied, Taiwan's financial institutions were compelled to exercise much stricter prudence in the extension of their loans secured by stocks (3.7% of their total loans). Consequently, Taiwan's nonperforming loans as a share of total loans during the crisis stood at an extremely low 3.8% (Kuo and Liu 1999). Similarly, the CBC closely monitored the level of foreign debts incurred by Taiwanese companies, and furthermore stipulated that firms raising foreign currency loans for domestic use had to invest in new plant facilities and not stocks and real estate, thus avoiding the speculative asset bubbles that had beset many Southeast Asian countries. The CBC also prohibited domestic banks from offering local currency accounts

[15] In relation to those derived from the trading of commodities, services and government-approved investments, as well as capital revenues and expenses derived from international trade.

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for their customers abroad and restricted outbound movements of the NT dollar, thus mitigating the currency's internationalisation, i.e. the growth of its off-shore market trading. This allowed the CBC to remain the sole market maker of Taiwan's currency.

Taiwan's 'liberalization plus' approach in international finance policy is further illustrated by events and developments occurring both during the 1997–98 crisis period and beyond. After a period of sustained currency market intervention during the late summer months of 1997 intended to counteract speculative attacks on the NT dollar, the CBC imposed new stipulations in October 1997 upon banks to decrease bad foreign loan ratios. Later on in May 1998, the CBC closed a loop-hole in the non-deliverable forward market that effectively constrained the flow of speculative capital flows. Around the same time, it also reintroduced an old monitoring measure, whereby foreign exchange traders had to immediately report any transactions exceeding $0.5 million for individuals and $1 million for corporations. A few months later in August 1998, the CBC invoked statutory powers that enabled it to make extraordinary interventions in the foreign exchange market to head off intense speculative pressure from international financiers such as George Soros.

These measures deployed by the CBC helped Taiwan ride through the region's financial crisis relatively unscathed. A similar approach to international finance liberalization was continued into the post-crisis period. By 2001, Taiwan's foreign exchange liberalization had reached the following status. Funds not involving NT dollar transactions could flow freely in and out of Taiwan. Meanwhile, non-NT dollar forex inflows and outflows relating to current account transactions were also completely liberalized, as were capital account-related forex transactions for trade and investment purposes, albeit requiring prior authorization by the CBC. More specifically, international capital flows stemming from transnational business activities were encouraged to transact through cross currency swaps, the idea being to minimize forex market volatility risks. Short-term capital movements, however, continue to be subject to certain restrictions, although some of these have been recently eased. For example, by October 2000 the ceiling on total permissible investments allowed per qualified foreign institutional investor (QFII) in Taiwan's domestic securities was raised from $1.2 billion to $1.5 billion, and raised further still to $2 billion a month later. Non-QFII foreign firms and individuals still face respective $50 million and $5 million caps on their investments in Taiwan's stock market. Furthermore,

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financial institutions managing trust funds earmarked for investment in foreign securities are prohibited from investing in highly speculative funds or financial derivatives, and also from acting as domestic agents for selling unapproved overseas funds.[16]

In general, the Taiwanese state's proclivity for institutionalized 'safety net' measures to accompany international finance liberalization thus remains strong, as other post-crisis policy developments further testify. For example, in January 2000 a $26 billion National Stabilization Fund and associated regulations were introduced to protect Taiwan from potential short-term volatility in forex markets following WTO entry. This related to the anticipated influx of foreign funds entering Taiwan after the full WTO-induced liberalization of its capital markets. A month later in February 2000, the CBC restated its intention to intervene in circumstances of severe speculative pressure upon Taiwan's currency. The following December, the CBC imposed a 5% required reserve ratio on all newly foreign currency deposits created in domestic banking units, the intention being to maintain adequate foreign currency liquidity in the banking system and stabilize the NT dollar in the currency markets. Later on that month, the ratio was raised to 10%, consequently helping the NT dollar exchange rate to rebound to 32.99 per US dollar. In April 2001, the CBC relaxed the limits on overseas investment by local insurance companies to help boost their profitability, allowing them to use up to 20% of their 'revolving funds' for such investment. However, they were simultaneously required by the Bank to hedge forex risks by undertaking cross currency swap contracts at amounts equivalent to the outward remitted funds designated for their foreign investments.[17]

A similar 'liberalization with re-regulation' approach has too been evident in recent changes to the financial aspects of Taiwan's Cross-Strait commerce policy. For example, on 19 September 2001 Mainland Affairs Council chief, Tsai Ing-wen, declared that the $50m ceiling on mainland investment projects would be replaced by an annual ceiling on total corporate investment in mainland China. According to Tsai, this was designed to give Taiwanese firms more flexibility while limiting the risks associated with excess capital outflows. Moreover, this constituted a shift from firm-specific, micro-controls to macro-controls, and would be implemented by the end of

[16] *Annual Report of the CBC, 2000*. From CBS website: www.cbc.gov.tw.
[17] *Taiwan Economic News*, 26.04.2001.

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2001. The government also made no promises on relinquishing its product-specific and industry-specific bans on Taiwanese firms Cross-Strait investments, and singular mainland investments over $50m would continue to be reviewed for approval by state officials.

IV. Conclusion

This analysis has contended that there are many paths to economic liberalization, and that the most effective do not entail surrender but rather an upgrading of the state's economic governance capacities. Our case study on certain technical aspects of Taiwan's foreign economic policy (FEP) have shown how liberalization has been effectively implemented with the assistance of parallel policy measures, which together have advanced the institutionalization of market order and market development within the Taiwanese economy. In many ways, this is commensurate with the emerging conventional wisdom on economic liberalization *per se*, as embodied within new social democratic perspectives on neo-liberal economic reform.

From this stems the 'liberalization plus' approach to Taiwan's technical FEP formation, as discussed in illustrative regard to the trade-industry policy nexus and international finance policy. In the former, progressive trade liberalization has been accompanied by an evolving paradigm of industrial policy that, amongst other things, retains a focus on empowering Taiwanese industries to take full advantage of the competitive discipline engendered by trade policy liberalization. As trade liberalization is intended to open up Taiwan's firms to greater international competition, so Taiwan's industrial policy is simultaneously designed to enhance the economy's export competitiveness and techno-industrial advancement—the tools may have changed but the underlying objectives of industrial policy have not. More generally, this is consistent with the evolution of the Taiwanese developmental state, in that it is adapting to the new economic challenges of the globalization era by combining economic openness with compensatory policies designed to enhance national competitiveness.

In Taiwan's international finance policy, it was shown how liberalization has been accompanied by tighter supervisory mechanism and the re-regulation of international capital and currency markets. Whilst Taiwan's financial market regimes have gradually opened up to foreign competition, so has the state's capacity to counteract the

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risks of international market volatility that potentially stems from the same financial openness. Moreover, international finance liberalization is not perceived by the Central Bank of China and other state institutions as simply an end in itself but rather part of broader developmental objective, that is to further advance Taiwan's financial market development and competitiveness. This too is consistent with Taiwan's evolving developmental statism. According to the CBC, a key stated policy objective of financial liberalization is to induce greater foreign capital inflows, which, in combination with Taiwan's substantial foreign exchange reserves, are to help foster 'new industry development'.[18] In sum, the general lesson from this case study is clear. Economic liberalization does not necessarily imply a withdrawal of the state's involvement in matters of economic governance—indeed, the Taiwanese experience demonstrates that liberalization can be most effectively implemented in an environment where comparatively high degrees of state capacity and institutionalized market order are evident.

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[18] *Annual Report of the CBC, 2000*. From CRC website: www.cbc.gov.tw.

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