Rethinking the Taiwanese Developmental State*

Yongping Wu

ABSTRACT The uniqueness of Taiwan's industrialization is that small and medium-sized enterprises (SMEs) had been the major contributors to exports. What has been responsible for the success of the SMEs? How far and in what ways did the state contribute to their success: can it be attributed to the government's industrial policy? The statist account of Taiwan's development, a dominant approach to explain its economic growth, is weak in answering these questions. This article argues that the existence of a unique industrial structure was key in the explanation of Taiwan's SME-led exports. The industrial structure was basically a consequence of the state's political strategies that determined its public policy towards the private sector. It argues that the market rather than industrial policy was the explanation of the industrial success of SMEs; the economic bureaucracy was a world of politics rather than a range of monolithic institutions; and strongman tactics rather than institutions were the source of state steering capacity and were responsible for the success of industrial policy. It concludes that Taiwan's development was a "politically inspired industrial success" rather than a state-led development.

Developmental state theory has been a dominant approach for over a decade to explain the economic success in East Asia. Taiwan's economic success is not attributed to the free market as the neo-classical economists have postulated. The state has been a key player in the economy. The "statist" school is helpful in drawing scholarly attention to the state. However, statism does not adequately explain the role of the state in Taiwan. One of its major weaknesses is its ignorance of politics. The uniqueness of Taiwan's industrialization is that small and medium-sized enterprises (SMEs) have been the major contributors to exports. What has been responsible for the success of the SMEs? How far and in what ways did the state contribute to their success; can it be attributed to the government's industrial policy? If not, then what is the explanation?

The statist account of Taiwan's development is weak in answering these questions. A new interpretation of the Taiwanese experience is needed. This article points out the lacunas in statism and adds a political dimension to the analysis of economic development. The article starts with an introduction to East Asian developmental state theory. It then points out the problems of the developmental state thesis to explain

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Taiwanese development, before clarifying its own account of Taiwan's development.

The East Asian Developmental State

According to statism, the states in Japan, South Korea and Taiwan were able to craft economic development through intensive intervention. The single-minded states steered industrialization in terms of long-term national interests, reining in domestic and international market forces and harnessing them for national ends. For this purpose, market rationality was often constrained by the priority of industrialization.[1]

What the adherents of this paradigm find in East Asia is a "governed market" instead of a free market. They argue that the states in East Asia often disregarded comparative advantage, which the neo-classical vision contends was strictly adhered to in East Asia, in order to promote selected strategic industries for the sake of future competitiveness. The states decided which industries should be developed and chose who should enter these industries. Using various policy instruments, they established incentives to promote and barriers to protect the targeted industries. In order to realize their goals, they often picked "winners," even "made winners." They often got the prices wrong by deliberately distorting them to induce the private sector to make decisions that served the government's goals.

Policy instruments and state–private sector co-operation are mentioned as two other sources of state capacity. Johnson holds that state capacity largely relied on the policy instruments of the government.[2] In East Asia, the governments used a wide range of policy instruments, including credits to incentives, import and export controls, and control of foreign exchange. Through these, the states were able to induce and guide private enterprises to meet their goals.[3] Some statists contend that state capacity also relies on institutional and organizational links with private enterprises.[4] Therefore, institutions are viewed as important elements of the

1. The statist view is well elaborated by Chalmers Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1924–1975* (Stanford: Stanford University Press, 1982); Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (Princeton: Princeton University Press, 1990); Alice Amsden, *Asia's Next Giant: South Korea and Late Industrialization* (New York: Oxford University Press, 1989); Stephan Haggard, *Pathways from the Periphery: The Politics of Growth in the Newly Industrializing Countries* (Ithaca: Cornell University Press, 1990); Frederic Deyo (ed.), *The Political Economy of the New Asian Industrialism* (Ithaca: Cornell University Press, 1987); Peter Evans, *Embedded Autonomy: States and Industrial Transformation* (Princeton: Princeton University Press, 1995); Peter Evans, Dietrich Rueschemeyer and Theda Skocpol (eds.), *Bringing the State Back In* (Cambridge: Cambridge University Press, 1985).

2. Chalmers Johnson, "Political institutions and economic performance: the government–business relationship in Japan, South Korea, and Taiwan," in Deyo, *Political Economy*.

3. Johnson, *Japanese Miracle*; Wade, *Governing the Market*.

4. Johnson, "Political institutions and economic performance"; Ziya Onis, "The logic of the developmental state," *Comparative Politics*, Vol. 24, No. 1 (October 1991), pp. 109–126. Evans emphasizes that "embedded autonomy" is a key element in the developmental state. See Evans, *Embedded Autonomy*. Weiss and Hobson propose a "governed interdependence"

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strong state in East Asia.[5] Haggard also emphasizes the determinant role of politicians and bureaucrats in final policy decisions.

The substantial use of subsidies is considered a major way by which the states in East Asia governed the economy. The state heavily subsidized a selected group of industries and subsequently exposed them to international competition, though this does not mean that the state was a generous philanthropist. In fact, it established discipline-specific stringent performance requirements in return for the subsidies. This was particularly true in South Korea.[6]

According to statism, the East Asian states guided industrialization through a coherent and capable economic bureaucracy which enjoyed a high level of autonomy and had remarkable capacity. Autonomy provided the state with the ability to formulate and pursue goals that were not simply reflective of the demands or interests of social groups or classes. State capacity enabled the state to implement official goals, especially over the actual or potential opposition of powerful social groups or in the face of recalcitrant socio-economic circumstances.[7] The provenance of autonomy and capacity is variously attributed to authoritarian political arrangements, historical legacies and external circumstances such as geo-political significance. However, the core reason is good institutional arrangements whereby the division of labour between politicians and bureaucrats enhanced the bureaucrats' ability to pursue policy goals.

That the interrelations between the state, local capital and multinational companies in East Asia differed from those in their Latin American counterparts is also taken as a key factor contributing to the formation of the "strong state" in East Asia.[8] The "linkage sequencing" in East Asia was that the state was built up before the multinational corporations and local capital developed.[9]

Statism provides the latest examples of and elaboration upon Gerschenkron's classic account of the role of the state in late development.[10] It contends that the role of the state in East Asia goes far beyond providing fundamentals as argued by the neo-classical economists. The

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footnote continued

model to highlight the importance of the link between government bureaucrats and the private sector. Linda Weiss and John Hobson, *States and Economic Development: A Comparative Historical Analysis* (Cambridge: Polity Press, 1995).

5. Haggard, *Pathways from the Periphery*; Chu Yun-han, "State structure and economic adjustment of the East Asian newly industrializing countries," *International Organization*, Vol. 43, No. 4 (Autumn 1989), pp. 647–672.

6. Amsden, *Asia's Next Giant*.

7. Theda Skocpol, "Introduction: bringing the state back in," in Evans *et al*., *Bringing the State Back In*.

8. Stephan Haggard, "The newly industrialising countries in the international system," *World Politics*, Vol. 38, No. 2 (January 1986); Alice Amsden, "State and Taiwan's economic development," in Evans *et al*., *Bringing the State Back In*; Amsden, *Asia's Next Giant*.

9. Peter Evans, "Class, state, and dependence in East Asia: lessons for Latin Americanists," in Deyo, *Political Economy*.

10. Alexander Gerschenkron, *Economic Backwardness in Historical Perspective* (Cambridge, MA: Harvard University Press, 1962).

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state is substantially involved in the shaping of the marketplace and is thus a critical factor influencing the process of economic development.

Problems of the Developmental State Thesis in the Case of Taiwan

What is explained? Statism's account of the Taiwanese experience has some merits. It delineates the basic characteristics of the state and state–society relations in Taiwan, including the state's authoritarian nature and its corporatist relations with society, its intensive use of a wide range of policy instruments, and the significance of the public sector in the state's effort to steer industrialization. It also deals with the provenance of the state's political dominance over society. The authoritarian political structure, historical legacies (having being a Japanese colony and an émigré regime) and external circumstances (its geopolitical significance during the Cold War and the contentious relationship across the Taiwan Strait) have all been cited as factors that contributed to the state's political dominance over society. In addition, it points out the *dirigiste* nature of the state in the economy.

In response to the generalized East Asian developmental state model, some researchers emphasize the differences in state structure and development strategy among Japan, South Korea and Taiwan.[11] These revisions advance understanding of the Taiwanese experience. However, more work needs to be done to refine this understanding.

What is questionable in the statist account of the Taiwanese experience? Statism's core assumption about the state in Taiwan is that it must have great steering capacity and coherent and consistent economic policies with the right institutional mix to sustain and to implement them. Is this really the case or is it a grossly idealized picture?

The assumption of a monolithic and unitary bureaucracy is key in the statist account of a meritocratic and capable economic bureaucracy in East Asia.[12] However, evidence shows that this is inaccurate and apolitical in the case of Taiwan. As correctly pointed out by Pempel, the logic of the developmental state thesis on the issue of bureaucracy is Weber's idealized bureaucracy, which is "totally depoliticised, socially disembodied, and in rational pursuit of a self-evident national interest."[13] In fact the economic bureaucracy was full of interest conflicts, ideological divisions, inter-bureaucratic rivalries, personality differences, factional struggles and clashes of opinion over policy issues. Basically, the economic

11. T.J. Pempel, "The developmental regime in a changing world economy," in Meredith Woo-Cumings (ed.), *The Developmental State* (Ithaca: Cornell University Press, 1999); Tun-Jen Cheng, "Political regimes and development strategies: South Korea and Taiwan," in Gary Gereffi and Donald L. Wyman (eds.), *Manufacturing Miracles: Path of Industrialization in Latin America and East Asia* (Princeton: Princeton University Press, 1990).

12. See, for example, Peter Evans, "Transferable lessons? Re-examining the institutional prerequisites of East Asian economic policies," *Journal of Development Studies*, Vol. 34, No. 6 (August 1998), pp. 66–86.

13. Pempel, "Developmental regime," p. 144.

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bureaucrats were divided into the presidential residence faction (so-called because of their close relationship with the first family) and the non-presidential residence faction. The financial and monetary officials belonged to the former. They were highly trusted by the Chiang family and were used to check the economic bureaucrats. Two major figures of this faction were Xu Boyuan and Yu Guohua, who had both been long-time governors of the Central Bank of China.

Prior to the mid-1960s, the US aid-financed economic planning agencies played a more important role than the routine ministries like the Ministry of Economic Affairs (MOEA) and the Ministry of Finance (MOF) in economic policy-making. These agencies included the Industrial Development Council (IDC, 1953–58), Economic Development Board (EDB, 1953–58), Council for US Aid (CUSA, 1959–63) and Council for International Economic Co-operation and Development (CIECD, 1963–73). They initiated all plans for industrial development and the MOEA and MOF did no more than follow or oppose these plans.[14] However, caution should be exercised when assessing the role of these agencies for the following reasons. First, they were short-lived (the IDC, the EDB and the CUSA for five years, and the CIECD for ten years). Institutional continuities were fragile. As late as 1985, the CEPD became the first institutionalized economic planning organ. Unlike in Japan and South Korea, where the pilot economic planning agencies were stable, the highest leaders in Taiwan scraped the economic agencies at will. An institution could be set up if the president thought there was a need but it could be dismantled if he disliked it. The classical instance is the replacement of the CIECD by the Economic Planning Board (EPB) in 1973 (which lasted five years). This change was Chiang Ching-kuo's personal decision. Differences between Chiang and the bureaucrats in the CIECD on economic issues were a major reason for his dismissal of this body.[15]

Secondly, the functions of these organs depended on who headed them. Their role would increase under the leadership of a strongman and be reduced without a strongman. The IDC under Yin Zhongrong was very active and efficient but was much less so when Jiang Biao was in charge because of his conservative style and low staff morale.[16] It sounded absurd when the newspapers headlines hailed: "To strengthen its administrative functions, the CIECD chaired by the deputy premier." In fact,

14. Wang Zhaoming, *Wang Zhaoming huiyilu* (*The Memoirs of Wang Zhaoming*) (Taipei: Shibao chuban, 1995), p. 76; personal interview notes.

15. There are two explanations for why Chiang Ching-kuo disbanded the CIECD. The first is that he felt that the it was so powerful that it presented a threat to him (Ye Wan-an, "Taiwan jingji sheji jigou de yanbian (1)" ("The evolution of Taiwan's economic planning agencies (part 1)"), Speeches at the Institute of Economics, Academia Sinica (Taipei, 1995), p. 60); The second explanation is that Chiang was at odds with the people from the CIECD over various economic issues. He thus disliked the CIECD (Kang Ludao, *Li Guoding koushu lishi* (*The Oral History of K.T. Li*) (Taipei: Zhuoyue, 1993), pp. 211–12); personal interview with K.T. Li, 1998. The author of this article argues that the dismisssal of the CIECD reflected Chiang's intention to strengthen his control over economics by way of winning support from the ministries and weakening the economic planning agency which was already powerful.

16. Wang Zhaoming, *The Memoirs of Wang Zhaoming*, pp. 51–53.

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they were not joking. The function of the CIECD was strengthened when Chiang Ching-kuo, then vice-premier, replaced premier Yan Jiagan as its head in 1969. The power and function of the IDC, EDB and CUSA increased once Yin took over as leader. The MOEA and MOF began to be active after K.T. Li headed them.

Thirdly, their autonomy from the highest leadership was precarious. While to some extent they were immune to pressure from other parts of the state, mainly the military, intelligence, parliament and the party, they were very sensitive to the will of the highest leadership.[17] There was a difference in the degree of autonomy the bureaucrats enjoyed between the Chiang Kai-shek and the Chiang Ching-kuo periods. Chiang Kai-shek gave his staff more discretion in daily routines while his son was inclined to meddle in very specific economic affairs.[18] According to K.T. Li, Chiang Ching-kuo had less trust in the bureaucrats than did his father.[19] However, even during the former period, Chiang Kai-shek had the final say in all important economic policies. Without the president's sanction, the institutions were meaningless. Pempel's criticism of the developmental state thesis's view of the bureaucracy is relevant: "Few contend that bureaucrats take their orders from political officials (elected or otherwise)."[20] Fourthly, conflicts were pervasive among these planning agencies and ministries such as MOEA and MOF.

Statism's second assumption about the state in Taiwan is that the economic bureaucracy had strong steering capacity in industrial growth. The state did show such capacity in some cases, such as in the textile industry in the 1950s, but it was questionable in other cases.

Findings on the failure of the state's effort to promote the automobile industry point the blame on the institutional arrangements of the economic bureaucracy. These included the bureaucratic conflicts between the MOEA's IDB and the CEPD (the two organs often advocated contradictory policies and frequently clashed over policy issues). There was also personal competition between the heads of the two organs who held different views about the project and had different personalities. In addition, there was a lack of the expertise required by the complex techno-economic changes as well as a lack of a qualified staff. The inability to insulate policy-making from the fierce lobbying of domestic and foreign car manufacturers was also responsible for the failure.[21] The case study of Hua Tung Heavy Trucks shows the diversity of elements in

17. It is true that the talents recruited by the economic planning agencies with higher salaries increased the pivotal role of these agencies but it is insufficient to assume that these agencies enjoyed unusual organizational autonomy. See Tun-Jen Cheng, Stephan Haggard and David Kang, "Institutions and growth in Korea and Taiwan: the bureaucracy,"*Journal of Development Studies*, Vol. 34, No. 6 (August 1998).

18. For example, from 1978 on, Chiang Ching-kuo chaired a series of economic meetings attended by all key economic officials. From the minutes of the meetings it is obvious that Chiang bypassed the prime minister and dominated the meetings. He gave instructions on every issue. See *Minutes of the Economic Meetings Chaired by the President*.

19. Personal interview with K.T. Li, January 1998.

20. Pempel, "The developmental regime," p. 144.

21. Walter Arnold, "Bureaucratic politics, state capacity, and Taiwan's automobile industrial policy," *Modern China*, Vol. 15, No. 2 (April 1989).

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the policy process: different goals pursued by various groups within the government, patterns of coalition and opposition among these groups, and patterns based not only on bureaucratic position but also on such factors as personal ties and educational training.[22]

The reversal of the government's decision to cancel the petrochemical industry's status as a key industry can also be cited. Adopting suggestions by academics, in 1981 the Sun Yunxuan cabinet decided to suspend further expansion of the intermediate stream sectors of the petrochemical industry, which had been listed in 1973 as one of the key industries by Chiang Ching-kuo, because of its oil-consuming and high-polluting nature. This decision, however, was reversed by the Yu Guohua cabinet in 1984 due to mounting pressure from the business sector and Yu's own close connection to the state-owned enterprises (SOEs) in this sector that had already become a vested interest. The petrochemical industry thus regained its status as a key industry.[23]

The "statist" account of the success of industrialization in East Asia focuses upon strategic intelligence. It assumes that industrial policy explains the industrial success of these economies, based on Wade's sectoral or industry-specific industrial policy. According to Wade, "a sectoral industrial policy aims to direct resources into selected industries so as to give producers in those industries a competitive advantage."[24] He assumes that this type of industrial policy is able to produce better results than an unguided policy, and the success of South Korea and Taiwan can be attributed to this. However, the argument has two problems. The first is that it cannot explain why some industrial policies succeeded while others failed. There certainly were some success stories, such as the petrochemical and semiconductor industries. However, there were some equally spectacular failures, such as the automobile industry. The second problem is that the selective industrial policy cannot explain the success of downstream industries, which were not part of the strategic design. Their performances were outstanding even though state intervention was conspicuously absent. It seems that the reasons for the success of these industries were more complex than the strategic intelligence account can address.

What is not explained in the statist account of Taiwan's development?
The real lacuna in the statist account of Taiwan's industrial success is the outstanding performance of small and medium industries. The SME

22. Gregory W. Noble, "Contending forces in Taiwan's economic policymaking: the case of Hua Tung Heavy Trucks," *Asian Survey*, Vol. 27, No. 6 (June 1987), pp. 683–704.

23. Wang Zhenhuan, *Shei tongzhi Taiwan?* (*Who Rules Taiwan?*) (Taipei: Juliu tushu gongsi, 1996), ch. 3; Chu Wan-wen, "Chanye zhengce de shifan xiaoguo: Taiwan shihua chanye de chansheng" ("Demonstration effects and industrial policy: the birth of Taiwan's petrochemical industry"), *Taiwan shehui yanjiu jikan*, No. 27 (September 1997); Li-min Hsueh, Chen-kuo Hsu and Dwight H. Perkins (eds.), *Industrialization and the State: The Changing Role of the Taiwan Government in the Economy, 1945–1998* (Cambridge, MA: Harvard Institute for International Development and Chung-hua Institution for Economic Research, 2001).

24. Wade, *Governing the Market*, p. 13.

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sector was a pivotal player in Taiwan's economy. The SMEs were major employers, accounting for over 50 per cent of all workers during the late 1970s and early 1980s. They were major producers, responsible for 44.9 per cent in 1976 and 47.6 per cent in 1984 of the total value of production. In particular, they were not only major exporters but also the engine – more tugboat than locomotive – of the whole Taiwan economy by virtue of their backward linkage to upstream SOEs and intermediate stream large enterprises (LEs). For example, the SMEs' share of the value of exports was over 60 per cent from 1981 to 1985.[25] Their tugboat role resulted in a "buyer-driven" economy in Taiwan. This differs from a "production-driven" economy where the larger firms in the networks create demand for the smaller firms outside the networks.[26] In a "buyer-driven" economy big businesses are upstream suppliers of intermediate goods and services, responding to the demands generated by manufacturing networks of small and medium-sized firms that, in turn, respond to the demands of buyers external to the producing networks. Production in these networks relies on external markets.[27] Taiwan's LEs are not organizing nodes in commodity chains.

These statistics in themselves are significant. However, if we compare Taiwan to South Korea and Japan, the significance of the SMEs in Taiwan's economy is even more striking. In South Korea and Japan, it is the conglomerates that contribute the greater part of GNP and provide most of the final products for export. In South Korea, for example, 70 per cent of its exports were generated by the ten top business groups in 1983.[28] Given the significance of SMEs in the Taiwanese economy, the analytical challenge is to find an explanation for their success.

Conspicuously, the SME sector was not strategically designed. The market in which it existed was not a governed market, so its success cannot apparently be attributed to the government's selective industrial policy. The challenge to Wade's account is that, if Taiwan's industrial success is attributed to industrial policy, is the success of the SMEs also attributed to this policy? If yes, how did it work? If not, what is responsible for their success?[29]

25. Jingji bu zhongxiao qiye chu (Department of Small-medium Business, Ministry of Economic Affairs), *Zhongxiao qiye tongji* (*Census of SMEs*) (Taipei, 1986), p. 234.

26. Gary Gereffi, "The organization of buyer-driven global commodity chains: how US retailers shape overseas production networks?" in Gary Gereffi and Miguel Korzeniewicz (eds.), *Commodity Chains and Global Capitalism* (Westport, CT: Praeger Publishers, 1993), pp. 96–99.

27. Gary G. Hamilton, "Organization and market process in Taiwan's capitalist economy," in Marco Orru, Nicole W. Biggard and Gary Hamilton, *The Economic Organization of East Asian Capitalism* (Thousand Oaks, CA: Sage Publications, 1997), p. 82.

28. Jong-Chan Rhee, *The State and Industry in South Korea: The Limits of the Authoritarian State* (London: Routledge, 1994), p. 204.

29. The only explanation Wade provides is no more than an assumption that the government can influence investment indirectly within the small-scale segment through influencing large-scale segment. See Wade, "Industrial policy in East Asia: does it lead or follow the market?" in Gereffi and Wyman, *Manufacturing Miracles*, p. 249.

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A New Explanation for the Taiwanese Experience: the Role of Industrial Policy

The explanation for the Taiwanese experience that follows starts from the revisionist literature on the developmental state model. Tun-Jen Cheng does a good job by going beyond the statists' simplistic treatment of industrial policy as a given and explores the social and political bases of the development strategies of Taiwan and South Korea. He places the state's development strategies in a broader socio-political context and shows how strategies were shaped by social and political conditions as constraints and impetuses from time to time.[30] His study adds the socio-political dimensions of economic policy. However, in order to get at a more complete picture of economic policy, we also need to know about the internal structure of the state bureaucracy which plays a pivotal role in the shaping of policy. This section focuses on two key issues in our understanding of Taiwan's economic policy making. On the issue of economic bureaucracy, my explanation is a bureaucratic politics-based account; on the issue of the state's steering capacity and the success of industrial policy, I propose a strongman-based account.

The economic bureaucracy is a world of bureaucratic politics. This article argues that the economic bureaucracy is a world of bureaucratic politics rather than, as statism suggests, a range of monolithic institutions.

I propose a three-layer analytic framework to understand Taiwan's bureaucratic politics. The highest layer was the political leadership, which was paramount. Men such as Chiang Kai-shek, Chen Cheng and Chiang Ching-kuo exercised authority without interference. In the final analysis, they were above the state and the KMT. They could and did make and break any bureaucratic institutions they wished. The effectiveness and even continued existence of individual agencies depended fundamentally upon the support of the leadership. The successes of the CUSA were due to the support of Chiang Kai-shek and Chen Cheng. Equally, the dismissal of the CIECD and its replacement by the EPB was a personal decision made by Chiang Ching-kuo. The legislature did not act as a significant check upon the president. The legislators had come from the mainland in 1949 together with the KMT, of which they largely were members, and they benefited from the freezing of elections to the National Assembly that, in the process, lost most of its autonomy.

The next layer immediately below the political leadership was the upper echelon of the state bureaucracy. Leading figures – the state ministers, heads of the economic agencies and so forth – were designated by the president in discussions with the prime minister, who himself was a member of the top political leadership but equally an appointee of the president. Formally these appointments were approved by the legislature but, certainly up until the late 1970s, it could do little more than approve the selection. It was out of this layer of ostensibly equal ministers and

30. Tun-Jen Cheng, "Political regimes and development strategies."

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agency heads that the strongmen emerged – pivotal figures who could command their agencies and above all had the support of the top leadership. There were five required conditions for an official to become a strongman: political support from the top leadership, political adeptness, initiative and responsibility, charisma, and a group of capable aides. These conditions differentiated the strongmen from the other heads of ministries and enabled them to play a leading role in the policy process.

Inevitably these senior officials had to compete upwards for the support of the top political leaders. This was the case even when two strongmen were at loggerheads over contentious policy issues. A typical example was the reform of the foreign exchange system. Yin and Xu clashed over policy options and were obliged to sell their proposals to Chen Cheng and Chiang Kai-shek. Neither Yin nor Xu could put their ideas into practice without the sanction of Chen and Chiang and the fate of their suggestions was completely in the hands of the political leaders. Chen and Chiang's support for Yin led to the adoption of his reform formula.

It would be a mistake to view the leadership as particularly vulnerable to such competition since the principal determinants of the relationship between the highest leadership and the bureaucratic strongmen were trust and other informal norms and practices. Yin and Li were the most prominent strongmen. Sun Yunxuan became another strongman, though less prominent, during his term as minister of economic affairs due to the strong support of Chiang Ching-kuo. Zhao Yaodong, who was named minister of economic affairs in 1981 and who was personally as strong and dynamic as Yin, was not able to play a leadership role because of lack of strong political support from the leadership and because of the smaller stage left to him as a result of the progressive but limited institutionalization of the economic bureaucracy.

Having secured the support of the leadership, the strongmen had to negotiate the third layer of the bureaucratic politics – the agencies, other constitutional ministries or extra-constitutional economic planning agencies. The third layer provided another condition for the strongmen to exercise power – resources and instruments – in addition to political support and their own charisma. These ministries and agencies had little autonomy. Their role and function depended on their heads, the bureaucrats at the second layer. Although prior to the early 1970s, the economic planning agencies were more active than the formal government ministries, they were short-lived. The political leadership scrapped them at will. Under such bureaucratic politics, the rule of individuals coloured the economic bureaucracy. Particularly prior to the late 1970s power and authority were attached to the strongmen rather than to the institutions.

Bureaucratic politics exists in every bureaucracy.[31] The nature of KMT politics highlights the high importance of bureaucratic politics in the

31. Graham T. Allison's analysis of American foreign policy is a classical clarification of bureaucratic politics. See Graham Allison, *Essence of Decision: Explaining the Cuban Missile* (Boston: Little, Brown, 1971); Graham T. Allison and Morton H. Halperin, "Bureaucratic politics: a paradigm and some policy implications," *World Politics*, Vol. 24 (Spring 1972), pp. 40–80.

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regime. The KMT was never a coherent party during its rule on the mainland, nor during its rule on Taiwan. It was a faction-based authoritarian political system. On the top of the structure was first Chiang Kai-shek and then his son Chiang Ching-kuo. Under the paramount leader, there were several factions, mainly the CC Clique, the Political Study Clique, the Youth Corps Clique and the Military Intelligence Clique. The rule and power of Chiang Kai-shek and Chiang Ching-kuo were based on the manipulation of the factions, balancing them and making them check one another. Although most of the political factions were weakened after the KMT retreated to Taiwan because of its self-reform and because some key figures had not followed Chiang Kai-shek to Taiwan, the ruthless power struggle within the KMT never ceased. When the old factions were weakened, new factions emerged. As Chiang Kai-shek aged, the succession struggle between the old and new factions became a new struggle within the KMT. The patron of the new factions was Chiang Ching-kuo.

The power struggle in the KMT from 1949 to the mid-1970s is a history of the Chiangs excluding and defeating their rivals and establishing Chiang Ching-kuo's position as his father's heir. The strife was mainly between Chen Cheng and Chiang Ching-kuo. Through a long build-up, Chiang Ching-kuo had his own people who were also divided into factions according to the length and origins of their associations. These factions consisted of three circles: inner, middle and outer.[32] Chiang Ching-kuo relied on his inner circle, a compromise of his father's veteran cadres, new people of his own, people seeking affiliation with him on their own initiative, and other prominent leaders with their own independent power bases.[33]

This faction-based politics and power struggle within the KMT determined the salience of bureaucratic politics in the economic bureaucracy. It was extremely important to distinguish between "us" and "them," between allies and enemies. The selection and use of economic bureaucrats affected the issue of factions and some norms of the political culture of the KMT state. The most important impact was that trust became a crucial condition in the leadership's selection and use of economic officials. Trust was based on loyalty, a lack of factional links and political ambitions, and good personal performance.

The case of Taiwan shows that statism's institution-based account of its economic bureaucracy is inaccurate. It is insufficient to assess the operation of the economic bureaucracy merely in terms of institutional arrangements. Political culture and formal and informal norms were key determinants. The role of the economic bureaucracy in Taiwan prior to the early 1970s cannot be reduced to institutions because the role of institutions hinged on three parameters. The first parameter was the

32. Edwin Winckler, "Elite political struggle: 1945–1985," in Edwin Winckler and Susan Greenhalgh (eds.), *Contending Approaches to the Political Economy of Taiwan* (New York: M.E. Sharpe, 1988), p. 150.

33. Quoted in Winckler, "Elite political struggle," pp. 157–58.

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crucial role of the major bureaucrats. Although the US aid-funded economic planning agencies provided a stage for the leading bureaucrats, the role of the former was largely up to the latter. Powerful institutions were related to strong bureaucrats while weak institutions were related to weak bureaucrats. The second parameter was the relationship between the politicians and the bureaucrats. The attitudes of Chiang Kai-shek and Chiang Ching-kuo towards the bureaucrats had centrally differing impacts on the role of institutions. Such a relationship can determine the efficiency and functions of the economic bureaucracy. This is also the case in the Japanese civil service system.[34] The third parameter was political culture. This played an "invisible" role in the economic bureaucracy because it significantly determined the role of individual bureaucrats.[35] This factor has been largely played down in the existing literature on Taiwan's economic bureaucracy. These parameters determined the inner workings of the economic bureaucracy.

The above discussion shows that the language of the developmental state captures something of the state relation to society but it is inadequate to deal with the complexities of policy making and the initial economic action within the state. This has to be understood in terms of "bureaucratic politics" or the "politics of bureaucracy."

The strongman, state capacity and success of industrial policy. Thus, in a world of bureaucratic politics rather than a unitary institutional mix, what is responsible for state capacity and the success of industrial policy?

Aoki *et al.* suggest that co-ordination failure is more fundamental than market failure to economic development.[36] My argument is that the co-ordination problem is not only critical in the market sphere but also crucial within the government. It is a determinant in both policy formulation and at the implementation level given the widespread differences and conflicts between different government agencies. A successful industrial policy must be the result of good co-ordination that can solve differences and conflicts among concerned government agencies, while a failure must be the result of poor co-ordination. Therefore, the focus is the mechanism that can solve the co-ordination problem within the government. Equally important, this mechanism at the same time must be able partly to resolve co-ordination failures between the state and market because policy implementation involves government–private co-operation. The solution is very much up to a mechanism derived from the

34. Hyung-Ki Kim, *The Civil Service System and Economic Development: The Japanese Experience* (Washington DC: The World Bank, 1996).

35. According to aides to Yin, Yan Jiagan played a significant role in co-ordinating between Yin Zhongrong and Chen Cheng and Chiang Kai-shek in all the major economic policies adopted in the late 1950s and early 1960s. Yin's arrogant and outspoken style was often an obstacle to acceptance of his policy suggestions by his colleagues and Chen Cheng (then prime minister). Personal interviews.

36. Masahiko Aoki, Hyung-ki Kim, and Masahiro Okuno-Fujiwara (eds.), *The Role of Government in East Asian Economic Development: Comparative Institutional Analysis* (Oxford: Clarendon Press, 1996).

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government which is able to link the government and market and to mobilize resources to help overcome co-ordination failures in the market.

The problem is, however, does the solution of co-ordination depend on institutions or on individuals? Evidence points to individuals as the answer. In the development of the semiconductor industry in Taiwan, the institutions prior to the early 1980s were weak and not in a position to co-ordinate among different government agencies and between the state and private sectors.[37] This created the stage for a strongman to play a role.

My argument is that state capacity and the success of industrial policy to a great extent depended on the leadership of strongmen because they could solve the co-ordination problem. There were three reasons that enabled a strongman to play such a role. First, he obtained political support from the highest leadership. This was crucial political capital which gave him legitimacy to remove obstacles for industrial policy. The second reason was the strongman's personal charisma. Charisma was very helpful in solving co-ordination problems. These two conditions remained crucial to the success of governmental promotion of industry. The third condition was that the strongman had resources, both financial and human, and instruments. Yin had access to US funding and both Yin and Li had a group of capable aides. Even when he lacked funds and/or human resources, the strongman could resolve these problems through political support by the top leadership, his own influence, connections and personal charisma. Li's role in the semiconductor industry is a perfect example of this. Li used many policy instruments, such as the Statute for Encouragement of Investment, to solve problems relating to capital, human resources and other links in the development of the semiconductor sector.

The success of industrial policy and industrial success. In explaining the role of the state in Taiwan's economic development, we need to distinguish between the success of industrial policy and industrial success. There were examples of successful cases in industrial policy, but there were also conspicuous failures. Industrial policy is insufficient to explain all successful industries. Conventional wisdom confuses the difference.

It can be argued that four conditions were required for an industrial policy to succeed in Taiwan. The first condition was political support from the political leadership, usually given to a strongman and critical in solving co-ordination problems. The case of Taiwan's automobile industrial policy is a typical case of lack of political support being responsible for the failure of an industry. The failure of co-ordination arose because

37. Shen Rongqing, "Taiwan jiti dianlu chanye xingcheng de lujin xuanze" ("The route choice of the formation of Taiwan's IC industry"), *Taiwan yinhang jikan* (*Quarterly of the Bank of Taiwan*), Vol. 48, No. 3 (1997); Constance Squires Meany, "State policy and the development of Taiwan's semiconductor industry," in Joel D. Aberbach *et al.* (eds.), *The Role of the State in Taiwan's Development* (New York: M.E. Sharpe, 1994); Kang Ludao, *Li Guoding*, ch. 9; Yang Aili, *Sun Yunxuan zhuan* (*A Biography of Sun Yunxuan*) (Taipei: Tianxia, 1989).

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the conflict between the CEPD and the MOEA could not be resolved,[38] blamed on a lack of political support. The second condition was the existence of a strongman, as discussed above. The lack of a strongman was the major reason for the failure of the automobile industrial policy. Strongmen can solve co-ordination problems; thus, this condition is related to the former condition. The third condition was a no-risk guarantee. It was a precondition for the private sector to invest in an industry. This was particularly important in Taiwan because in many industries, such as steel, petrochemicals and semiconductors, the private sector was very reluctant to invest in an industry until it became profitable. The SOEs played a leading role as pioneers and models in establishing these industries. The fourth condition was policy design. This concerns the operation of market forces. Policy design can either restrict or facilitate market competition. In many cases, the Taiwanese state did not allow industries to be monopolized by a few operators. In the petrochemical industry, for instance, the state deliberately let in as many LEs as possible. This contrasts with South Korea's "one item, one firm" principle of promoting the petrochemical industry.[39] There were similar practices in the steel and semiconductor industries. The success of these industries shows the success of an industrial policy that facilitates market competition. This type of policy had both political and economic considerations. It aimed to avoid monopoly and political rivalry and to encourage competition.

As to industrial success, it may involve industrial policy. However, in many cases, it involves more than this. This is found in Japan, which is viewed by statism as a proto-model of a developmental state in which industrial success was attributable to the government's successful industrial policy.[40] It is more conspicuous in Taiwan. Small and medium-sized firms manufactured the majority of the products exported by Taiwan. The SMEs' success was not particularly linked to the government's industrial policy and therefore cannot be explained by a selective industrial policy. An explanation for this success remains a critical challenge for an understanding of Taiwan's industrial success.

A New Explanation of the Taiwanese Experience: The Success of the SMEs

The analytic challenge is to explain the extraordinary performance of

38. Arnold, "Bureaucratic politics," pp. 178–214.

39. Hyung-Ki Kim and Jun Ma, "The role of government in acquiring technological capability: the case of petrochemical industry in East Asia," in Aoki *et al.*, *The Role of Government in East Asian Economic Development*, pp. 111–12.

40. Japanese products, such as cameras, colour televisions, pianos, zippers, tape recorders, magnetic recording tape, watches and clocks, calculators, machine tools, textile machinery, ceramics, and robots, flooded international markets during the 1960s to 1980s. But firms "developed under their own power without any particular benefits from industrial policy measures." Ryutaro Komiya, Masshiro Okuno, and Kotaro Suzumura (eds.), *Industrial Policy of Japan* (Tokyo: Academic Press, Inc., 1988), pp. 7–8.

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the SMEs.[41] My account is that Taiwan's unique marketplace enabled the SMEs to develop an industrial production system predicated upon the existence of an array of societal goods and the ability to mobilize these goods so as to offset the disadvantages they otherwise faced in terms of capital shortages and so forth. The peculiarity of Taiwan's industrial structure rested in a strict division of labour between upstream SOEs, intermediate stream LEs and downstream SMEs. This structure had two features. The first was the "dualistic market structure" in which the SOEs and LEs jointly monopolized the domestic market while the SMEs had free run in the export markets. The second was the "tripartite market structure" within which there was a strict division of labour, where SOEs monopolized the upstream industries, LEs were entrenched in the intermediate stream industries and SMEs focused their activities downstream. This marketplace resulted from state action and the interaction between the state and private actors. It was the critical prerequisite for the performance of the SMEs in export markets in that it created necessary space for the SMEs by excluding the SOEs and LEs.

It should be emphasized however that the industrial structure was not in itself the explanation for SME success. Rather, this can be attributed to an industrial production system predicated upon the existence of an array of societal goods and the ability to mobilize these goods so as to offset the disadvantages the SMEs otherwise faced in terms of capital shortages and so forth. This is the explanation for the unusual success of Taiwan's SMEs.

The SMEs did benefit from some general measures of the state, like land reform, promoting education, keeping labour costs at a low level, the devaluation of currency and export tax rebates. However, the underlying point is that these conditions were not sufficient to enable the SMEs to become successful exporters. There must be some further explanation for their success. This article argues that the explanation lies in Taiwan's unique market structure. In order to clarify this it is necessary to distinguish between two different markets. The first consisted of the upstream and intermediate stream industries in which the SOEs and LEs operated. The second was the downstream industries which were dominated by the SMEs. The state managed to govern the first market while leaving the second one to market forces. Industrial policy refers to state action to influence the development of industries. Such state actions

41. A considerable amount of literature in Chinese is devoted to explaining the growth of SMEs. See, for example, Chen Jiexuan, *Xieli wangluo yu shenghuo jiegou: Taiwan zhongxiao qiye de shehui jingji fenxi* (*Cooperative Networks and Life Structure: A Socioeconomic Analysis of Taiwan's SMEs*) (Taipei: Lianjing, 1994); Zhou Tiancheng and Lin Zhicheng, *Taiwan zhongxiao qiye de fazhan jizhi* (*The Development Mechanism of Taiwan's SMEs*) (Taipei: Lianjing, 1999); Yu Zongxian and Wang Jinli, *Taiwan zhongxiao qiye de chengzhang* (*The Growth of Taiwan's SMEs*) (Taipei: Lianjing, 2000). For English literature, see Yongping Wu, "State, social and economic organizations, international context, and the prosperity of small-medium-sized enterprises in Taiwan (1950–1985)," in Ferry de Goey and Jan Willem Veluwenkamp (eds.), *Entrepreneurs and Institutions in Europe and Asia 1500–2000* (Amsterdam: Aksant, 2002); Hill Gates, *China's Motor: A Thousand Years of Petty Capitalism* (Ithaca: Cornell University Press, 1996), ch. 10.

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existed only in the first market. Therefore, the scope of the application of the industrial policy account is irrelevant to the second market since the state let the SMEs have free run in the downstream sectors. These industries were not strategically designed and the market was not governed. SME success was not attributable to strategic state design. It was mainly attributable to a capital substituting industrial production system and societal goods.

Therefore, the questions are "how did this industrial structure come into being?" and "what was the role of the state in its formation and persistence?" One conclusion is that the industrial structure had deeply political roots which derived from the state's strategy to maintain power.

The nature of the KMT regime. Many researchers have pointed out that state–private sector relations in Taiwan differed greatly from those in Japan and South Korea. The Taiwanese state distanced itself from business. It is even more salient that there was almost no direct link between the state and the SMEs. The reasons behind this type of state–business relationship were the regime's anti-business ideology, its nature as an authoritarian regime and sub-ethnic divisions.[42] However, the KMT's nature as an émigré regime is largely overlooked and its implications are ignored.

The states in South Korea and Taiwan shared an essential concern with security.[43] Yet their differences were significant: the KMT was an émigré regime while its South Korean counterpart was not. This difference significantly determined the state's different public policy towards large enterprises and to a great extent resulted in two different patterns of industrialization: SME-led export-oriented industrialization in Taiwan and conglomerate-dominated development in South Korea. Decolonization led to different results in Taiwan and South Korea in terms of politics. Although it weakened the state in South Korea,[44] a new state emerged from the society. However, the state that was strengthened by decolonization in Taiwan was not formed from the former colony; rather it was imposed from the outside. When the defeated KMT central government fled to the island in 1949, what it faced was a hostile (mainly because of the February 28 Incident of 1947 in which 10,000–20,000 locals are estimated to have been killed by the KMT army), and a resentful (being unfairly treated by the mainlanders) and scornful (because of the prevalent corruption of the KMT officials) local majority who made up 80 per cent of the total population. While locals were excluded from politics, they constituted the majority of the private sector. The KMT regime's view and stance toward large enterprises was determined by its distrust of the locals, in contrast to South Korea where the

42. Wade, *Governing the Market*; Tun-Jen Cheng, "Political regimes and development strategies."

43. Meredith Woo-Cumings, "National security and the rise of the developmental state in South Korea and Taiwan," in Henry S. Rowen (ed.), *Behind East Asian Growth: The Political and Social Foundation of Prosperity* (London: Routledge, 1998).

44. Tun-Jen Cheng, "Political regimes and development strategies," pp. 146–47.

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state forged an alliance with business groups (*chaebols*) for industrialization. In Taiwan, the KMT was not only politically predominant over society but also economically vigilant against LEs in order to prevent the emergence of political rivals. Compared to the ruling parties in South Korea and Japan, the KMT also claimed uniqueness in other three aspects: as possessing an anti-business mentality, as a Leninist/quasi-Leninist party, and as an economic actor in own right. Being a quasi-Leninist party largely strengthened the KMT's organizational strength. Running business enabled it to be economically independent. All these explain the regime's arms-length relationship with business.

The unique characteristics of the KMT regime and its vulnerable geographical position put political concerns on the top of the state agenda. Defence expenditures were geared primarily to the external political goal of the state and, above all, security from mainland aggression across the strait. Domestically, political rather than economic goals were paramount.[45] As shown below, however, the pursuit of domestic political goals was to have a very real relevance to economic development.

State political strategies towards society. The nature of the émigré regime encouraged the Taiwanese state both to dominate societal forces and to keep a distance from them. The main elements of the dominant strategies were the authoritarian arrangements of the state structure and the corporatist arrangements in the state's relationship with society.[46] These arrangements allowed the state to keep a distance from the major societal forces in order to avoid being captured and to maintain its relative independence. These political strategies had significant consequences on state public policy towards the private sector and the ways it dealt with the economy.

It is insufficient, however, to explain the reasons the state adopted these strategies only in terms of the nature of the regime. It is necessary to look further at state–society relations. The Taiwanese state differed significantly from that in South Korea and Latin American countries in terms of its relations with society and foreign capital. In many Latin

45. Between 50 and 80% of government expenditure went to defence and diplomacy from 1950 to 1970. Caizheng bu, *Zhonghua minguo jinrong tongji (1967)* (*Financial Statistics of the ROC (1967)*) (Taipei: Ministry of Finance), pp. 36–37; Caizheng bu, *Zhonghua minguo jinrong tongji nianbao* (*Annual Report on the Financial Statistics of the ROC*) (Taipei: Ministry of Finance, 1986), pp. 116–117.

46. Yun-han Chu, "Guazhan jingji yu weiquan zhengzhi tizhi" ("Oligopoly and authoritarianism in Taiwan"), in Hsin-huang Hsiao *et al.* (eds.), *Jiepou Taiwan jingji: weiquan tizhi xia de longduan yu boxue* (*Dissecting Taiwan's Economy: Monopoly and Exploitation under the Authoritarian Regime*) (Taipei: Yeqiang chubanshe 1992); and "The realignment of business-government relations and regime transition in Taiwan," in Andrew MacIntyre (ed.), *Business and Government in Industrializing Asia* (St. Leonards: Allen & Unwin Pty Ltd., 1994); Thomas Gold, *State and Society in the Taiwan Miracle* (New York: M.E. Sharpe, 1986); Edwin Winckler, "Industrialization and participation on Taiwan: from hard to soft authoritarianism?" *The China Quarterly*, No. 99 (September 1984), pp. 481–499; Wade, *Governing the Market*; Alice Amsden, "State and Taiwan's economic development," in Evans *et al.*, *Bringing the State Back In*.

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American countries, alliances were forged between the states and either the working class or the capitalists involved in import substitution and foreign capital. These alliances were political as well as economic and therefore determined the pattern of economic development. In South Korea, industrialization was characterized by a conglomerate-dominated pattern. In Latin America, the triple alliance of the state, local capital and foreign capital was responsible for the second import substitution industrialization,[47] which contrasts sharply with East Asia's shift to export-oriented industrialization. It is salient that in South Korea the state fostered a few large conglomerates and allied with them after the 1961 military coup on the grounds of economic development.[48] Although the KMT regime had a close relationship with a few mainland and Taiwanese capitalists and land reform gained support from the peasants, prior to the 1970s the state in Taiwan did not rely on social forces very much. The reason that governments in South Korea and Latin America allied with certain social classes is that they were politically or economically weak and so they had to rely on others. The state monopoly of the financial system, upstream industries, basic industries and infrastructure enabled the state in Taiwan to be economically independent. It was therefore able to keep a distance from social forces.

State public policy toward the private sector. The regime's political strategies encouraged the KMT to practise a particular type of public policy towards the private sector: protecting and restricting LEs while neither encouraging nor restricting SMEs.

The state fostered a number of LEs by virtue of protection during import substitution industrialization. During the 1950s, by controlling imports, controlling entry, providing credit through state-owned banks and distributing foreign exchange, the state encouraged a number of private firms to become involved in import substitution production. These enterprises grew into large enterprises and business groups in subsequent decades. The motive behind the fostering and protecting policy was both economic and political. To relieve the severe pressure to recover from war damages, to meet the basic needs of the increased population resulting from the influx of 2 million immigrants from the mainland (increasing the total population to 8 million), and to realize the goal of recapturing the mainland, the KMT had to increase production. The KMT faced a society with no entrepreneurs as a result of the Japanese monopoly over the economy during colonial rule. There was therefore a need to foster a private sector. The principle behind the promotion of the private sector was to select and foster economic winners as well as

47. Peter Evans, *Dependent Development: The Alliance of Multinational, State, and Local Capital in Brazil* (Princeton: Princeton University Press, 1979); Fernando Cardoso and Enzo Faletto, *Dependency and Development in Latin America* (Berkeley: University of California Press, 1979).

48. Karl Fields, *Embedded Enterprises: Business Groups and the State in Korea and Taiwan* (Ithaca: Cornell University Press, 1994); Jung-en Woo, *Race to Swift: State and Finance in Korean Industrialization* (New York: Columbia University Press, 1991), ch. 6.

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political supporters among both mainlanders and locals. The enterprises that were picked by the government were allowed access to state-owned resources, ranging from credit to foreign exchange, and thus were able to monopolize the domestic market jointly with the SOEs. A few capitalists were politically selected to be recruited into the KMT's CSC. A relationship was established between the state and these firms. This relationship can be considered to be "close" when compared to the state–SME relationship. But it was far from close when compared to the state–business group relationship in Japan or South Korea. This kind of relationship persisted until the mid-1980s when it was replaced by an alliance of the state and business groups as a result of the Taiwanization of the KMT, democratization and the unprecedented growing influence of the business groups.

On the other hand, the state remained watchful over the LEs and restricted them. This was largely because the majority of the LEs were owned by Taiwanese. The state became increasingly vigilant against the LEs from the 1970s when they developed into business groups. The restrictions operated in three ways. First, there were laws and regulations. The Company Act restricted the size of business operations. It closely regulated reinvestment by restricting inter-firm equity flows. These laws blocked industrial integration. Secondly, the export promotion policy was universalistic rather than particularistic. It kept entry barriers low and incentives universal. This differed from the method that the South Korean state used to promote exports, which channelled resources – particularly cheap credit – to a few conglomerates to make them the nation's export champions.[49] It also deviated from its own method of promoting import substitution industrialization during the 1950s which fostered a number of private enterprises. Thirdly, prior to the 1980s the state blocked the LEs from upward expansion to the upstream industries and some key sectors such as petrochemicals, finance and infrastructure. The upstream SOEs played a strategic role in this respect. This prevented the LEs from becoming vertically integrated conglomerates. Such restrictions had consequences on the size of the business groups. Compared to their Japanese and South Korean counterparts, the leading business groups in Taiwan were less vertically integrated as well as much smaller in size.[50] Prior to the mid-1970s, the state practised a neutral policy towards the SMEs, neither encouraging nor restricting them. There was no encouragement because the SMEs were not important, while there were no restrictions because the SMEs did not threaten the regime. The result of protecting and restricting LEs while ignoring SMEs was that the LEs became entrenched in the domestic market while the SMEs focused on the export market. Rejected by the formal financial system, the SMEs turned to the unorganized financial market. The state's attitude towards the unorga-

49. Jung-en Woo, *Race to Swift*; Amsden, *Asia's Next Giant*; Ku-hyun Jung, "Business–government relations in the growth of Korean business groups," *Korean Social Science Journal*, Vol. 14 (April 1988).

50. See G. Hamilton, M. Orru, and N. Biggart, "Enterprises groups in East Asia: an organization analysis," *Financial Economic Review* (Tokyo) (1987), Table 1.

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nized financial market was significant: it regulated it, although improving the SMEs' financial market was not its first concern. It is clear that the rise of the SMEs in export markets was not the intent of the state. When the government began to promote exports in the late 1950s, the officials did not expect the SMEs to become major exporters because of economies of scale.[51] This consideration is apparently reflected in the Statute for the Encouragement of Investment, a major move taken in 1960 which aimed at promoting exports. The Statute limited incentives in two ways: it was applicable to limited-liability companies only and it aimed at encouraging an expansion of the scale of production by requiring a minimum level of productivity. The first restriction excluded 73.3 per cent of the SMEs that were sole proprietorships, while the second restriction also excluded many SMEs.[52] These conditions clearly indicated that the government expected the larger size firms to be the major exporters.

The state's SME public policy underwent a dramatic shift after the mid-1970s. This change was triggered by the political troubles due to the legitimacy crisis and demands for political participation as a result of Taiwan's loss of its UN seat and economic problems caused by the oil crisis, increasing international competition and the increase in wages. In dealing with these problems, the KMT regime suddenly discovered the significance of the SMEs. They could help in its Taiwanization scheme – the regime's major method to thwart political opposition. Their exports had become increasingly significant to the economic growth that the KMT desperately needed as a new source of legitimacy in the wake of a series of diplomatic setbacks. The SMEs were also viewed as a significant force by the KMT regime in its effort to restrict the LEs that were becoming increasingly influential. Against this background, Chiang Ching-kuo's repeated emphasis on the importance of advancing SME policy and his call for government officials and public banks to provide assistance to SMEs were not merely a consideration of economics.[53] The state was encouraged to adopt a more active SME public policy: from neutrality to encouraging. Consequently, a series of measures that aimed at promoting the SMEs was developed.

51. Ye Wanan, "Yixie zhongda jingji zhengce de beijing ji juece guocheng" ("The backgrounds and policy process of some important economic policies"), *Zai zhongyang yanjiuyuan jingji yanjiusuo de xilie yanjiang zhi'er* (*Series of Speeches at the Institute of Economics, Academia Sinica*), 1995, p. 18.

52. Lin Zhongxiong and Peng Baixian, "Zhongxiao qiye jinrong yu yiban jinrong zhi bijiao" ("A comparison of the provision of finance of small industry and general finance), in Chen Mingzhang (ed.), *Taiwan zhongxiao qiye fazhan lunwenji* (*Essays on the Development of Taiwan SMEs*) (Taipei: Lianjing, 1994), p. 428; Liu Taiying, "Taiwan zhongxiao qiye touzi huanjing zhi yanjiu," in. , p. 450.

53. See, "Zongtong zhuchi caijing huiyi jilu" ("Minutes of meetings chaired by the president"); "Zongtong zhuchi gongshangjie huiyi jilu" ("Minutes with business people chaired by the president"), *Li Guoding Archives* (Taipei: Archives of the Institute of Modern History, Academia Sinica).

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Public policy and the industrial structure. A clear conclusion can be naturally derived from the above analysis: state political strategies and public policy towards the private sector policed and determined the industrial structure. In other words, in effect the state designed and policed the marketplace. This public policy resulted in a kind of industrial structure in which there was a strict division of labour between upstream SOEs, intermediate stream LEs and downstream SMEs. The unanticipated consequence of the industrial structure obliged the SMEs to export since access to domestic markets was denied to them and afforded them a near monopoly of the export market. The state policed industrial organization to preserve the division of labour it had secured through a variety of instruments. These included a universalistic rather than a particularistic export promotion policy from the late 1950s, state maintenance and regulation of the "unorganized" financial market which was the major source of capital for the SMEs (that were denied access to the publicly owned financial system), reinforcement of the LEs' inward activities through "financial constraints" and distribution of other economic rents, strengthening the SOEs' upstream monopoly, and not least the state's restrictions on firm size and legal discouragement of expansion that might have created dangerous political rivals. The consequences for the SMEs were highly significant: immunity from competition from the SOEs and LEs without the loss of the benefits of the input of the intermediate products of the LEs and SOEs, and a marketplace that facilitated societal goods.

However, in understanding such a role for the state four points must be borne in mind. First, much of this role was not economically but politically motivated, the result of a regime's pursuit of non-economic goals such as holding on to power, maintaining stability and defence. The industrial structure was not designed to provide a marketplace in which SMEs might flourish, but this was its effect. Secondly, the role of the state in defining the industrial structure was critical but not always intended or anticipated. The state was not only the unwitting architect of this unique industrial structure but also the witting and watchful policeman that safeguarded the industrial division of labour. Thirdly, it was a result of the interactions of state and private sector actors. The magnitude of such interactions was far greater than co-ordination through institutional linkages. It included indirect and invisible interactions. Fourthly, when the state realized the significance and utility of the industrial structure to its rule, it became a policeman to safeguard this structure.

The clear-cut cleavage between the two markets was a striking feature of the Taiwanese political economy until the mid-1970s. We have argued that the political strategies of the state changed at that time as a new basis for the legitimacy of the regime was sought in response to US recognition of the PRC. The response was Taiwanization and a concerted effort to link to the success of the SMEs. The promotion of the semiconductor and computer industries was the first clear example of a willingness both to target the SMEs and to allow the LEs into new economic activities. The state was less and less the policeman of upstream economic activities and

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more and more the champion of integrated industrial development. The significant consequence of this change is that the dualistic division of the market structure for traditional industries did not appear in that for new industries or for the hi-tech industries. This new marketplace was integrated. While the former was largely an accidental consequence of state action, the latter was a result of intentional state design. The changing role of the state in the formation of the marketplace was a result of the state view of industrial development: it was increasingly committed to integrated sectoral development. It was also a consequence of the change in the state's political concerns in response to the changing state nature, state structure, state–society relations and international circumstances. This is not, however, to imply that a new institutionalized steering capacity had come into existence. The success of industrial promotion in both the semiconductor and computer industries was the work of two remarkable men. The leadership of strongmen remained decisive.

The role of SOEs in the industrial structure. In the state's policing and design of the marketplace, the SOEs played a strategic role. Although the role of the SOEs is noted by statism, their significance is not fully interpreted. According to Wade, the SOEs were used by the state as a policy instrument to govern the market. Whether this was a reason for or the result of the arm's length bureaucracy–private sector relationship, the heavy presence of the SOEs helped complement the co-operation between the bureaucracy and private firms. They also were used to influence private capital by inducing private investment into new fields with high entry barriers and to influence downstream industries through price policy.[54]

In fact, that the state owns enterprises is not unique to Taiwan. In all countries states not only act as regulators but are also producers.[55] In many countries, states play the role of demiurge by becoming involved in directly productive activities in ways that not only complement private investments but also replace or compete with private producers.[56] Provision of infrastructure and other products and services is a traditional state role. Although the level of the Taiwanese state presence in these fields is among the highest in the developing economies,[57] the difference is in degree, not in type. However, what is different is that the Taiwanese state owned all upstream industries. The impact of this is far reaching. It concerns not only policy instruments and public–private co-operation, but the marketplace as well. The upstream SOEs played a dual strategic role in the formation and persistence of Taiwan's industrial structure. First, their presence became a necessary precondition for the establishment of Taiwan's most important industries, such as petrochemicals, steel and information. Their establishment was either a response to the develop-

54. Wade, *Governing the Market*, pp. 179–180.
55. Evans, *Embedded Autonomy*, pp. 77–81.
56. *Ibid*. p. 79.
57. Wade, *Governing the Market*, pp. 176–77.

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ment of the downstream SMEs, such as petrochemicals, or the initiation of a new industry, such as the information industry. Regardless of the reason for their establishment, the presence of the SOEs became a necessary precondition for the development of these industries. They were initiators in the information industry. Although they emerged in the petrochemical industry as a response to the backward linkage of the downstream SOEs, they induced the emergence of the intermediate industries which were invested by the LEs. The role of the first, second and third naphtha-cracking plants built by the China Petroleum Corporation are excellent cases.[58] This model was repeated in the role of state-sponsored or joint state–private ventures – Taiwan Semiconductor, United Microelectronics, Industrial Technology Research Institute and Electronics Research Service Organization – in the development of the semiconductor industry.[59] Without these upstream SOEs, the LEs would not have invested in this sector; the risks would have been too high. The SOEs' significance goes far beyond intervention. It concerns having or not having certain industries. In this regard, looking strictly at the standard of efficiency of the SOEs is too narrow because it minimizes their significance to the economy. What is notable in the case of Taiwan is that the SOEs could help solve co-ordination problems when market failures occurred. This was the case in the steel, petrochemical and semiconductor industries. At the initial stage of these industries, the LEs had no interest in investing in them. There was a market failure because market forces on their own would not develop these industries. There was a need for co-ordination to remedy the market failure. The SOEs played such a role by initiating the projects. It is worth noting that the SOEs often served such a function at the expense of efficiency. In order to promote the intermediate petrochemical industries, the upstream SOEs sacrificed profits to fulfil policy tasks.[60] The Taiwanese case suggests that it is inadequate to see the role of the SOEs merely in terms of efficiency.

Conclusions

This article has tried to bring scholarly attention to the political dimension of Taiwan's development. Its findings suggest that the KMT regime was hardly a developmental state. The state's economic policies were subordinate to its political concerns and changed when the latter changed. The highest politicians were preoccupied with security, military goals and holding on to power. The majority of government expenditures went into defence rather than into the economy. The financial bureau-

58. Chu Wan-wen, "Demonstration effects and industrial policy"; "Import substitution and export-led growth: a study of Taiwan's petrochemical industry," *World Development*, Vol. 22, No. 5 (1994), pp. 781–794.

59. Sung Gul Hong, *The Political Economy of Industrial Policy in East Asia: The Semiconductor Industry in Taiwan and South Korea* (Cheltenham, Glos: Edward Elgar, 1997), ch. 3; Shen Rongqing, "The route choice of the formation of Taiwan's IC industry"; Meany, "State policy and Taiwan's semiconductor industry."

60. Chu Wan-wen, "Import substitution and export-led growth"; "Demonstration effects and industrial policy."

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crats, who held important instruments and were sanctioned by the highest leadership, were concerned with revenue and balance of payments. They checked the economic bureaucrats. Only a few bureaucrats were concerned with economic development. Providing economic rents in exchange for political support by the capitalists often overrode the government's economic concerns, thus compromising the regime's economic goals. Given the importance and significance of politics to the course of economic development, Taiwan's economic success cannot be explained by "state-led industrialization." Instead, it is better understood as a "politically inspired industrial success." This article also indicates that the assumption of the developmental state thesis that economic performance is a result of state intention is not true. Economic success is a result, regardless of or despite state action or inaction.

These findings support two claims of the statist account of the Taiwanese experience: the state was politically dominant and economically *dirigiste*. However, the article argues that political dominance and economic *dirigisme* cannot be equated with autonomy and steering capacity. The state's political dominance was not transformed into the autonomy of the economic bureaucracy. Its *dirigisme* did not necessarily convert to steering capacity.

This article has shown the importance of politics and leadership in economic development. Individual cases show that political action, essentially leadership, could create successful industries, such as the semiconductor industry, but not always, such as the automobile industry. It also shows that politics was very important in indirectly shaping the marketplace.

The explanation for the success of the SMEs confirms the basic stance of the neo-classical thesis that maintains that a market which facilities the operation of market forces is essential to economic growth. Nevertheless, it refutes the neo-classical claim that this market can and should form itself; in contrast, it shows that this market did not and could not form on its own. To a great extent, it was shaped by state action and by the interplay between the state and private actors.

Last but not least, the findings of this article demonstrate that development is not a sole goal of the state. Regime survival and the maintenance of power are as important as, if not more important than, economic development on the state agenda. They also have consequences for economic development.

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