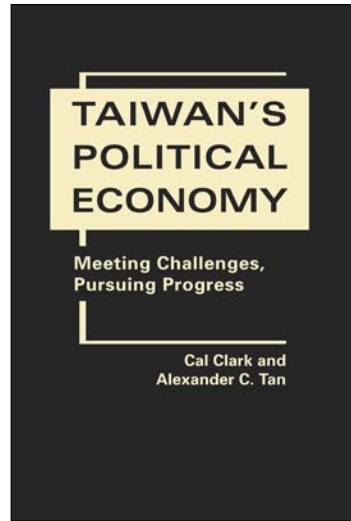


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Taiwan's Political Economy:  
Meeting Challenges,  
Pursuing Progress

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# 1

## The Taiwan Paradox

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The evolution of the political economy of the Republic of China on Taiwan (ROC) appears rather paradoxical. From the 1960s through the 1980s, the country went through a series of economic transformations that have been called an “economic miracle.” This was followed by a successful democratic transition from the late 1980s to the mid-1990s that might be considered a “political miracle” in view of the country’s long era of authoritarian rule. In the early 1990s, therefore, Taiwan could be considered a success story and a model for developing nations. Yet rather than living happily ever after its economic and political transformation, the ROC has been confronted by a series of challenges over the past two decades.

Economically, Taiwan advanced quite rapidly from domestic light industry in the 1950s to an export boom based on these manufactured goods in the 1960s and early 1970s to substantial industrial upgrading into the heavy and high-tech industries from the late 1970s through the early 1990s. Moreover, the fruits of economic development were widely shared as poverty and income inequality were reduced substantially, creating a record of “growth with equity” (Chan and Clark, 1992; Galenson, 1979; Gold, 1986; Wade, 1990). In the political realm, while development had clearly been retarded by the authoritarian Kuomintang (KMT) regime for much of the postwar era, Taiwan went through a remarkably smooth and consensual democratic transition between the mid-1980s and mid-1990s (Chao and Myers, 1998; T. J. Cheng and Haggard, 1992; Y. H. Chu, 1992; Copper, 1997; Fell, 2005; Rigger, 1999b; Tien, 1989, 1996a).

Yet despite these remarkable successes, Taiwan was soon to enter troubled waters marked by growing conflict with and threat from the People’s Republic of China (PRC), fears about the hollowing out of its

previously vaunted economy, and vicious polarization and gridlock in its domestic politics (Clark, 2006). As is normal in the industrialization process (Kuznets, 1976; Rostow, 1960; Schumpeter, 1950), many of the country's traditional industries have been forced to move offshore, especially to China, in search of low-cost labor (S. A. Y. Lin, 2002; Y. S. Wu, 1995). Furthermore, the economy is increasingly being squeezed between developing nations that are taking over Taiwan's old industries and the most developed economies in the world that provide stiff competition in emerging sectors (J. Wong, 2010). Moreover, the growing economic integration with China creates the threat of dependence on a political rival that is trying to quash the very existence of Taiwan (Kastner, 2009). Politically, the nation's new democratic polity has been marked by hyperpartisanship and never-ending vicious political and personal battles that have brought policy gridlock, the politicization of economic policymaking, and scandal after scandal (Clark, 2006; Tan, 2008).

We argue here that many of the challenges facing Taiwan in the early twenty-first century derive from unanticipated and unintended costs of its previous successes. In particular, what worked to promote successful economic and political development at one point in time later became counterproductive in the changed circumstances created by Taiwan's rapid developmental trajectory. In the economic realm, for instance, small and medium enterprises (SMEs) were a dynamic driving force in Taiwan's industrial upgrading from the 1950s through the 1980s (Lam and Lee, 1992; Myers, 1984; V. W. C. Wang, 1995; R. I. Wu and Huang, 2003). But by the 1990s, the characteristics that had made SMEs so successful in the past were undercutting their ability to contribute to the ROC's future growth (J. Wong, 2010; R. I. Wu and Huang, 2003). Politically, democratization ended authoritarian abuses (Rigger, 1999b) and forced the major political parties to be much more responsive to popular desires, which led, for example, to the creation of what is now considered one of the best health care systems in the world (J. Wong, 2004). In contrast, democratization has also made effective decisionmaking more difficult by politicizing economic and financial policy (Tan, 2008) and polarizing the polity on ethnic identity (Clark, 2006; W. C. Lee, 2005).

Yet the ongoing challenges that Taiwan faces should not obscure the nation's major accomplishments. Its hard-won democracy can now be considered consolidated and legitimate; certainly, no mean accomplishment. For example, election results and power transitions are widely accepted, and the political repression and abuses of the authoritarian era are now unthinkable. In the economic realm, Taiwan has become a fairly

prosperous society, decent levels of growth have been maintained, and China has not been able to gain much leverage from the growing economic integration across the Taiwan Strait.

Ironically, therefore, Taiwan is now being confronted by the costs of success of its previous development pattern. That is, the very institutions and strategies that worked in the past have become counterproductive in the present. This calls to mind Mancur Olson's (1982) theory of *The Rise and Decline of Nations* that argued political stability, which is generally seen as a prerequisite for economic development, can become dysfunctional over time because it is associated with the rise of powerful interest groups that use their political clout to distort the economy in the pursuit of their own vested interests. For Taiwan, such a theoretical perspective has decidedly mixed implications. On the one hand, it suggests that the ROC's current confrontation with its "costs of success" might well have been inevitable. On the other, the fact that the situation is far from entirely bleak should remind us of the nation's half-century of flexibility and success in the face of developmental challenges.

## Plan of the Book

We begin this book about the evolving political economy of Taiwan with two chapters on economic and political development in the Republic of China. In these chapters, we provide an overview of the country's political economy and show how its developmental history and past achievements have created the current costs of success with which it now must deal. In the next three chapters, we discuss three different types of challenges that are now confronting Taiwan: first, the economic situation; second, the problems created by the nation's political institutions; and, third, how what appear to be perverse political strategies by the two major political parties have produced vicious polarization and policy gridlock, although there are some recent signs that the political climate may be moderating. Finally, we seek to draw a balance sheet for the contemporary political economy and conclude that, despite the costs of past successes, Taiwan continues to progress through an eclecticism beyond orthodoxies.

In Chapter 2, we analyze Taiwan's economic miracle. Between the late 1950s and early 1990s, Taiwan's economy went through a series of economic transformations from primarily agricultural to export-based light industry, to heavy industry, to high-tech industries and some advanced

services. These transformations were fairly rapid and occurred with what, in retrospect, was surprising ease. They also represented a complex interaction between the state and the private business sector, which was politically important because the government was dominated by mainlanders (i.e., those who came to Taiwan with Chiang Kai-shek in the late 1940s) while the business sector was dominated by Taiwanese (i.e., long-time Chinese residents whose ancestors mostly came to Taiwan before the Japanese colonial period). The state clearly played a key role in promoting the country's economic transitions, but it just as clearly did not engage in the highly interventionist industrial policies of such developmental states as Japan and South Korea. Indeed, through the 1980s, the core of Taiwan's export bonanza came from SMEs that had few direct ties to the regime. In the chapter, we describe the first four principal stages of Taiwan's economic transformation (we discuss the fifth in Chapter 4), present two case studies to provide more detail and nuance to the analysis, and adduce a model of the role of the state in the country's economic development.

In Chapter 3, we discuss the surprisingly easy democratic transition. Industrialization sooner or later creates a more educated middle class that demands political participation and reform (Jackman, 1975; Lipset, 1959; Neubauer, 1967). From this perspective, democratization in Taiwan seems to have been delayed quite significantly by Chiang Kai-shek's authoritarian Kuomintang Party since the democratic transition did not really commence until the late 1980s. Yet once it started, it proceeded smoothly and fairly quickly. As with the economic transition, divergent groups deserve credit for Taiwan's successful democratization. In particular, both reformers within the ruling KMT and political opponents of the regime, who formed the Democratic Progressive Party (DPP), helped push political reform forward, creating a broad base for a democracy. We begin the chapter with a brief summary of the authoritarian era, then conceptualize Taiwan's democratization in terms of a series of formal and informal political pacts, describe the evolving nature of the country's party system, and discuss how the major issues have helped to structure political competition.

In Chapter 4, we consider whether Taiwan is evolving toward an increasingly boxed-in economy. The ROC was one of the pioneers of rapid development in the third world after World War II. This had both advantages and disadvantages. On the one hand, there were few models for its development strategy in the late 1950s and 1960s, which made its reliance on export-led growth somewhat problematic. On the other, once globalization

and the international product cycle began to push important industries out of the developed world, Taiwan was well situated to take advantage of these economic opportunities. Conversely, Taiwan's very economic success over the past half-century has progressively narrowed these opportunities and boxed in its economy. Taiwan's growing prosperity has now almost entirely priced it out of the low-cost labor niche in the world economy, promoting the loss of considerable parts of its industry to competitors that followed it up the international product cycle. Much of this loss has been to China, with whom its economy has become increasingly integrated, thereby creating a potentially worrisome dependence on an emerging superpower that threatens Taiwan. Moreover, as the gap between Taiwan and the leading industrial (or now, more accurately, post-industrial) nations narrows, Taiwan's ability to compete with them is put under increasing stress. For example, through at least the 1980s, SMEs were the core of Taiwan's dynamic export economy. Yet SMEs have had a particularly hard time upgrading past a certain stage in the development process, and their decline is almost certainly linked to the growing inequality and social strains in Taiwan. We begin the chapter with a theoretical conceptualization of the normal pattern of economic development and apply this model to explain both Taiwan's rapid development through the late 1980s and its decelerating growth since then. We then illustrate the argument that Taiwan's recent economic challenges are at least partially the result of its past successes by two case studies that evaluate the extent to which the ROC's economy is being boxed in by the changing role of its SMEs and the growing economic integration across the Taiwan Strait.

In Chapter 5, we argue that serious problems have arisen because of some perils of democracy. Taiwan's political institutions, which were inherited from the authoritarian era, have hampered democratic politics and created such undesirable effects as a policy gridlock that undermines the government's ability to respond effectively to the changing economic and international environment. There are two distinct reasons for this. First, institutional authority remains blurred because the supreme leaders of the past (Presidents Chiang Kai-shek and Chiang Ching-kuo) were generally unconcerned with institutional niceties so that there was little interest in working out constitutional anomalies. For example, it is somewhat unclear in the democratic era whether the president or the premier controls the executive and whether the premier and the cabinet should be considered subordinate to either (or both) the president and the Legislative Yuan. Second, Taiwan has had a long tradition of patronage politics, but

economic policy had been kept fairly well insulated from it. In the democratic era, however, this separation broke down because of politicians' need for more funds to remain politically competitive and because of the unwillingness of either the KMT or DPP to fight corruption with any enthusiasm. Thus, economic policy became increasingly politicized, which undercuts state capacity to promote development. In the chapter, we discuss the overall institutional imbroglio and then provide a detailed illustrative case study of the politicization of the financial sector.

In Chapter 6, we examine the polarization from perverse political strategies in Taiwan politics. Over the past decade, political competition in the ROC has become quite vicious and personal, making the accommodation that is necessary for normal policymaking difficult to achieve. Again, this reflects the authoritarian era where the development of democratic norms about respect for differing political perspectives was actively repressed and retarded. However, several other factors appear to contribute to a type of politics that, to rephrase Thomas Hobbes's (1962: 11) famous description, is nasty, brutish, and never-ending. Once the two major parties (the KMT and DPP) became fairly evenly balanced at the end of the 1990s, both evidently came to the conclusion that their best campaign strategy was to appeal to their most committed base constituencies. This has resulted in much more polarization at the elite level than among the general citizenry on very central issues such as national identity and relations with China. Consequently, the legitimacy of almost any policy initiative that is even tangentially related to national identity comes under strident challenge and other important issues are often ignored. Overall the rancid political environment makes any type of policymaking, including economic, difficult in general, leading to gridlock and institutional stasis. In the chapter, we describe the eruption of partisan polarization in Taiwan and examine several possible interpretations about why it occurred. We then analyze public opinion data to show the discontinuity between the elites and general citizenry on national identity and cross-strait relations issues. In the conclusion, we propose several explanations for why the major parties in Taiwan have seemingly acted somewhat irrationally in view of the distribution of public opinion.

In Chapter 7 on eclecticism beyond orthodoxies, we seek to provide a balance sheet of how Taiwan has responded to its costs of success. Taiwan is certainly facing a wide variety of current challenges. Yet this should not obscure the many things of which the country can be justly proud. It has a consolidated democracy, a prosperous society, and a still



dynamic economy; it is a country that is fairly stable by international standards; and it has a half-century of responding innovatively and flexibly to serious challenges both internal and external. Despite significant economic and political stress and turmoil, therefore, Taiwan appears to be confronting its costs of success in at least a moderately competent manner. We begin the chapter by providing a model of the costs of success that Taiwan is now facing, then summarize the factors that suggest a continuing resilience despite these challenges, and conclude with the argument that Taiwan's economic and political development derives from a flexibility stemming from the nation's eclecticism beyond orthodoxies.