PRIVATE GOVERNANCE IN TAIWAN

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ABSTRACT

In the process of rapid political democratization and economic liberalization in East Asia, the development state theory seems to lose its applicability. This paper suggests a theory of private governance to explain the transitional political economy in Asia. In a case study of Taiwan, this paper demonstrates that the theory of private governance has a number of advantages over the developmental state theory. First, it offers an institutional explanation for the outflow of Taiwan's small and medium-sized enterprises and the positive impact of their private governance on Taiwan's economic growth. Second, it explores the micro and institutional factors that lured Taiwan's big businesses into politics. Third, it provides a dynamic analytical framework to explain the changing state-business relationships and their impact on economic performance without being constrained by a disappearing developmental state.

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I. Where Have All the Developmental States Gone?

During the 1980s the developmental state theory replaced both the modernization theory and the dependency theory as the dominant theory of political economy. The evidence of rapid economic growth in Japan, Taiwan, Singapore, and South Korea in the postwar era made the developmental state theory the jewel in the crown in academic discussion as well as in policy-making circles. In recent years, however, this theory has seemed to lose contact with the real world. First, except for Singapore, all of the other three countries have proceeded with rapid political democratization and economic liberalization. These states no longer fit the original definition of a developmental state. Second, no other developing countries have established a similar developmental state, although some countries, like China and Malaysia, have replicated similar economic performance. Finally, without a developmental state, Taiwan and South Korea continued to maintain relatively high growth rates during the global recession of the early 1990s. Is the theory of the developmental state a theory only applicable to a small number of cases for a limited period of time? Is there a theory that can account for the political economy of these Asian countries both before and after democratization?

This paper will argue that the theory of private governance has a comparative advantage over the developmental state theory in explaining several central questions in Taiwan's transitional political economy: In the past ten years or so, how did Taiwan's business sector utilize its alternative modes of private governance to protect or maximize its interests in the midst of chaotic domestic political struggles and global recession? How did Taiwan's investments in China by small and medium-sized enterprises survived and prospered under the double pressure from both the Taiwan government and China's risky environment? And why did big business actively involve in Taiwan's uncertain politics? The next section discusses the developmental state theory and the theory of private governance. The third section uses the private governance theory to analyze Taiwan's transitional political economy. The last section summarizes this analysis.

II. Developmental State and Private Governance

A. Developmental State

The theory of the developmental state suggests that the existence of a developmental state contributed to the rapid economic development in Japan, Taiwan, Singapore, and South Korea in the postwar years. A developmental state is politically autonomous from interest group influence and is administratively strong in order to implement consistent, interventionist, pro-business policies.[1] Why is state intervention necessary? Why not simply introduce free market to the already highly-regulated Third World markets, as neoclassical economists have suggested? The developmental state theorists (hereafter, statists) argue that free market, if it ever existed, may be appropriate for advanced industrialized countries where capital and labor markets are efficient. It is not suitable for late developers, which wish to resolve all developmental problems in a short period of time. The purpose of statist intervention is not only to create pockets of free market in order to encourage production efficiency but also to construct a "guided capitalist market" (White 1988, 3) or a "governed market" (Wade 1990, 26) in order to create market niches in a competitive world. Sometimes the developmental state needs to deliberately set "prices wrong" for long-term developmental goals (Amsden 1989, 14). A typical developmental state is the one that promotes industrial adjustment, discourages speculative investments, creates new industries, transfers technology to the private sector, protects infant industries, searches world market information for domestic producers, deters local market exploitation, reduces the welfare system in order to reduce labor costs, and provides assistance to private enterprises according to their performance (Appelbaum and Henderson, 1992, 21-22).

This version of the developmental state theory has been challenged by non-statists as well as the statists themselves on both theoretical and empirical grounds.[2] For instance, it does not specify the causal mechanism that leads to economic performance (Doner 1992, 399-400; Moon 1990, 25); its conception about state autonomy and capacity is ambiguous (Clark and Lemco 1988; Lam 1990); and interventionist policies may turn out to be counter-productive (Arnold 1989; Lee 1991).

The neo-statists believe that a lot of these theoretical and empirical problems can be corrected if the developmental state theory takes into account the institutional mechanisms that connect the state to the society. Therefore, Evans (1989, 575) recommends the study of the "embedded state," which has an "intervention capacity built on historical experience and a relatively organized set of private actors who can provide useful intelligence and a possibility of decentralized implementation." Moon and Prasad (1993) suggest the inclusion of policy networks to improve upon the developmental state theory. Okimoto (1989, 17) speaks of Japan's market structure, which provides multiple points of entry for state intervention, such as keiretsu, intercorporate stockholding, banking-business ties, subcontracting networks, trading companies, and industrial associations. And Winkler (1993) expands the domain of the developmental state to a "developmental regime," which consists of the state and its institutional networks with the society.

Admirably, the neo-statist prescriptions have greatly improved the theoretical and empirical validity of the developmental state theory. Nevertheless, several vital weaknesses remain in this body of literature. First, the theory is only remotely related to various forms of private governance, such as subcontracting, commodity chains, and interlocking directorships, which have a direct impact on company and market performance. Neither does the theory say much about the adaptive micro-behavior of management and labor in response to environmental changes. Second, by incorporating social, institutional factors into the analysis, the developmental state theory tends to be either overdeterministic or unverifiable. It becomes a descriptive analytical framework. Finally, this state-centered approach has to bring the society back into the analysis and greatly modify, if not abandon, its strong claims of state-led economic development, since the state is no longer the direct cause of economic development.

The fundamental strength and weakness of the developmental state theory is its focus on state policies. This is a strength because, after all, the state makes state policies. It is also a weakness, however, because the most immediate cause of economic performance is not state policies but business, which is usually assumed away by the statists in a neoclassical economics manner. Just as the pluralists (e.g., Migdal 1988) have argued that state policies may ultimately come from social groups, the statists have similarily argued that business activities or company performance is ultimately dependent upon the state-political environment. Either way, the theorists have to demonstrate the tightly connected, logical relationships among the variables, but not by assuming the most immediate variables away. The following theory of private governance is intended to clarify the business sector variable, which, after clarification, may be incorporated into either the statist or pluralist analyses.

B. Private Governance

An appropriate starting reference for the private governance literature is Alexander Gerschenkron's work (1962), which has also been regarded as a classic textbook on the developmental state. Although Gerschenkron argues that late developers, such as Germany and Russia, had to rely on non-free-market institutions in order to efficiently mobilize their resources and catch up with the early developer (i.e., Great Britain) in a short period of time, the state was not the only such institution, as the later statists have interpreted. In contrast to the socialist intervention by the Russian state, the German state was dependent on the banks and cartels to sort out economic priorities and enforce industrial order. Even in the later development stage in Russia, the banks had more operational control over economic development than the omnipotent state. Therefore, the formation of these resource-mobilizing social institutions becomes an interesting subject to explore. How are they formed in the first place? What kind of functions do they serve? How do they interact with the state? How do they reduce collective action problems and information flow problems? And how do they create competitive advantages in the global market?

Business scientists have long studied different types of interfirm relationships that have a direct impact on company performance. But situating interfirm relationships in a socio-political environment seems to start with the literature on the private governance in advanced industrial countries, especially the literature on corporatism.[3] The assumptions of private governance usually build on the micro-concepts of bounded rationality, transaction cost, and X-efficiency in the firm and market. Then, the literature discusses available forms of private governance that would maximize the long-term profits of firms under specific economic, social, and political constraints. Scholars have developed different conceptions to describe various aspects of private governance, such as "flexible production" (Deyo, Doner, and Fields 1993), "national competitive advantages" (Porter 1990), and "diversified quality production" (Streeck 1992).

This private governance literature, sometimes called the "new political economy," makes the following general arguments (Streeck 1992, 3): First, different production patterns can be functionally equivalent responses to common economic challenges. Second, socially regulated economies may perform better than markets and hierarchies under certain technological conditions. Third, appropriate institutional regulation and political intervention may contribute to both equity and efficiency in an open world economy.

In contrast to the state-centered orientation of the developmental state view, the private governance literature is society-centered. The state may be a very important variable in some forms of private governance, for instance, corporatism. In other forms it may be remotely relevant. Table 1 provides an illustration of different forms of governance, including those close to the developmental state.[4]

TABLE 1. Types of Governance

<--- State-Centered Society-Centered --->

Communism

Public Enterprises
Party Enterprises
Administrative Guidance

Public-Private Joint Ventures
Strategic Alliances
Clientelism

(PRIVATE GOVERNANCE)
Business Associations
Satellite Systems
Subcontracting
Commodity Chains
Interlocking Directorship
Interfirm Agreements
Informal Contracts
Informal Clubs
Socially-based Linkages
Conglomerates

Free Market and Hierarchies (Firms)

In the Asian context the private governance theory has been applied to Japan by a few scholars, who were informed by the weaknesses of the developmental state theory (Dore 1986; Friedman 1988; Lynn and McKeown 1988; Okimoto 1989; Ouchi 1984; Vogel 1985). Even fewer scholars have attempted to explore the private governance in other Asian countries. The exceptions are Laothamatas's work (1992) on Thai business associations, Kuo's (1994) on Taiwan's and the Philippines' corporatism, Gereffi's projects on Asian commodity chains (1993; Gereffi and Pan 1993), and Hamilton and Biggart's studies (1988; 1991) on Asian business groups.

Although it provides a stronger, more direct explanation for company or industry performance than the developmental state theory, the private governance literature still suffers from two weaknesses. First, the linkage between the micro performance of each private governance form and the macro performance of an economy is not clear, especially if macroeconomic policies, such as monetary and fiscal policies, are concerned. Second, different forms of private governance may be so idiosyncratic to each country that generalizable causal arguements are hard to make. Some forms of private governance may work in one country but fail in other countries. In the following, I will build on this private governance literature, with its weaknesses in mind, to analyze the transitional political economy in Taiwan.

III. Private Governance in Taiwan

Explanations of Taiwan's political economy have been dominated by the developmental state school (Amsden 1979; Crane 1982; Gold 1986; Pang 1988). With the end of the authoritarian rule of the Jiang family in 1987, however, the developmental state theory began to lose its applicability as well. As a result of democratization, the autonomy and capacity of the Taiwanese state faced challenges from assertive, newly elected representatives and from increasingly well-organized social groups. Although the statists (e.g., Chu 1994) may still emphasize the state's power sources and the continuity of state structure in the short run, they will face the ultimate dilemma of a relative decline of state power and the democratization of the state structure. Even before the end of authoritarian rule in Taiwan, scholars have found cases where the state had blundered in its industrial policies, for instance, the automobile industry (Arnold 1987). An alternative theory of political economy is in order to account for both the continuity and the long-term transformation of Taiwan's political economy.

A. Private Governance before 1987

Even during the pre-1987 period, when the Taiwanese state was the dominant economic actor, Taiwan's business community was organized in a number of ways to cope with both the changing and risky economic and political environment. First, the Taiwanese business community was organized into state-corporatist business associations. In addition to various professional associations, in 1952 the mainlander government established the Chinese National Association for

Industry and Commerce (AIC) as a formal channel of interest articulation for Taiwanese business leaders. Unlike the National Industry Association and the National Commerce Association, whose governing boards were dominated by mainlanders and were not subject to periodic elections due to martial law regulations, the AIC governing boards regularly recruited Taiwanese business leaders. In 1961 the mainlander president of AIC was replaced by a Taiwanese, Gu Zhenfu, who was later elected a member of the ruling party's Central Committee. Since its establishment, among other interest-articulation activities, the AIC has held monthly breakfast meetings which have included business leaders and high-level economic officials (Xu 1991, 60, 114).

Other business associations had varying performance in terms of their representation functions. Most of them served more political control functions than interest representation. However, the textile associations and the Taiwan Electrical Manufacturers' Association, which served the locomotive industries of Taiwan's economic miracle, had a significant influence on national economic policies. At the same time, producers in the same industry would compete on quality and prices, but they also cooperated on market-information sharing, technology diffusion, product development, and, sometimes, mutual investment (Kuo 1994).

Second, producers established production satellite systems in order to share the risks and costs of production while realizing the benefits of specialization and scale economy. The private sector first experimented with satellite systems in the late 1960s, without state assistance. In fact, the state's tax laws (especially value-added taxes) discriminated against companies joining the systems. After more than one decade of lobbying, the government finally formed the Center-Satellite System Promotion Task Force under the Ministry of Economic Affairs to assist in the establishment of such systems. The number of satellite systems and firms joining the systems began to increase dramatically.

Third, multi-purpose business groups were formed by extended family members as well as investors. These business groups not only shared capital and personnel within the groups but also connected with other groups through interlocking directorships. Leaders of these business groups often assumed positions in city councils, provincial assemblies, the national assembly, and party organizations (Numazaki 1986).

Other forms of private governance included the widespread use of postdated checks, which facilitated capital mobilization in an otherwise rigid, official banking system (Caldwell 1976); the formation of more than ten informal business clubs accessible only to business and political leaders (Xu 1991, 116-123); and other socially based linkages, such as marriage, regional associations, local factions, and blood relationships (Chen and Chu 1992; Xu 1991, 86).

During this period Taiwan's private governance displayed a number of characteristics. First, major business activities involved the pursuit of profits instead of rent. Although local oligopolies, public and party enterprises, and regulated business constituted a significant portion of Taiwan's economy before 1987, the major part of the economy was connected to the export market, where rent-seeking behavior was kept to a minimum and cooperative behavior was encouraged.

Second, the business community tried to reduce the negative state intervention and regulations that had been imposed during the import-substitution period of the 1950s. Because of war preparation and the legitimacy crisis, the immigrant government imposed tight controls over the island's economy during the 1950s. The 19-Point program of 1959 began a series of economic liberalization measures. As the direct beneficiaries of economic liberalization, the business community assisted in identifying red tape and simplifying state regulations. If some negative state regulations, such as banking and credit regulations, could not be reduced, the business would utilize its private governance to circumvent state regulations in order to mobilize production inputs.

Third, due to the embryonic nature of inputs markets, the business community needed to invite positive state intervention on a selective basis, including financial assistance, technology transfer, and tax incentives. To a large extent, the business community utilized its various governance channels to directly or indirectly provide information on positive state policies. The state played the role of cleaning house for all the information inputs.

Fourth, although the business community was relatively actively involved in economic policy-making, it carefully kept aloof from politics. The two authoritarian rulers of the Jiang family had no taste for mixing business and politics. Partially due to the Confucian distrust of business ethics, partially due to the fact that the business community was composed of Taiwanese, the business community had little influence over national politics. Taiwanese business leaders were frequently recruited into government and party organizations, but their influence was restricted to economic issues, not political, social, or military ones.

Finally, large and small enterprises were well-connected through different forms of private governance. They faced similar economic, political, and social constraints, and, therefore, needed to cooperate in order to share the profits and risks. Even in the highly regulated domestic markets, large enterprises maintained formal and informal contractual relationships with small enterprises.

In sum, before 1987 Taiwan's business community relied on a variety of private governance forms to cope with problems of embryonic inputs markets, authoritarian rule, and the uncertain international market. More state-centered governance, such as public enterprises, party enterprises, clientelism, and public-private joint ventures, were restricted to regional oligopolies and domestic markets.

B. Private Governance after 1987

In the late 1980s Taiwan's political democratization and economic adjustment had a dramatic impact on business maximization behavior. Although many features of the pre-1987 private governance remained, the most prominent feature of the post-1987 private governance is the difference between large and small enterprises in their reaction to these shocks.

Small and medium-sized enterprises (SMEs) did not react strongly to political democratization, since they were not well-organized, well-connected political groups. However, they were very sensitive to economic adjustment pressures. Due to American pressure from 1985 to 1990, Taiwan dollars appreciated by almost 40% [exact statistics to be double-checked], which dealt a fatal blow to these SMEs that had survived on small profit margins of export products. The United States also compelled the Taiwan government to adopt a series of import liberalization measures, which opened the domestic market not only to American products but also to cheap imports from less developed countries. Furthermore, rising labor costs and growing environmental consciousness added additional costs to production. Due to the suddenness of these economic adjustment pressures, SMEs adopted the strategy of exit: They either closed down their operation or moved abroad, especially to China.

Because of their small size and flexible production, SMEs soon found their second home in mainland China. From 1987 to 1992 Taiwan's investment in China increased from 80 (pledged) cases to more than 10,000 cases; the total investment amount increased from $100 million to $9 billion. Since the government tightly controlled the capital outflow of large enterprises, the overwhelming majority of Taiwanese investments in China were SMEs.

These investments proceeded with a great amount of political and economic risk. On the one hand, the Taiwanese government first regarded such investments as treason, i.e., economically subsidizing an enemy. Gradually, under the pressure from the private sector, the government began to relax some regulations, but overall controls remained tight. On the other hand, China was a socialist economy in transition. Uncertainty and opportunism in the market and state-market relationships were the major obstacles to profit making.

In response to these political and economic risks, SMEs took advantage of their private governance to protect and maximize their profits. On the home front they continued to maintain business relationships with companies that provided production inputs and marketing networks. They also utilized various private and institutional channels (e.g., professional associations) to influence the government's mainland policies on economic issues in order to facilitate trade. Because of the collective nature of SMEs, the Taiwan government has had trouble enforcing its regulations on such activities. On the mainland side these SMEs adopted similar collective strategies to protect their operations and penetrate the local market. They extended their socially-based linkages in the locality, established formal or informal investors' clubs, and brought business partners (suppliers, users, and competitors) to new markets (Kuo 1992; 1994).

In contrast to the SMEs, Taiwan's large enterprises reacted differently to the shocks of political democratization and economic adjustment. Because of their economic and political resources, the large enterprises had more options. First, they continued to benefit from their business transactions with the SMEs that had moved to China and other Southeast Asian countries. After the government relaxed its regulations on investments in China, large enterprises followed in the footsteps of SMEs but without incurring the political and economic risks that small enterprises had assumed.

The large enterprises also expanded their cooperation with SMEs as well as with multinational corporations. The number of Center-Satellite Systems increased from 32 in 1987 to more than 130 in 1993, enrolling more than 2,000 companies by the end of 1993. Initiated by business associations, several "strategic alliances" were formed among large enterprises, with the participation of multinational corporations, to explore technology- and capital-intensive products, such as notebook PCs, fiber-optical communication, HDTVs, high-memory chips, and multi-media communication (TEAMA 1992?; Chen 1992). In the export sector of the post-1987 years, therefore, there has been a strong continuity in Taiwan's private governance.

The second option for large enterprises was to venture into Taiwan's regulated markets, such as government procurement projects, military contracts, banking, transportation, securities market, and protected industries. Before discussing these new ventures, a few paragraphs about the political environment are necessary.

In the final years of Jiang Jingguo's rule, Taiwan's political system began to democratize both within the ruling party and between the KMT and the opposition party (Tien 1989). Within the ruling party, younger elites were recruited to the administrative and legislative branches to replace the first generation of mainlanders. With the death of Jiang Jingguo in 1988 and the retirement of all first-generation representatives in 1991, the political vacuum was filled by contenders who were relatively equal in terms of their political and economic resources. Since the death of Jiang Jingguo, the question of constitutional framework has not been resolved, thus feeding the continuous political struggle between the "mainstream faction," which President Li Denghui heads, and the "non-mainstream faction," which is a coalition of first-generation mainlanders, second-generation mainlanders, and Taiwanese politicians who are excluded from President Li's patronage system. Because of these factional struggles and elections, politicians at all levels have actively sought business support for their expensive campaigns.

The majority of the opposition forces established the Democratic Progressive Party (DPP) in 1986 in defiance of the martial law. The DPP continued to expand its electoral base at both the local and national levels. In the first post-martial law election of 1989 the DPP won 31% of popular vote. In 1991 the DPP won 24% of the vote and sent 66 representatives to the first legislature elected entirely from Taiwan. In the 1993 election of county magistrates and city mayors, the DPP captured 41% of the vote. The DPP is betting on winning the upcoming presidential election to be held no later than 1996.

Envisaging uncertainty and chaos in the transition to democracy, large businesses began to get involved in politics. The first organized business involvement occurred in 1983 with the establishment of an informal group, Thirteen Knights (Shisan Taibao), in the legislature by thirteen legislators with strong business backgrounds. Although the leader of the group, Cai Chenzhou of the Guotai Conglomerate, was sentenced to and died in jail due to his banking scandal, this precedent paved the way for other business leaders to enter politics. In the 1983 election of non-martial law legislators (those elected from Taiwan instead of from China) many business leaders or business-supported candidates were elected. In the 1990 presidential election, business leaders were involved in the negotiation process among candidates and helped to consolidate the power of President Li. In other national and local elections, business involvement was much more active than before 1987. In addition to elections, business leaders also supported political/research foundations for particular politicians. For instance, the Evergreen Conglomerate established the Institute for National Policy Research in support of President Li; the Hualong Conglomerate sponsored the Democracy Foundation for Guan Zhong, who is the arch enemy of President Li; and a political swinger, Qu Chuanghuan, found business support for his National Policy Council (Guojia Fazhan Cejinhui). Finally, business leaders were incorporated into the semi-official Strait Exchange Foundation, which was the executive arm of Taiwan's mainland policies. Half of the organization's directors were business leaders, and its president has been a business leader.

Why would the business community get directly involved in politics? In his observation of Western capitalism, Elster (1985, 419-21) concludes that capitalists in general would abdicate their political power, i.e., not get directly involved in politics, because (a) the capitalists would incur opportunity costs for reducing their attention to their own businesses; (b) they would confront labor directly and cause a class war, whereas maintaining a facade of impartial state rule would help reproduce capitalism; and (c) the capitalist state and pro-business representatives were sufficient to articulate and implement pro-business policies.[5] In the post-1987 Taiwan, however, these conditions did not hold.

First, the capitalists were able to acquire windfall profits from highly regulated markets which had been accessible only to public and party enterprises or to very few incorporated business elites. For instance, in 1988 a group of legislators pressured the government to liberalize the securities market, which had been dominated by a party enterprise. After the liberalization most of these legislators established their own securities companies or sat in the boards of directors of new companies established by their close friends or relatives. Because of the abundance of surplus capital and the politicians' access to insider information, these securities companies became one of the most profitable businesses after 1987. These companies were so rich that their sponsored candidates would have a higher chance of winning than those supported by the ruling party (Xu 1991, 132). Another example of the economic gains of political involvement was the Evergreen Conglomerate. Because of its help with presidential election and local elections, the Evergreen Conglomerate was given several unprecedented privileges in transportation business (Xu 1993, 81-82).

Entering politics also gave business leaders direct access to public procurement projects. Many legislators would use their budget power in exchange for contracts with public enterprises, such as the government-owned China Construction Company and the Veteran's Construction

Company, which monopolized government construction projects and often charged as high as 30% above competitive prices (Yang 1992, 128).

Second, the class war was of no concern to Taiwan's capitalists due to the weakness of labor movements. Before 1987 the authoritarian rulers' distaste for business was a more important reason for deterring business involvement in politics. The "Thirteen-Knight Scandal" was regarded as President Jiang Jingguo's warning to the business community not to over-extend its political influence. With the end of Jiang dynasties and the rise of a pro-business president, Taiwan's capitalists no longer worried about political involvement. For instance, President Li appointed a business leader to the chairmanship of the National Assembly in appreciation of his personal assistance in the 1990 presidential election (Xu 1993, 101).

Third, political involvement by business created a vicious cycle during the transitional period. Business leaders first supported politicians from behind the scene. Then, their political opponents would utilize political machinery, such as tax auditors and prosecutors, to harass the business supporters. In order to protect their existing interests, these business leaders would support more politicians or to get elected themselves. After all, in the middle of a changing political ecology, who can take care of one's interests better than oneself? The battle between the "mainstream faction" and "non-mainstream faction" is the best example of this. The leader of the Hualong Conglomerate, Ong Daming, sponsored the Democracy Foundation for his friend Guan Zhong, who was a political rival of President Li. The government then investigated the business transactions of the Hualong Conglomerate and sent a few managers to jail, causing the Conglomerate's stock prices to tumble. In revenge, legislators sponsored by the Hualong

Conglomerate initiated a congressional investigation of the Evergreen Conglomerate, which was a loyal supporter of President Li. Three ministers of transportation lost their jobs as a result. Ong finally decided to run in a legislative election and got elected, thus sparing a criminal conviction by the government. After the election the stock prices of the Hualong Conglomerate skyrocketed.

Another example of protecting business interests is the "Steel Club" of legislators who were the oligopolies of Taiwan's regulated steel market. In 1988, bowing to foreign pressure, the government sent a proposal to the legislature to reduce tariffs on steel products. Instead of reducing tariffs, these "Steel Club" legislators directly negotiated with other legislators and passed a bill that increased the tariffs on steel products (Yang 1992, 115).

In order to increase their access to political power and protect the secrecy of political influence, large enterprises began to rely more on informal clubs and socially based linkages. Local factions, for example, building on their local oligopolistic enterprises, started to penetrate national politics in order to gain access to nationally regulated markets. At the same time, large enterprises reduced their attention to business associations due to the public nature of these organizations and to the more active participation of SMEs in associational activities.

The outflow of SMEs to China and the involvement in regulated markets by large enterprises have unintentionally contributed to Taiwan's satisfactory economic performance in recent years. Most of the SMEs that moved to China were losing their competitiveness in Taiwan. They would have to close down one way or the other. By moving to China while maintaining business transactions with suppliers and users in Taiwan, they provided a breathing space for other companies in Taiwan, which were engaging in structural adjustment. Without the indirect trade with China, the Taiwan economy would have experienced much smaller growth rates.

Although engaging in rent-seeking behavior, large enterprises also contributed to Taiwan's overall economic growth, at least in the short run. Political economists have argued that rent-seeking behavior in the short term may stimulate a pseudo investment confidence and mobilize under-utilized resources, although its long-term effect may be disastrous (Lemarchand and Legg 1972). Because of their involvement in politics, large enterprises brought competition to Taiwan's hitherto regulated markets and forced uncompetitive public enterprises either to become competitive or to privatize. The current windfall profits accruing to these new entrants reflect the consumer loss that had been appropriated by the state or the party. In the long run, with increased competition from home and abroad, the profit margins will reflect market conditions. Furthermore, because of their connections with SMEs through different forms of private governance, the profits can be distributed downward and create multiplier effects.

In sum, large and small enterprises in Taiwan reacted differently toward political democratization and economic adjustment. The SMEs utilized various forms of private governance to protect their investments in China against a hostile Taiwanese government and a risky investment environment. The large enterprises, while continously benefitting from their business connections with these SMEs, made their inroad to Taiwan's highly profitable regulated markets through active involvement in politics. Various forms of private governance continued to serve the interests of both small and large enterprises and helped the overall economic development.

IV. Conclusion

The above analysis demonstrated that the theory of private governance has a number of advantages over the developmental state theory in explaining Taiwan's transitional political economy. First, it offers an institutional explanation for the outflow of Taiwan's SMEs and the positive impact of private governance on Taiwan's economic growth. Second, it explores the micro and institutional factors that lured Taiwan's big businesses into politics. Third, it provides a dynamic analytical framework to explain the changing state-business relationships and their impact on economic performance without being constrained by a disappearing developmental state.

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NOTES:

1. For representative studies of the Asian developmental states, see Amsden (1979; 1989), Appelbaum and Henderson (1992), Clough (1978), Gold (1986), Haggard, Kim, and Moon (1991), Haggard and Moon (1983), Johnson (1982; 1987), Jones and Sakong (1980), Kohli (1986), McCord (1991), Robison (1988), Wade (1990), White (1988).

2. For criticisms of the developmental state, see Clark and Lemco (1988), Deyo (1987, 16-17), Doner (1992, 399-400), Kuo (1994, chap.1), Lam (1990, 28-29), Moon (1990, 25).

3. For the literature on private governance, see Deyo, Doner, and Fields (1993) on flexible production, Gereffi and Wyman (1990) on commodity chains, Lazerson (1988) on the subcontracting between large and small firms, Schmitter (1990) on sectoral governance mechanisms, Streeck (1992) on diversified quality production. Corporatism literature includes Berger (1981), Cawson (1985), and Katzenstein (1985).

4. See also Schmitter's 14 types of governance (1990, 17).

5. Elster lists five reasons why the capitalists would abdicate from power: no self-confidence, preemption of dethronement, the adversaries may do better to protect their interests, opportunity costs, and abdication may increase their bargaining power. I group these five reaons into three.