

London School of Economics and Political Science

**Re-examination on the Role of the State in the Development
of Taiwan's Small and Medium-Sized Enterprises, 1950-
2000:**

The state, market and social institutions

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Declaration

I certify that the thesis I have presented for examination for the MPhil/PhD degree of the London School of Economics and Political Science is solely my own work.

Abstract

Much research has been devoted to the story of Taiwan's post-war economic development. The neo-classical economists argue that its government created a free market economy which led to rapid economic growth. The revisionists, Robert Wade and Alice Amsden, address the role of the state in formulating and leading the economic miracle. One of the characteristics of the Taiwanese economy was that the small and medium-sized enterprises (SMEs) were found in great numbers (around 90%) in Taiwanese manufacturing industry. These SMEs were export-oriented and contributed greatly to the export growth in the 1970s and the 1980s. The success of the Taiwanese manufacturing SMEs was usually attributed to the market and the development policies which the state established and enforced.

However, the existing literature ignores (1) the further development of the SMEs after the late 1980s; (2) the role which Taiwanese society played in the rise and the development of the SMEs. This ignorance over-estimates the role of the state in the development of the SMEs in the post-war era. The present dissertation re-examines the argument of the neo-classical economists and the revisionists by finding a historical pattern and tracing the further development of the SMEs after the late 1980s. To what extent did the market established by the state and the state development policy supported the rise and the development of the Taiwanese manufacturing SMEs from 1950 to 1980? What puts into question the influences of the state on the SMEs after the late 1980s? Why did the state have limited influences on the SMEs after the late 1980s?

The dissertation finds that Wade and Amsden over-estimated the role of the state in the rise and development of the SMEs by explaining the limited influences of the state on the SMEs after the late 1980s. The research, by clarifying the relation of the state, market and social institutions from the historical pattern, demonstrates that the social institutions are adapted to the changing environment and continuously provided important financial sources to facilitate the SMEs' business operations from 1950 to 2000.

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Re-examination on the role of the state in the development of Taiwan's small and medium-sized enterprises, 1950-2000: the state, market and social institutions

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Glossary of Terms and Acronyms

Bensheng ren	本省人	
Biaohui	標會	
Chiang Ching-kuo	蔣經國	
Chiang Kai-shek	蔣中正	
CCP	Chinese Communist Party	中國共產黨
DPP	Democratic Progressive Party	民主進步黨
Deng Xiaoping	鄧小平	
Daohui	倒會	
EOI	Export-Oriented Industrialisation	
EPZ	Export Processing Zone	
FDI	Foreign Direct Investment	
Formosa Plastic Group	台塑集團	
FM theory	Free Market Theory	
GM theory	Governed Market Theory	
Hai Cang Project	海滄計劃	
Hakka People	客家人	
Hoklo People	福佬人, 閩南人	
ISI	Import Substitution Industrialisation	
Jaio Shang	郊商	
Koxinga (Zheng Chenggong)	國姓爺 (鄭成功)	
KMT	Kuomintang	中國國民黨
Les	Large Enterprises	
Lee-Teng-hui	李登輝	

NIE	New Institutionalism Economics	
New Party	新黨	
No hurry, Be patient	戒急用忍	
NTD	New Taiwanese Dollars	新台幣
OEM	Original Equipment Manufacturer	
One country, Two systems	一國兩制	
Pao Cheng Group	寶成集團	
PLA	People's Liberalisation Army	中國人民解放軍
PRC	The People's Republic of China	中華人民共和國
ROC	The Republic of China	中華民國
Tangwai	黨外	
Ting Hsing Group	頂新集團	
RMB	Reminbe	人民幣
SM theory	Stimulated-free Market Theory	
Special State-to-State Relations	兩國論	
SOEs	State-owned Enterprises	
UPEC	Uni-President Enterprises Corporation	統一企業集團
Waisheng ren	外省人	
Whampoa Military Academy	黃埔軍校	
Wushang	五商	
Zhen Zhilong	鄭芝龍	

Part I. Introduction

When the Kuomintang (KMT) lost the second Chinese Civil War in 1949 and retreated to Taiwan, conflicts continued across the Taiwan Strait. From 1949 to 1979, battles and bombings continued. During this period, despite the military and political resistance, Taiwan's post-war economic development was a successful model for other developing countries. In 1956 GDP per capita in Taiwan was USD 232.74; in 1986 it had increased to USD 6618.29.¹ In the 1950s the major export was agricultural products; by the 1980s the major export products had become manufacturing goods. In addition to the rapid economic growth and industrial transformation, the Gini coefficient was low.

One of the features of the Taiwanese economy was that the small and medium-sized enterprises (SMEs) proliferated in great numbers (around 90%) in Taiwanese manufacturing industry. These SMEs were export-oriented and contributed greatly to the growth in exported goods in the 1970s and 1980s.² Moreover, research indicates that the great number of SMEs led to the low Gini coefficient in Taiwan. The success of the Taiwanese manufacturing SMEs and the rapid growth of the Taiwanese economy were usually attributed to the successful state-led development model. The role of the government in supporting the development of the manufacturing SMEs and creating economic prosperity is considered significant.

Much research has been done regarding the story of Taiwan's post-war economic development. This dissertation re-examines the argument of the neo-classical economists and the state-led development model proposed by Robert Wade and Alice Amsden, regarding the role of the state in the rise and development of the Taiwanese manufacturing SMEs in the post-war period. To what extent did the market established by the state and the state development policy supported the rise and the development of the Taiwanese manufacturing SMEs from 1950 to 1980? What raised doubts about the influences of the state on the SMEs after the late 1980s? Why did the state have limited influence on the SMEs after the late 1980s?

One strand of the existing literature highlighted the significance of the free market economy which the Taiwanese government created for the upsurge in private

¹ Heston, Alan, Summers, Robert, and Aten, Bettina, Penn World Table Version 6.2, Centre for International Comparisons of Production, Income and Prices at the University of Pennsylvania, September 2006. http://pwt.econ.upenn.edu/php_site/pwt62/pwt62_form.php. (accessed 11 January 2011).

² Small and Medium Enterprise Administration, Ministry of Economic Affairs, Executive Yuan R.O.C. (Taiwan), *White Paper on Small and Medium Enterprises in Taiwan, 2005* (Taipei, 2006) pp.1-2.

enterprises. It argues that the government established a suitable environment with a market mechanism for manufacturing SMEs to prosper. This strand of the literature is usually questioned, because similar institutions do not necessarily create economic prosperity in other countries. Therefore, in the other strand of the literature, scholars such as Robert Wade and Alice Amsden address the significance of the state in Taiwan's post-war development. This group of scholars considers that the state has done more than create a suitable environment. The development policies established the institutions, created the incentives and guided and directed the development of the manufacturing SMEs. The prosperity of the manufacturing SMEs was planned, supported, guided and directed by different policies of the government at different stages of their development. It is also worth noting that the state's ability to do all these things related to the type of political system that Taiwan had in the post-war period.

A free market economy can create a suitable environment; however, a suitable environment does not necessarily create prosperity for the manufacturing SMEs. The state-led economic development model argued by Wade and Amsden raises the question: did the state's policies directly or indirectly lead to the prosperity of the SMEs? The first strand of the literature focuses on the market mechanism, while the second strand of the literature addresses the role of the state. Both ignore the part played by Taiwanese society in the rise and development of the SMEs. In other words, both strands of the literature regard Taiwanese society as a passive receiver of a market mechanism and of the state's policies.

This dissertation first tries to fill the gap of knowledge about the dynamics of a society which supported the development of the manufacturing SMEs and facilitated manufacturing SME business operations from 1950 to 2000. Although it is not new to address the role of society in the development of SMEs, this dissertation further identifies a historical pattern in order to describe how the social institutions transformed and provided support to the SMEs under institutional changes. When analysing Taiwan's post-war economic development, the existing literature usually focuses on the post-war period from 1949 to the 1980s. Few have examined the historical heritage before 1949 and the further development of the SMEs after the late 1980s. The omission of historical heritage and continuity over-estimates the role of the state in the rise and the development of the manufacturing SMEs in the post-war period and under-estimates also the dynamics of the society which supported the

manufacturing SMEs. This dissertation traces socio-economic history back to 1522 and creates a historical model in order to see the historical heritage as it relates to the dynamics of the Taiwanese society in its trade and business operations.

The research project finds that Wade and Amsden over-estimate the role of the state in the rise and the development of the manufacturing SMEs, whereas the neoclassical economists over-estimate the role of the market established by the state in the rise and the post-war development of the manufacturing SMEs. Both the state and the market which the state established gave only limited support to the manufacturing SMEs' capital formation and turn-over fund. It was the state which, without meaning to, created a space for the social institutions to provide financial support to the SMEs. And this social dynamics which supported the SMEs financially in their post-war development continuously facilitated SME business operations across the Taiwan Strait under the government's restrictions from the late 1980s to 2000. The Taiwanese SME investment in China after the late 1980s questions the role of the state in the post-war development era. It shows that the state had only a limited influence on the manufacturing SME business because the manufacturing SMEs did not rely on state support, contrary to Wade and Amsden's interpretation; instead, the reliance on social institutions for capital sources avoided the state's constraints on their pursuing economic interest in China. The social dynamics of the social institution was inherited from the historical pattern and adapted it to the changing environment.

The present dissertation has six parts. The first part provides a general historical background, literature review and theoretical framework for the structure of the dissertation. The second part traces a historical pattern from 1522 to 1945. The historical pattern concerns the operation of trade and business under different political and economic institutions in order to identify the function of social dynamics in Taiwanese economic history. The third part re-examines the role of the state, the market and social institutions in the rise and the development of SMEs from 1949 to 1980. The fourth part shows the evidence that the government had only a limited influence on the further development of the Taiwanese SMEs. The fifth part then explains how and why the government had such limited influence. The sixth part concludes with the findings from this dissertation.

Chapter 1 Historical Background, 1949-1980

The turning point in modern Taiwanese economic history was caused by two significant historical events: the political struggle between the two modern Chinese political parties: the Kuomintang (the KMT) and the Chinese Communist Party (the CCP); and the U.S. intervention in cross-strait relations in 1950. The second Chinese Civil War broke out in 1945.³ The CCP finally won the war and the KMT retreated to Taiwan in 1949.⁴ Political and military tensions, however, continued across the strait. In 1949 the Truman Administration decided not to intervene in the Chinese Civil War. However, the Sino-Soviet Treaty and the outbreak of the Korean War in 1950 changed U.S. attitudes towards the KMT government in Taiwan. The Sino-Soviet Treaty was signed on 14 February 1950; it shows that the CCP government of the New China decided to ally itself with the USSR. The Korean War broke out on 25 June and two days later the U.S. Seventh Fleet was deployed to the Taiwan Strait.

Further allies and economic aid to the KMT government in Taiwan were implemented by the Eisenhower administration from 1953.⁵ The alliance with the U.S. and the economic aid played a significant role in Taiwan's post-war economic development. The U.S. intervention created temporary peace across the strait and the economic aid stabilised the economic situation in the early post-war period.⁶ From then on, the Cold War influenced the U.S. strategy in Far East Asia and the consequent changes facilitated Taiwan's post-war economic development.

³ The first Chinese Civil War began in 1927 and had an intermission in 1937 when the Japanese invaded China. From 1927 the KMT government castigated the Soviet Republic of China as rebels and began to wage war on bandits. In 1934 the CCP was forced to leave Jiangxi and began the 'Long March'. This was the retreat movement of the CCP; the massive military retreat was from the east to the north and west and the troops traversed 8,000 miles over 370 days. The journey passed through some of the most difficult terrain in western China and finally the Communist army arrived in Shaanxi. The KMT army under the command of Chiang Kai-Shek continued to suppress the Communist troops until 1937 although during the Second Sino-Japanese War, the CCP and the KMT, at certain stages, cooperated and fought against Japan. Without cooperation, the Japanese empire would have wiped out both sides. For further details see Wang, Guande, Liu, Chenzong, Li, Huachen, *Zhongguo gongchandan shi* (Taipei, 2003); Dang De Wenxian Bianjibu, *Zhonggong danshi zhongda shijian shushi* (Beijing, 1993).

⁴ Yang, Zhenya and Su Zhongpo, *Guogong liandan guanxi shi* (Nanjing, 1990); Lin, Da, *Guogong neizhan: huguo yu jiefan*, (Taipei, 2006).

⁵ Garver, Joha, *The Sino-American Alliance: Nationalist China and American Cold War Strategy in Asia*, (London, 1977); Lasater, Martin, *U.S. Interests in the New Taiwan* (Oxford, 1993); Leffler, Melvyn, "The Emergence of an American Grand Strategy, 1945-1952," in the *Cambridge History of the Cold War*, eds. Leffler, Melvyn P. and Wesrad, Odd Arne (Cambridge, 2010) vol.1, pp. 67-89; Niu Jun "The Birth of the People's Republic of China and the Road to the Korean War," in the *Cambridge History of the Cold War*, eds. Leffler, Melvyn P. and Wesrad, Odd Arne (Cambridge, 2010) vol.1, pp. 221-243.

⁶ Huang, Xiurong, *Guogong guanxi qishi nian* (Guangdong, 1998).

Taiwan's economic development model was popular in the 1980s and the 1990s. Much has been written about the successful model of the Four Asian Tigers. The focus of this research lies in the role of the state in leading economic development. Gerschenkron indicates that state intervention was a substitute for industrialization and economic development in backward countries. According to him, state intervention could compensate for the lack of the prerequisites for modernization, notably the inadequate supplies of capital, skilled labour, entrepreneurship and technology capacity.⁷ Moreover, he believed that institutional reforms could remedy some of the backwardness which retarded economic growth; and clearly, institutional reforms demand government participation.⁸ In the history of Taiwan's post-war economic development, the KMT government usually fitted into the Gerschenkronian model.

The present historical review is based upon the Gerschenkronian model in showing how the KMT government reformed institutions and compensated for the lack of prerequisites for the further development of the manufacturing SMEs at different stages; it is based upon the needs of Taiwan's economy and the changing international economic environment from 1949 to 1980. This chapter outlines the history of Taiwan's post-war industrialisation and economic development from 1949 to 1980. It focuses on showing how the state began industrialisation, established a market and designed the development programme and how its development policies guided and assisted the rise and development of the manufacturing SMEs.

1-1. Post-war Industrialisation of Taiwan 1945-1980

After the war, the Taiwanese economy was in a bad situation. The first severe problem was inflation. In addition, the production of the two main agricultural crops, rice and sugar, had sharply declined in 1945, having gradually reduced from 1942.⁹ Regarding the population, the defeat in the Chinese Civil War forced the KMT

⁷ Gerschenkron, Alexander, *Economic Backwardness in Historical Perspective: a Book of Essays* (Boston, 1962).

⁸ Fishlow, Albert, *Miracle or Design?: Lessons from the East Asian Experience* (Washington DC, 1994).

⁹ For reasons for the inflation problem and the reduction in agricultural production, see Wu, Congmin "Taiwan zhanho de exin wujia pengzhang," paper presented in Taiwan wuliu lin niandai de lishi xinsi, Guoshiguan yantao hui (Taipei, 2005).

officials, soldiers and their families to retreat to Taiwan.¹⁰ The economic inflation, the reduction in agricultural production and the sudden increase of population made the post-war situation very difficult.

In these circumstances, the first step to restore the economy began with the adjustment of the agriculture sector. In 1945 77.6% of the arable land was dominated by the landlords who comprised only 2.03% of the total Taiwanese population. Conversely, the peasants dominated 88.3% of the total population but owned only 22.4% of the arable land. 70% out of the total peasant population were tenant-farmers. Moreover, the rent for their land ranged from 50% to 70% of their total earnings.¹¹ These statistics indicate that the high level of rent lowered the living standard of the peasants and reduced their incentive to increase production. Therefore, the aims of the government were to create such an incentive and to transfer the land capital to the industrial sector.

There were four significant policies concerning land reform in Taiwan: The 'Land-to-the-tiller' programme (in 1947), reduction of the farm rents programme (in 1949), the programme to exchange of rice for fertiliser (in 1950) and the 'sale of the Republic's land' programme (in 1951).¹² The land reform policies increased agricultural production and the percentage of tenant-farmers went down from 36% in 1952 to 7% in 1980.¹³ Meanwhile, the landholders whose lands were purchased were compensated with government securities and bonds. The compensation included 70% of the government land bonds (ten-year liquidation with a 4% annual interest rate). The other 30% included the stocks of the four largest state-owned enterprises (the cement industry, paper-making, mining and forestry), which facilitated the subsequent privatization of these state-owned enterprises.¹⁴ The holding of government securities

¹⁰ After the Japanese left Taiwan, the population was 6.09 million; in 1951 it rose to 7.88 million, which was 10% higher than five years earlier. For further details, see Selya, Roger Mark, *Development and demographic Change in Taiwan* (New Jersey, 2004).

¹¹ Jiaoyu bu shuwei xuexi , *Taiwan de tudi gaige (diyice), gaozhong lishike zxin ronru jiaoxue jiaocai fazhan*, <http://www2.wordpedia.com/TaiwanPedia/content.aspx?id=18212&x=18533>. (accessed 20 April 2011).

¹² Ranis, Gustav, "Industrial Development," in *Economic Growth and Structural Change in Taiwan: The Postwar Experience of the Republic of China*, ed. Galenson, Walter (Ithaca, 1979), pp. 206-262. Kuo, Shirey, W. Y., *The Taiwan Economy in Transition*, (Colorado, 1983), pp. 23-52.

¹³ Directorate-General of Budget, Accounting and Statistics, Executive Yuan R.O.C. (Taiwan), *Statistical Yearbook of the Republic of China* (Taipei, 1984), pp.380-383; Council for Economic Planning and Development, Executive Yuan R.O.C. (Taiwan), *Taiwan Statistical Data Book* (Taipei, 1984), p.57; Council of Agriculture, Executive Yuan R.O.C. (Taiwan), *Taiwan Agricultural Yearbook* (Taipei, 2000), pp.6-7.

¹⁴ Tudi Gaige jinian guan, <http://www.landreform.org.tw/html/02-06.htm>. (accessed 20 April 2011).

and bonds led the landholders' families to see it as tradable capital. The policy translated land capital into private business capital in the market; around seven hundred million Yuan of the land capital was transferred to the industrial sector.¹⁵

The KMT government then saw the import substitution industrialisation (ISI) policy as the means to collect and transfer agricultural capital over to modern industry. In the early stage of the ISI policy, the main exports focused on agricultural products, in particular sugar (sugar was the main export in the 1950s accounting for 50% of Taiwanese exports).¹⁶ The fundamental problem for ISI policies is that all the needed capital goods and raw materials for development have always had to be imported. The government needs capital to import these necessary goods. The export sector (in the early post-war stage, typically of primary commodities, because they were not needed for industrialisation) usually paid for the ISI programme through heavy taxes. Therefore, the incentives for exporting reduced when the need for importing increased. The situation can be found in most Latin American countries. Such problem did not occur in Taiwan because of government policies and the U.S. aid.

The ISI programme was carried out in conjunction with other measures, such as tariffs, import controls and multiple exchange rates, in order to save capital and develop domestic industry.¹⁷ The KMT government then transferred the foreign capital (earned from agricultural exports) and raw materials (or other necessary machinery for the development of modern industry) into developing light industries (in particular the textile industry) in Taiwan. At the same time, in order to increase the incentives for export, the government established the indirect tax rebate system for exporting industries.¹⁸

Another significant factor is the U.S. influences on Taiwanese ISI. The U.S. aid during this period was vital in stabilizing and enhancing Taiwanese economic transformation.¹⁹ Figure 1-1 shows the allocations of U.S. economic aid by sector of the economy from 1951-1965. The largest amount of U.S. economic aid went to infrastructure; a large percentage of it was also spent on human resources and on

¹⁵ Lee, Teng-hui, *Taiwan nongye fazhan de jingji fenxi* (Taipei, 1980).

¹⁶ Gold, Thomas, *State and Society in the Taiwan Miracle* (London, 1986), pp.47-55.

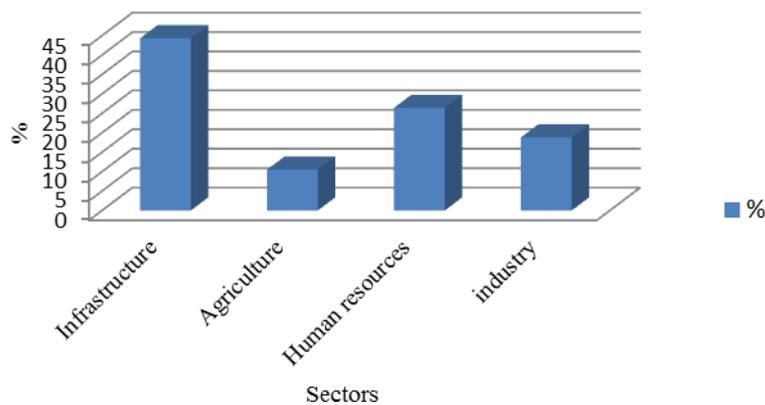
¹⁷ Dessus, Sebastien, Shu, Jiadong and Xu, Maoxian, *Taiwan jingji de yuandong li* (Taipei, 1996).

¹⁸ Jenkins, Glenn, P., Kuo, Shirley, C.Y. and Sun, Kenan, *Taxation and Economic Development in Taiwan* (Cambridge, MA, 2003).

¹⁹ Jacoby, Neil, H., *U.S. Aid to Taiwan: a Study of Foreign Aid, Self-help and Development*, (New York, 1966), pp.150-156.

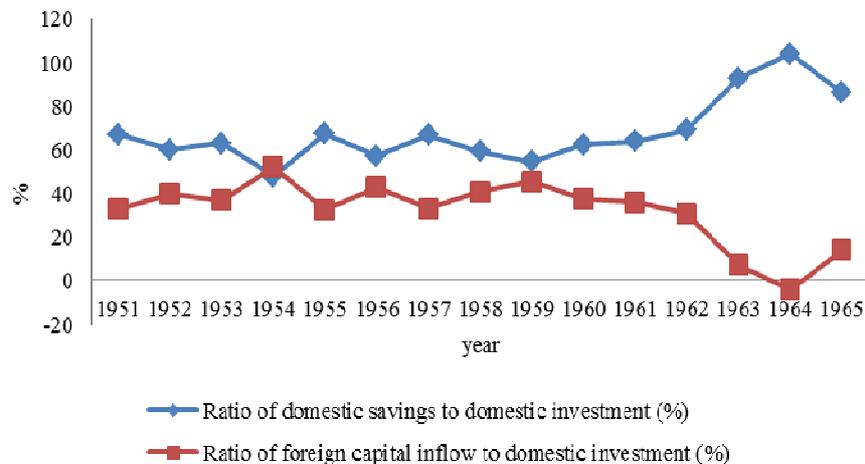
industry. Figure 1-2 shows the U.S. aid and foreign capital inflow as a percentage of domestic savings and domestic investment. The ratio of U.S. aid capital inflow to domestic investment dominated at 30% to 50%. Jacob indicates that the U.S. foreign aid helped pay for the imported goods and raw materials and the U.S. military assistance programme also helped to reduce unemployment and implemented local resources for infrastructure contracts.²⁰

Figure 1-1. Allocation of the U.S. Economic Aid by Sector of the Economy in Taiwan (%), 1951-1965



Source: Council for Economic Planning and Development, Executive Yuan R.O.C. (Taiwan), *Taiwan Statistical Data Book*, (Taipei, 1962 and 1966), p.121, p.136.

Figure 1-2. U.S. Aid and Foreign Capital Inflow as a Percentage of Domestic Savings and Domestic Investment (%), 1951-1965



²⁰ *Ibid.*, pp.117-126.

Source: Directorate-General of Budget, Accounting and Statistics, Executive Yuan R.O.C. (Taiwan), *National Income in Taiwan Area, the Republic of China* (Taipei, 1981), p.249, p. 254.

Note: 1. Domestic saving refers to savings generated domestically, exclusive of foreign transfer receipts. 2. As U.S. aid was terminated in 1965, column (2) includes only foreign capital inflow after 1961; before this, it refers to U.S. aid.

The impact of the land reform and the ISI programme on the early development of the SMEs can be appreciated from the rise of the small-scale processing industry and the labour surplus in the rural areas. There are two different opinions on the emergence of small-scale processing factories in the rural areas. Research by Park and Johnston indicates that in the mid-1950s, with the increase of rural income, the need for services and simple consumer goods increased. This led to the early stage of SME development in Taiwan, a stage which was mainly rural-based and to do with food processing.²¹

Nonetheless, some researchers indicate that, although the land reform policies and the improvement of agricultural technology increased agricultural production, the living standard of the peasants was not improved. The government, on the one hand, exploited the agricultural surplus by imposing taxes and exchanging rice for fertiliser. On the other hand, the government held down the price of agricultural products. Moreover, the 'land-to-the-tillers' programme scattered the cultivated land. The plots became smaller and the improvements in technology brought a labour surplus to the rural areas. This led people in the rural area to take part-time jobs. The research shows that the smaller the amount of cultivated land per family, the higher the percentage of part-time workers. In the mid-1950s this induced the emergence in the rural areas of food processing SMEs.²²

The land reform increased the labour surplus for light industry and the ISI programme created a market for the development of the SMEs mainly in the food processing industry. Although the SMEs appeared in the mid-1950s, their scale and contribution were barely noticeable. The further development was affected by the policy changes in the late 1950s and early 1960s.

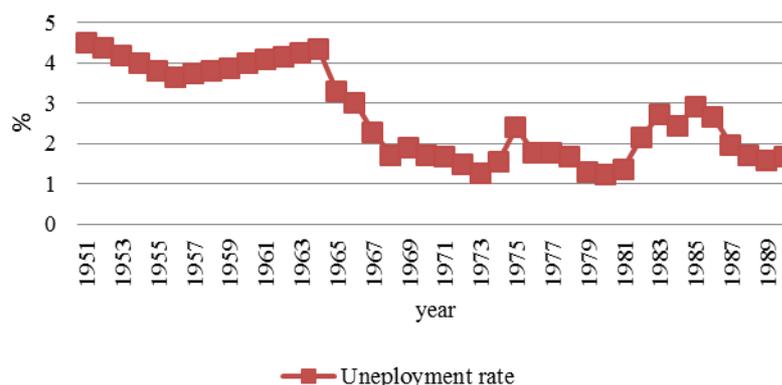
Some economic problems and external factors in the late 1950s led the ISI policy to change to export-oriented industrialisation (EOI). There are two popular

²¹ Park, Albert and Bruce Johnston, 'Rural Development and Dynamic Externalities in Taiwan's Structural Transformation', *Economic Development and Cultural Change*, vol.44, no.1 (1995), pp.181-208.

²² Huang, Jinjie, "Tudi gaige jiqi dui Taiwan nongcun yu nonmin de chongji," in *Zhanho Taiwan de zhuanxing jiqi zhanwang*, ed., Huang, Jinjie (Taipei, 2006); Gu, Yingchan, *Tudi shichan niuqu yu diannong gaige* (Taipei, 1995).

explanations for the policy changes in the late 1950s. The first concerns the problems of the domestic economy. Analysis shows that there was overproduction from the light industries because the domestic market was small and unable to absorb domestically produced goods. This caused an industrial slowdown in the mid- and late 1950s.²³ Meanwhile, the emergence of the SMEs in the food processing industry in the rural areas also implied the problem of a labour surplus. Figure 1-3 shows the unemployment rate in Taiwan from 1953 to 1980. It is clear that from 1953 to 1966 the unemployment rate remained above 5%. The second factor is the adjustment of the U.S. policy. As Lin and Chen's research indicates, the U.S. government re-examined its economic aid policy in 1959 and began gradually to reduce its economic aid to Taiwan. This reduction gave the KMT government problems in the balance of payments of deficits and too little foreign exchange to continue the ISI policy.²⁴

Figure 1-3. Unemployment Rate in Taiwan (%), 1951-1989



Source: Directorate-General of Budget, Accounting and Statistics, Executive Yuan R.O.C. (Taiwan), *Yearbook of Labour Statistics, Republic of China* (Taipei, 1981), p.335.

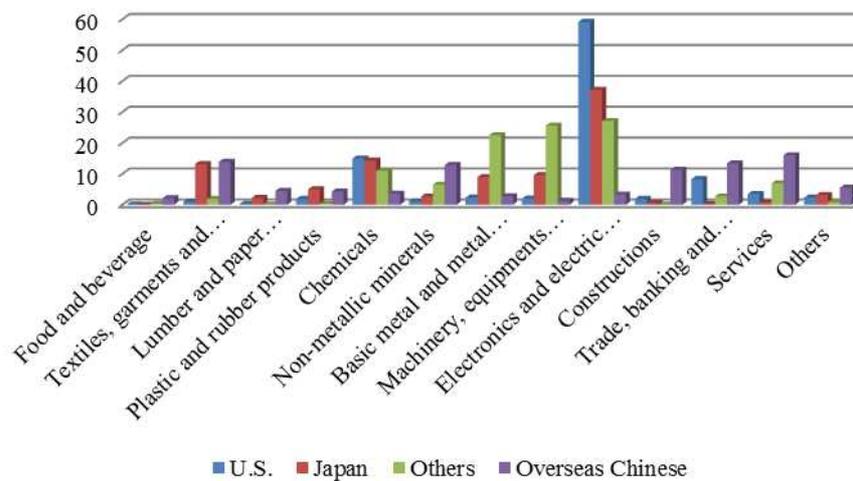
Both internal and external problems in the early 1960s affected the changes of policy to EOI. The EOI policy focused on attracting FDI to Taiwan and encouraging exports. With the rising production costs in some of the developed countries, such as the U.S.A. and Japan, these corporations began looking to invest where production costs would be cheaper. In order to attract FDI, the government launched a series of policies to control the price of agricultural products and maintain the standard of

²³ Wu, Rongyi, *The Strategy of Economic Development: A Case Study of Taiwan* (Louvain, 1971); Lin, Ching Yuan, *Industrialisation in Taiwan 1946-72: Trade and Import-Substitution Policies for Developing Countries* (London, 1973).

²⁴ Galenson, Walter "How to develop successfully: Taiwan model," in *Experiences & Lessons of Economic Develop in Taiwan*, eds. Li, Kuoting and Yu, Zongxian (Taipei, 1982), pp.37-58.

living of the peasants at subsistence in order to push surplus labour forces in the rural sector to the industrial sector in which foreign enterprises were investing.²⁵ Figure 1-4, below, shows that the largest amount of foreign investment lay in the textile, chemicals and electronic machinery sectors. These sectors are typically labour-intensive and require large numbers of cheap workers. The Taiwanese economy provided foreign firms with sufficient labour at a low cost, who came from the rural areas in particular. Moreover, the KMT government established Export Processing Zones (EPZs) for the FDI and encouraged exports through tax exemptions for exporters within the EPZs. The benefits of the foreign investment included technology transfers, the opening of the international market and gradually increased exports.²⁶

Figure 1-4. Foreign Investment Commitments by Industry and Origin (%), 1952-1975



Source: Ministry of Economic Affairs, Executive Yuan R.O.C. (Taiwan), *Report of Economic Growth and Structural Change in Taiwan* (Taipei, 1975), p.249.

The EOI policy in the 1960s significantly influenced the rise of the SMEs by opening the export market and by the amount of knowledge transferred from the foreign factories in the EPZs. In the mid-1960s, the government encouraged SMEs to go abroad themselves with the support of special loans, technology, tax exemptions and preferential terms. At the same time, most of the SME owners in the early period of EIO policy learned skills and knowledge from the foreign factories in the EPZs.

²⁵ Shi, Jizeng “Nong gong buman jian gongzhi chayi yu laoli yidong-shuang xiang chuli zhi guanzi,” *Taiwan renli zhiyuan huiyi lunwen* (Taipei, 1979).

²⁶ Gold, T., *op.cit.*, pp.57-74.

Later, many of them started their own businesses.²⁷ When these foreign corporations found that the Taiwanese SME subcontracting system could provide cheaper production costs, they placed order within the subcontracting system rather than setting up their own factories in the EPZs. This change increased the numbers and profits of the Taiwanese SMEs. Although the 1970s saw an oil crisis and decline of FDI in Taiwan, the Taiwanese SMEs had replaced the large foreign enterprises and become the main contributor to the growth in Taiwanese exports.²⁸

1-2. Results of the Economic Development and the Contribution of the SMEs to the Taiwan's Rapid Economic Growth

In the late 1970s the major economic structure was transformed from the model of the early 1950s. Figure 1-5 below shows the growth rate of manufacturing industry by sectors from 1951 to 1979. It is clear that the growth rate of the food processing industry remained high from the early 1950s; and it was overtaken by the growth rate of electrical machinery at the end of the 1970s. The growth rate of electrical machinery showed a steep upward curve as time went by. Moreover, the export structures also responded to the changing structure of manufacturing industry. Figure 1-6 presents the export structure in Taiwan in 1953 and in 1979. It shows clearly that in 1953 the dominant group of exported goods was in processed foods; conversely, in 1979 export goods were dominated by industrial products.

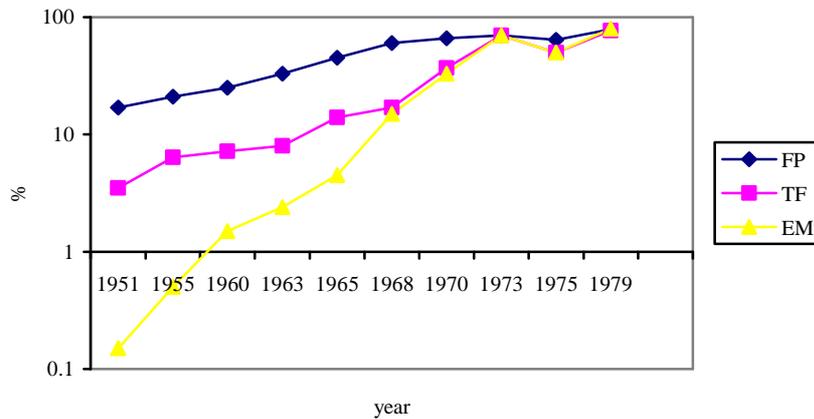
The contribution of the SMEs can be analyzed from the changing export structure and the growth rate of manufacturing industry. Figures 1-7, 1-8 and 1-9, below, present the sources of manufacturing output growth by industry group from 1956 to 1976. It is clear that the food processing industry contributed the largest percentage of export expansion; yet the largest percentage of export expansion in the 1960s shifted to electronic machinery. In the 1970s, textiles, electronic machinery, and manufacturing rose quickly. Figure 1-10 below shows the export commodities from 1953 to 1970. The statistics indicate the commodities of different sectors for

²⁷ It is believed that employers would acquire wealth more effectively and rapidly than employees. This idea was also related to the historical lack of a social welfare system in Taiwan, which motivated people to earn more money and take care of themselves. For further details, see Kuo, Shirley W. Y. and Fei, John C. H., *The Taiwan Success Story: Rapid Growth with Improved Distribution in the Republic of China 1952-1979* (Colorado, 1981).

²⁸ Wang, Yiding "Maoyi zhengce," in *Taiwan jingyen Sishi nan 1949-1989*, eds. Gao, Xijun and Li Cheng (Taipei, 1991), pp.204-231; Liu, Bangli, 'Zhanho Taiwan weishanxin maoyi wanlu de jiango', *Taiyin jikan*, vol.47, no.1 (1996), pp.125-150; Chu, Wan Wen "Japanese General Trading Companies in Taiwan," *ISSP Working Paper Series*, vol.90, no.3 (1989).

export and the changing percentages making up the total of goods exported during this period. By tradition, sugar had always dominated the exported commodities and was always a vital economic crop for Taiwan from the colonial period. In 1970, however, the percentage of electrical appliances soared. As shown in Zhou and Lin's book, from the 1960s to the 1990s, the SMEs dominated more than 90% of manufacturing industry. Figure 1-11 shows the contribution of Taiwan's SMEs to foreign exports. It is clear that SMEs accounted for 80%-90% of Taiwan's foreign exports from the late 1960s to the 1980s.²⁹ The evidence shows the significance of the SMEs in manufacturing industry and their contribution to Taiwan's export growth.

Figure 1-5. Rapid Growth Rate of Food Processing, Textiles and Footwear and Electrical Machinery Industries, 1951-1979 (1979=100)

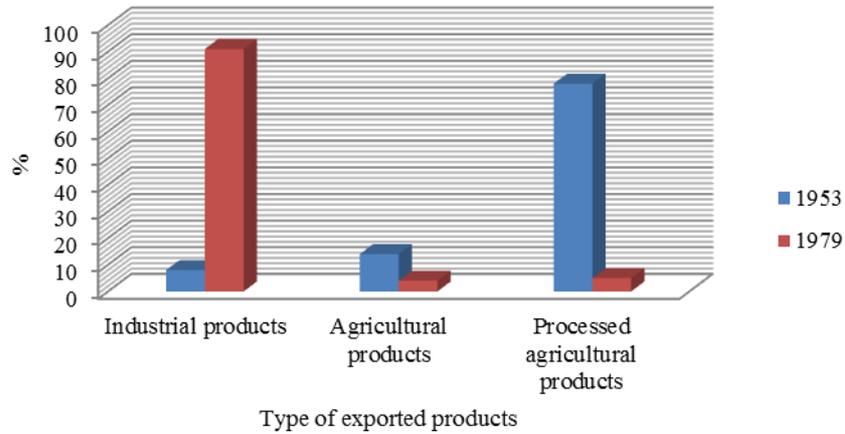


Source: R.O.C. Council for Economic Planning and Development, Executive Yuan R.O.C. (Taiwan), *Taiwan Statistical Data Book*, (Taipei, 1962, 1966 and 1980), p.14, p.14 and p.1.

Note: FP= food processing industry; TF= textile industry; EM= footwear, electrical and machinery industries.

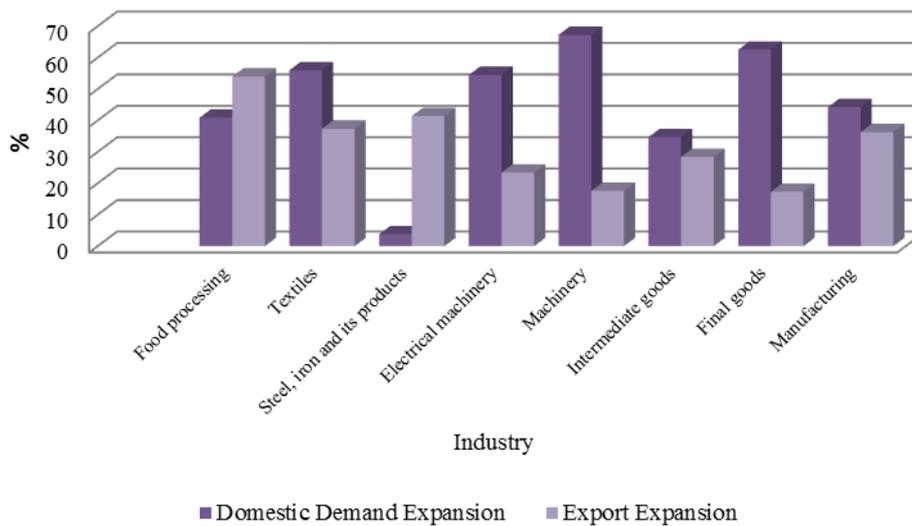
²⁹ Zho, Tiancheng and Lin, Zhicheng, *Taiwan zhongxiao chiye fazhan de jizhi* (Taipei, 1999), pp. 31-70.

Figure 1-6. Comparison of Export Structure in Taiwan in 1953 and in 1979 (%)



Source: Council for Economic Planning and Development, Executive Yuan R.O.C. (Taiwan), *Taiwan Statistical Data Book* (Taipei, 1980), pp.203-204; Ministry of Finance, Executive Yuan R.O.C. (Taiwan), *Monthly Statistics of Exports and Imports*, no. 101 (1978), pp.131-132.

Figure 1-7. Sources of Manufacturing Output Growth in Taiwan by Industry (%), 1956-1961



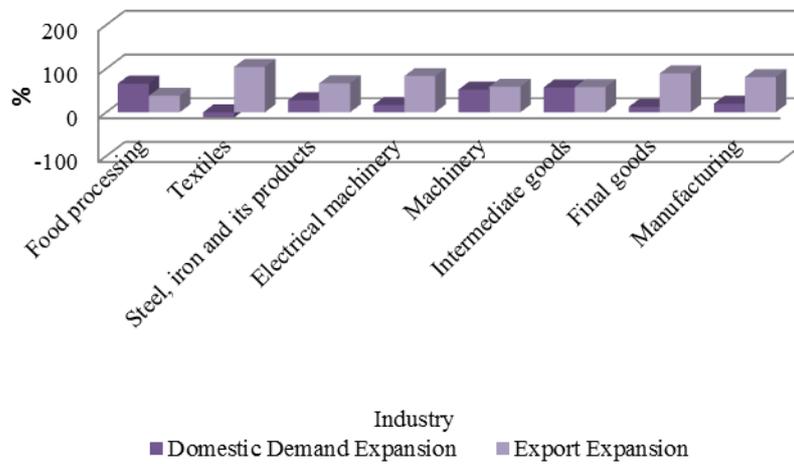
Source: Council for Economic Planning and Development, Executive Yuan R.O.C. (Taiwan), *Taiwan Statistical Data Book* (Taipei, 1984), p.33-34.

Figure 1-8. Sources of Manufacturing Output Growth in Taiwan by Industry (%), 1961-1971



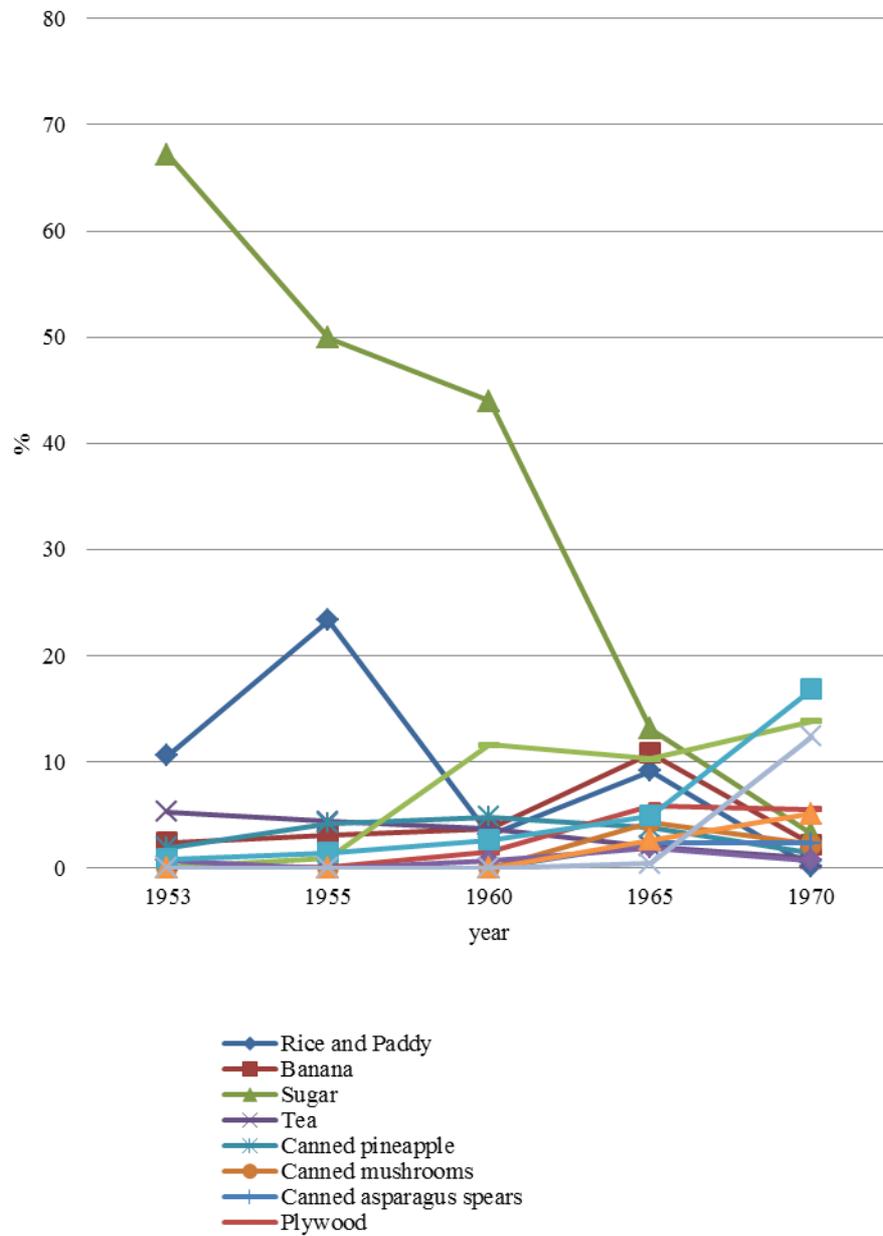
Source: Council for Economic Planning and Development, Executive Yuan R.O.C.(Taiwan), *Taiwan Statistical Data Book* (Taipei, 1984), pp.33-34.

Figure 1-9. Sources of Manufacturing Output Growth in Taiwan by Industry (%), 1971-1976



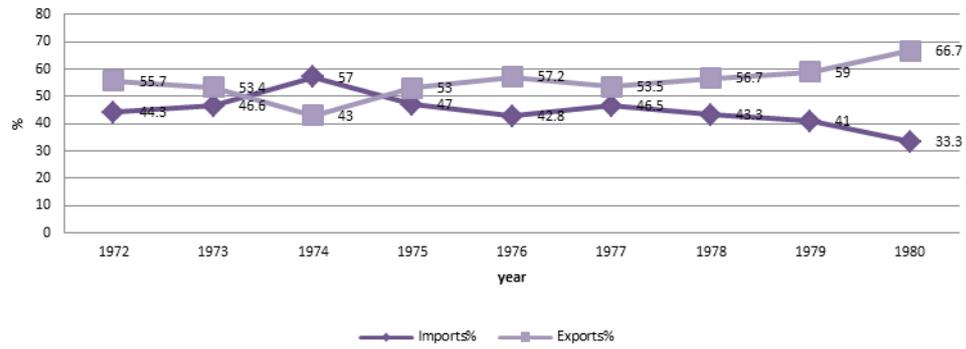
Source: Council for Economic Planning and Development, Executive Yuan R.O.C. (Taiwan), *Taiwan Statistical Data Book* (Taipei, 1984), pp.33-34.

Figure 1-10. Major Exports of Commodities in Taiwan (%) 1953-1970



Source: Council for Economic Planning and Development, Executive Yuan R.O.C. (Taiwan), *Taiwan Statistical Data Book* (Taipei, 1980), pp.203-204.

Figure 1-11. Imports and Exports of the Taiwanese Manufacturing SMEs (%), 1972-1980



Source: Bureau of Economic Research, Central Bank of the R.O.C., *The Survey of Industrial Financial Situations in Taiwan, Republic of China, 1973-1995*, (Taipei, 1996), pp.15-37.

Chapter 2. Literature Review

Discussions on Taiwan's economic development have been popular since the 1980s. These discussions have touched on the different disciplines of economics and political economy, mainly focused on explaining Taiwan's success by clarifying the key factors which contributed to its rapid economic growth. The conventional view usually highlights the significant role of government in its development process; the differences lie in the levels and means discerned of the government's intervention. Two broad groups of writers may be identified on this basis: the neoclassical economists and the state-led development model of Robert Wade and Alice Amsden.

The neoclassical economists suggest that it was the free market economy established by the state that enabled private business to develop. These writers do not, however, specify the particular support that a free market might give to the rise and development of SMEs. They claim that the state created and maintained a suitable environment, but without picking any winners for the market. It was the mechanism of a free market economy that led to the development and prosperity of the SMEs. Robert Wade and Alice Amsden, however, argue that the state of the Taiwanese government did more than create a free market economy. The state governed the market and provided both direct and indirect support to the rise and the development of the manufacturing SMEs. These two theoretical frameworks are most popular in explaining Taiwan's post-war economic success.

The state-led model of Wade and Amsden is the most used theoretical framework to explain why and how Taiwan enjoyed such rapid economic growth, in particular when Taiwan's post-war economic development is compared with that in Latin America. They argue that the actions of the state made all the difference. This chapter reviews these two groups of theories with a specific focus on the impact of the state and of the market on the rise and development of the manufacturing SMEs. The first section reviews the general theoretical frameworks of the two groups for Taiwan's growth. The second section then focuses on the way in which these theories explain the rise and development of the manufacturing SMEs in the post-war period. The third section raises questions based upon the review of the literature. Finally, hypothesis of this research is formulated on the basis of the questions and the literature on the two theoretical models.

2.1. *The Role of the State and the Market in Taiwan's Economic Development*

The first group of writers analyses Taiwan's economic development within the theoretical framework of neoclassical economists. One strand in this group, the free market (FM) theory, argues that Taiwan's success was founded on the establishment of a free market economy. The success of a free market is that it efficiently allocates resources, encourages competition among private businesses and leads to rapid economic growth. Another strand, the simulated-free market (SM) theory, indicates that Taiwan's success was attributable to the government which created an adequate environment for economic activity. In this view, the government controlled certain institutions in order to facilitate the allocation of resources. For example, Stiglitz indicates that the governments in North East Asia successfully create a suitable market, controlling banking and finance institutions and directing and supplementing the actions of the private sector in the market. Although this strand supports the idea that government needs to play a certain role in economic development, it believes that less government intervention and more liberalisation policies would speed up economic growth. The key point is that the government provides the climate for trade and economic activity, but does not replace the market.³⁰

Some economic analysts support the neoclassical theory. Young, Kim and Lau clarify the dynamics of Taiwan's post-war rapid economic growth in these terms. Their analysis shows that productivity was not the engine for East Asian rapid economic growth.³¹ On the contrary, the rapid growth was contributed by 'the rise in participation rates, investment to GDP ratios, and educational standards and the intersectoral transfer of labour from agriculture to other sectors with higher value added per worker'³². These factors indicate the significant role played by the government in creating a suitable market.

The second group of writers does not accept neoclassical economists and usually condemns its approach for focusing on economic issues and performance and ignoring the impact of different types of political regime on economic development. Wade, for example, argues that both free market theory and simulated market theory

³⁰ Stiglitz, Joseph E., 'Some Lessons from the East Asian Miracle', *The World Bank Research Observer*, vol.11, no.2 (1996), pp.151-178.

³¹ Young, Alwyn, 'The Tyranny of Numbers: Confronting the Statistical Realities of the East Asian Growth Experience', *The Quarterly Journal of Economics*, vol.110, no.3 (1995), pp.641-680; Kim, Jong-Il and Lau Lawrence J., 'The Source of Asian Pacific Economic Growth', *The Canadian Journal of Economics*, vol.29, special issue: part 2(1996), pp.S448-S454.

³² Young, A., *op.cit.*, pp.674-675.

can explain only in part the Taiwanese development story. He indicates that the FM and SM theories ignore the impact of political arrangements on economic development and these liberalisation policies (or semi-liberalised policies) do not necessarily or automatically bring about economic growth (in particular when comparing different countries which also adopted liberalisation policies, since not of them manage to increase economic growth).³³ But both divisions of the second group highlight the important role of the state in Taiwan's economic development.

The first division focuses on the way in which the political system encouraged economic development by analysing the relations of the state and society from a historical perspective. Gold adopts the comprehensive approach which explains the internal relations between the political system and local society and shows how these relations influence the development and changes in the economic structure. This structure is therefore constructed by the changing relations between the political system and local society in history; and the historical legacy limits the changes in the economic structure.³⁴

Taking this approach, Gold explains that the reason for the success of the KMT development policies in the post-war period was connected with the colonial legacy and the lack of connections between the KMT and the local Taiwanese society. Before the colonial period, Gold argues, there was no local capital in Taiwanese economy; during it, the Japanese colonial government intentionally depressed the development of local Taiwanese capital. In line with Gold, Booth argues that there was 'no established class of industrial or financial entrepreneurs to feel threatened by new directions in economic policymaking' and therefore the pressure from these groups on the KMT government was slight.³⁵ Both Gold and Booth indicate that the historical legacy encouraged the implementation of KMT's development policy, since Taiwan had so few local industrial capitalists. Moreover, the lack of connections with the local society obviated the influence of other local interest groups on the early reform policies, such as land reform policy.

³³ Wade, Robert, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (New Jersey, 2004), pp.52-72.

³⁴ Gold, T., *op.cit.*, pp.11-20.

³⁵ *Ibid.*, p.33; Booth, Ann, "Initial conditions and miraculous growth: Why is Southeast Asia Different from Taiwan and South Korea?" in *Southeast Asia's Industrialisation: Industrial Policy, Capabilities and Sustainability*, ed. Jomo, Kwame Sundaram (London, 2001), pp.30-58.

Similar opinions can be found in Rodrik, Grossman and Norman, whose research shows a very low Gini coefficient for income and land distribution in Taiwan. They explain that the phenomenon resulted from the insulation of the government from local pressure groups.³⁶ In other words, the development policies were implemented successfully without interference from any interest group, because the KMT was able to reconstruct the society and with its authoritarianism maintain both political and social stability. Given this stability, the Taiwanese government was able to channel funds for investment, create a market system under state control and guide Taiwanese enterprises to the world capitalist system.³⁷ Similar arguments can be found in Hossain, Gregor, Chang and Zimmerman and the investigation of the World Bank in 1995.³⁸

The second division basically follows the idea of the first division that Taiwan's type of political system made it easier to implement the state's development policy. It focuses on the analysis of the policies implemented by the strong state and shows how these policies led to rapid economic growth. Wade proposes the Governed Market (GM) theory, which similarly holds that an authoritarian kind of state can carry out more efficient policies for development. The GM theory can apply to several development policies, including land reform, fixed agricultural prices and the control of FDI. Strong government leadership can be found only in certain heavy industries, which are capital intensive and related to national security.

Although the KMT was an authoritarian regime, the relations between it and the enterprises do not fit into the GM theory. The technocrats, when making industrial policies, did indeed consult with entrepreneurs, who found how the government would help them in their business. By this means, the KMT government gained the support of these capitalists and maintained political and social stability. Moreover, Wade's analysis does not oppose all free market and simulated market theories. His analysis shows that Taiwan had free trade, a free domestic market, free labour market, unregulated curb market and government supply of primary public goods; these fit

³⁶ Rodrik, Dani, Grossman, Gene and Norman Victor, 'Getting Interventions Right: How South Korea and Taiwan Grew Rich', *Economic Policy*, vol.10, no.20 (1995), p.92.

³⁷ Gold, T., *op.cit.*, p.22.

³⁸ Rahman, Fazlur A., *Asian Tigers: Economic Success: Lessons for Bangladesh* (Dhaka, 2001); Gregor, James, A., Chang, Maria Hsia and Zimmerman, Andrew, B., *Ideology and Development: Sun Yat-sen and the Economic History in Taiwan* (Berkeley, 1981); World Bank Policy Research Report, *The East Asian Miracle: Economic Growth and Public Policy* (Oxford, 1993).

into the free-market theoretical framework. In terms of the simulated-free-market theory, the KMT government had strict regulations on banking and, to enhance industrial competitiveness, promoted other industrial policies, such as education and R&D. He concludes that the story of Taiwan's economic development cannot be explained by a single principle; but it is worth noting that what the Taiwanese government had done for economic development was more than the neoclassical economists had described.³⁹

The economic analyses of Rodrik, Grossman and Norman agree that the role of government was significant, but they find it in a different field. According to their research, export growth was not the engine for Taiwan's rapid economic growth, but an investment boom which induced an economic boom. They indicate that most of the development policies for encouraging exports were already made in the 1950s and the 1960s, yet export growth did not occur until the 1970s. They argue that growth in Taiwan was 'investment-led'; this required not only a suitable investment environment for the government to create, but also no impediments to take-off, and the provision of investment subsidies, administrative guidance and the use of public enterprises. This finding indeed strengthens the active and productive role of the government in Taiwan's economic development. In addition, they agree that the stable political and social conditions were significant in supporting Taiwan's economic development.⁴⁰

The neoclassical economists minimise the role of government in economic development and the other strand of literature criticised them for saying that the establishment of institutions does not automatically lead to growth. Therefore, the role of government began to appear significant in creating incentives, controlling institutions and guiding private sectors in the market. Whether and how far the government interfered or governed the market, most writers hardly specify the relation of the state and the manufacturing SMEs, nor the way in which these development policies or institutions assist the foundation of the private sectors, the manufacturing SMEs in particular. The question then arises, 'was it these liberalised institutions and policies (as the neoclassical economists suggested) or the governed, guiding and directing policies (as the second group of writers argue) that automatically or efficiently led to the rise and the development of SMEs?'

³⁹ Wade, R., *op.cit.*, pp.26-29, pp.297-298.

⁴⁰ Rodrik, D. Grossman, G. and Norman, V., *op.cit.*, pp.53-107.

2-2. *The Role of the State and the Market on the Rise and the Development of the SMEs*

The neoclassical economists do not particularly address the support of a free market economy to the rise and the development of the SMEs in post-war Taiwan. According to the theory, the market allows individuals participating and competing in the market. The market allocates resources based upon the competition. In addition to this, the government controlled the banking system and supply the market with key elements that facilitate private business. These elements include government's investment in GDP and education and the transfer of labour. Particularly, the state successfully transferred labour surplus from agriculture to manufacturing industry; this provided SMEs with sufficient labour forces with lower cost. In addition to this, government's contribution to education is also considered significant in providing SMEs with trained workers for manufacturing industry. In general, the neoclassical economists suggest that a free market economy with adequate supplies from the government facilitated the prosperity of the manufacturing SMEs in Taiwan.

Unlike the neoclassical economists, Wade and Amsden analyse how state support for the manufacturing SMEs led to rapid export growth in the 1970s and 1980s. Wade actually indicates that the manufacturing SMEs usually complained that the government did not help them, although the government paid attention to the SMEs' needs.⁴¹ Field analyses how this 'consultation' actually worked. The government used the commerce and industrial organisations to collect the necessary information for further policy adjustment. However, the private sector had no influence on the subsequent policy. In other words, the relationship was hierarchical and distant.⁴² Both Wade and Field explain this distance in terms of ethnic problems between the mainlanders, the local Taiwanese. Meanwhile, this distance also created more freedom for the SMEs to operate in the market. In addition, Wade argues that government consultation and the support for the private businesses, however slightly could have enhanced the capitalist support for the KMT regime.

Since the relations between the state and the SMEs were hierarchical and distant, Wade's analysis recognises that little support was supplied directly by the state to private businesses, in particular manufacturing SMEs. Nevertheless, Wade,

⁴¹ Wade, R., *op.cit.*, pp.297-305.

⁴² Fields, Karl, "Strong states and business organisations in Korea and Taiwan" in *Business and the State in Developing Countries*, eds. Maxfield, Sylvia and Schneider, Ben Ross (Ithaca, 1997), pp.122-151.

Amsden and Khan and Blankenburg all agree that state support indirectly benefited the development of SMEs. The government's intervention in the development of certain large industries influenced the development of manufacturing SMEs by providing credit, technical assistance, raw materials, intermediated goods and a flow of skilled labour from large firms to SMEs. According to their research, the government's indirect support to the SMEs has three separate aspects.

In terms of technology, the state played an important role in the technology spin-off from the state-owned enterprises (SOEs) and large enterprises (LEs) to the manufacturing SMEs. The technology spin-off includes the flow of managerial know-how and skilled personnel to the SMEs. That is to say, the SOEs and LEs provided trained high-tech personnel for firms participating in the market. Khan and Blankenburg further analyse the impact of Taiwan's industrial policy on the development of small-scale industries by its support technologies through the rent-management strategy from the 1950s to the 1980s. This suggests that the state licensed and subsidised technologies to the private sector. The success of the policy was in accordance with both the education policy and the separation of political and business sectors within Taiwanese society.⁴³

The second aspect was to provide cheaper materials or intermediate goods to the downstream manufacturing SMEs. Amsden and Khan argue that the Taiwanese SOEs and LEs provided the SMEs with cheaper materials and intermediate goods. This was considered significant support for the manufacturing SMEs since it reduced the transaction cost of importing materials from abroad.⁴⁴ The third aspect was related to financial support. There are two different opinions concerning this indirect aid. To begin with, Cheng indicates that the KMT was cautious in using finance as an industrial policy to support the selected industries, because big capital might challenge its authority. In other words, the KMT did not use a credit policy to shape Taiwan's industrial development. Instead, it favoured and supported other social groups, such as manufacturing SMEs, to counter the development of big capital.⁴⁵

⁴³ Khan, Mushtag H. and Blankenburg, Stephanie "The Political Economy of Industrial Policy in Asia and Latin America," in *Industrial Policy and Development: The Political Economy of Capabilities Accumulation*, eds., Dosi, Giovanni, Cimoli, Mario and Stiglitz, Joseph, (Oxford, 2009), p.352.

⁴⁴ Amsden, Alice 'Big business and urban congestion in Taiwan: the origins of small enterprises and regionally decentralised industry (respectively)' *World Development*, vol.19, no.9 (1991), pp.1121-1135; Khan, M. and Blankenburg, S., *op.cit.*, p.352.

⁴⁵ Cheng, Tunjen "Guarding the Commanding Heights: the State as Banker in Taiwan," in *the Politics of Finance in Developing Countries*, eds., Haggard, Stephan and Lee, Chung H. and Maxfield Sylvania (Ithaca, 1993), pp.55-92.

This argument implies that the state's indirect financial support for the SMEs resulted from the political concern of the KMT to maintain its political authority.

Still, the other group acknowledges that it was difficult for the SMEs to gain financial support from the state and the banks because there were so many SMEs. In these circumstances, as indirect financial support to SMEs the state provided credit capital. Since it was difficult for the SMEs to secure loans from the banks, the SOEs and LEs played a significant part in providing trade credit, equipment and working capital loans to the SMEs. This relationship was significant, since the SOEs and LEs provided capital flows to support the SMEs in their business operations.⁴⁶ A similar argument can be found from the investment-led theory which brings out the significance of investment subsidies, administrative guidance and the use of public enterprises which indirectly provide credit and materials or intermediated goods to support the development of private enterprises and SMEs.

2-3. Problems in the Existing Literature

There are five problems raised in the existing literature.

The first problem is related to the market which was established and maintained by the state. The supplies provided by the state for the market's use include investment, education and the transfer of labour forces. Although these are significant elements, it is not specified whether this market provided a source of financial capital to found SMEs. Regarding this issue, the neoclassical economists do not specify whether the market established by the state was able to provide necessary and sufficient credit to the SMEs.

The second problem concerns the historical perspective on the relations of the state and the society for the sake of economic development. The literature regards Taiwanese society as the passive receiver under an authoritarian regime. In addition to the historical legacy which forbade the rise of a capitalist class and the lack of connections between the KMT and the local society, Gold also contends that the culture of Taiwanese society more easily 'accepted a moralistic authoritarian state and arrogant bureaucracy with a partner's familiar concern for the citizens' day-to-day life as normal'⁴⁷. Booth assumes that there were no well-established financial and industrial organisations in post-war Taiwanese society and this reduced the chance of

⁴⁶ Khan, M. and Blankenburg, S., *op.cit.*, p.352; Amsden, A., *op.cit.*, pp.1121-1135.

⁴⁷ Gold, T., *op.cit.*, p.125.

pressure from the local interest groups. This type of relationship helped the development policies to be implemented.

However, concerning the attitudes towards the authoritarian regime, Gold does not specify which part of Taiwanese culture more easily accepted the authoritarian state. Moreover, Lin's research clearly indicates that there were well-organised local businesses and industrial groups in Taiwan before the colonial period. During this period, although the Japanese dominated the large enterprises, local industries and commerce were operated by the local Taiwanese businessmen. These groups even dominated cross-strait investment and trade and were considered modern enterprises. Evidence for this can be found from the tax records of the Japanese colonial government. The tax was mainly collected from customs or was indirect. Furthermore, Japanese enterprise was less involved in small and medium-sized factories and was not influential in the production and sales departments in certain industries.⁴⁸

The literature considers that Taiwan lacked a capitalist class and that Taiwanese society was the passive receiver of an authoritarian economic policy because it ignores the history of Taiwanese society before the Japanese colonial period. The lack of historical analysis thus neglects some significant social relations and the development of the private business sector. In other words, the existing literature concerns only with the way in which the state stabilised the society so as to allow economic development; it ignores the dynamics of a society which facilitated and supported the rise and the development of the manufacturing SMEs.

The third problem is related to the impact of the interests of the authoritarian system on the formation of economic policy. Gold, Booth and Wade suggest that the authoritarian system played a significant role in Taiwan's post-war economic development. On the one hand, they indicate that the authoritarian system which constructed the hierarchical and distant relations could avoid the problem of other interest groups influencing its policies. On the other hand, the authoritarian system controlled the resources, monopolised the market and dominated the institutions. The exclusion of other interest groups and the control exerted by the authoritarian system facilitated the implementation of the policies under government's plans. This explains

⁴⁸ Lin, Man-houng, 'Youguan rijishidai Taiwan jingjishi de sizhong wujie', *Taiwan: a Radical Quarterly in Social Studies*, no.23 (1996), pp.147-157.

why and how the development policies could be implemented successfully, leading to rapid economic growth.

Although the authoritarian system did possess more power to control the economy and plan for economic development, the existing literature does not specify the impact of the state's interest on form of its development policy. They do not explain how the state's interest influenced the formation of this policy and whether the state's interest was responsive to the needs of the manufacturing SMEs in their operations, although Wade takes into account that the state's support to the SMEs expected reciprocal support from them.⁴⁹ However, this argument disregards the limited local elections in Taiwan before the mid-1980s and does not clarify how the SME's support can be evaluated without general or presidential elections in which they could show it under a one-party political system.

The fourth problem is related to the state's indirect support for the manufacturing SMEs. Most researchers do not specify which industries benefited from the licensed technology spin-off from the state. This spin-off mostly benefited the high-tech manufacturing industries in the late 1980s. However, the traditional manufacturing SMEs did not necessarily benefit in the same way. Shieh indicates that most of the SME owners learned the skills from the places where they had originally worked, not always SOEs or LEs. Moreover, his research also describes how the SME owners upgraded their own new technology through their contractors' networks.⁵⁰ All this questions how far the government supplied these SME owners with skills and technology.

The analysis of Wade and Amsden indicates that the Taiwanese SMEs had difficulties in borrowing from the formal financial system. Their analysis challenges the neoclassical economists' view that the market established by the state did not provide enough sources of credit sources for the SMEs. Wade, Amsden and Rodric suggest that the state provided important indirect finance support for them. However, this ignores several aspects of the support and the investment subsidies. The research does not specify whether the investment subsidies went to the manufacturing SMEs or the large enterprises; or what kind of requirements was made for the private

⁴⁹ Wade, R., *op.cit.*, p.306.

⁵⁰ Shieh, Guoxiong, 'Heishou bian taojia- Taiwan zhizaoye zhong de jieji liudong', *Taiwan: a Radical Quarterly in Social Studies*, vol.2, no.2 (1989), pp.11-55; Shieh, Guoxiong, 'Shito, tojia yu liyeji zhi huohua: Taiwan xiaoxing zhizhao danwei chuangli ji cunhui guichen', *Taiwan: a Radical Quarterly in Social Studies*, vol.15 (1993), pp.93-129.

enterprises to access this help. In the 1970s and the 1980s, the contribution of the SMEs to exports was higher than that of the large enterprises. If the government's direct investment subsidies did not go specifically to the SMEs, it is difficult to argue that it supported their development. The main problem is not the policy itself, but rather the SMEs' ability or eligibility to access the support.

Finally, there has been little analysis of the further development of manufacturing SMEs after the late 1980s. The research on Taiwanese economic development by Wade and Amsden shifts the focus to the rise and development of the high-tech manufacturing enterprises. This rise added more strong evidence to their state-led development model. However, in the late 1980s several significant changes occurred: the political transformation, the changing economic situation and the opening of China's markets. These factors significantly affected the further development of the traditional manufacturing SMEs, which the existing literature does not trace.

In sum, the existing literature ignores the historical legacy before the Japanese colonial period, the dynamics of the society and the further development of the SMEs after the late 1980s. These omissions overestimate the support by the state for the SMEs and underestimate other dynamics which induced the rise of the manufacturing SMEs and facilitated their business operations. Therefore, the questions of the present dissertation are based upon the argument of the neoclassical economists on the role of the market and the argument of Wade and Amsden on the direct and indirect support of the government to the SMEs. How far did the market established by the state and the support of its development policy effectively facilitate the rise and the development of the manufacturing SMEs during the post-war period? How do the political transformation, the changing economic situation after 1980 and China's open market after the late 1980s raise questions about the role of the state in the development of the SMEs at this time? Finally, how do historical similarity and continuity account for the function of the social institutions which supported and facilitated business operation of the manufacturing SMEs in the changing environment?

2-4. Hypotheses

The state has a significant influence on the entry requirements of the market. Although the state opened a market for the SMEs, this market did not provide any source of financial capital for the foundation and business operations of the SMEs.

The direct and indirect support of the state to the SMEs was limited. This being the case, it had limited influences on the further development of the SMEs in China after 1987.

The historical pattern opens a space for the functioning of social institutions and identifies the transformation and the support over time of the social institution for business operations within the changing institutional frameworks. The transforming social institutions, within the space created by the formal institutions, supported the development of the manufacturing SMEs in the post-war period and after the late 1980s facilitated their work in China under the constraints of the Taiwanese government by providing essential financial capital for business operation.

Chapter 3. Theoretical Framework and Methodology

The existing literature focuses mainly on the significance of the market and the state in the case of the SMEs' development. However, the analysis of the state and market ignores the state's interest in the formation of the development policies. This leads to leaving out how far the manufacturing SMEs benefited from the policies. Moreover, the role of Taiwanese society in this process is usually ignored or it is considered a passive receiver. Some research has addressed the role of society in the development of the SMEs. Nevertheless, society is not independent of the market and the state and it fails to trace through history any way of accounting for the development and transformation of Taiwanese social institution. This leads to unclear relations between the state, the market and the social institutions and fails to show how the social institutions provided support to the SMEs.

The theoretical framework of this research falls into two sections: the first focuses on the relations of the state, the market, social institutions and their impact on economic activity. In order to clarify these relations, this section contains three main theoretical frameworks: New Institutionalism Economics (NIE), the sociological institutional theory and the approach of the historical legacy, in order to create a historical pattern which may clarify the dynamics of the social institutions in the formal institutional frameworks which facilitated and supported trade and business in Taiwan. The historical pattern also shows the continuity, discontinuity, similarity (or differences) and transformations of the social institution at different points.

The second section focuses on the impact of the political system and the state's interest on the formation of economic policy. The existing literature usually agrees that the authoritarian system enhanced the state's ability to implement economic policies efficiently, without exploring the power structure and the impact of this structure on the economic policy as it formed. The three main theoretical frameworks in this section are the political theories of Huntington and Wintrobe, the economic voting theory and the theory of economic voting in a transition economy. The section first explores the structure of the authoritarian system and how it enhanced the state's influences and control on the economy. Then it focuses on the impact of the political transformation on the relations between the state and the society and on the formation of economic policy. Since the theoretical framework in this section pays less attention to the historical legacy, the analysis of these theoretical frameworks is integrated into the historical pattern.

The methodology section integrates the theories reviewed in the two sections and is concentrated on three periods: the historical pattern of 1522-1945, the post-war period 1950-1980 and the further development after the late 1980s. In each of these, the state's interest, the impact of the state's interest on the formation of the policies and the market, the impact of the state and the market on the function of the social institutions and the support of the social institutions for the SMEs (or business groups before 1950) under these formal institutions is analysed.

3-1. The State, the SMEs and the Social institutions

The NIE approach extends the analysis of the rational choices framework based upon the neoclassical approach. It emphasizes the problems of asymmetrical information and transaction costs which this approach ignores. Coase indicated the critical role of institutional frameworks and transaction cost in economic activity. According to him, the existence of firms, organizations or institutions can be used as an effective way of minimizing transaction costs.⁵¹ That is, an institution can be regarded as a rational entity which is designed to facilitate and regulate business transactions in order to maximize profits.

Williamson indeed assumes that the relations of firms and markets are more complicated than even Coase stated. Williamson indicates that the framework of organizational failures derives from their bounded rationality, uncertainty, asymmetrical information and opportunism; integration and cooperation between firms emerged as a consequence. In these circumstances, relationships between specific suppliers and demanders are thus constructed and became significant. These relationships constitute special social networks, which are characterised by cultural norms and values and these to a certain degree enhance trust and minimise transaction risks.⁵²

North, expanding the analyses of Coase and Williamson, defines institutions as controlling the rules of a game which is used to reduce uncertainty and lower transaction costs. According to him, there are formal types of constraint (such as laws and regulations) and informal types (such as norms and conventions), both of which are components of institutions. In his opinion, these two types are interlocked and

⁵¹ Coase, Ronald H., 'The Nature of the Firm', *Economica*, vol. 4 (1937), pp.386-405.

⁵² Williamson, Oliver E., *Markets and Hierarchies: Analysis and Antitrust Implications*, (New York, 1975).

delaminated and in them “the effectiveness of enforcement shapes the whole character of the game”⁵³. In some circumstances, such as “high information costs, the absence of effective government, limited numbers of goods and limited trades, limited food preservation”⁵⁴, the informal rules which are constructed by social networks may stabilise transactions. Consequently, informal institutions can be considered as “extensions, elaborations and modifications of formal rules”⁵⁵.

Sociologists have pointed out, however, that institutions as described by the NIE alone could not facilitate economic transactions. The sociologists analyse the dynamics of the informal institutions mentioned by North at a deeper level. They argue that economic activity is socially constructed and is significantly influenced by culture. Weber and Polanyi believed that institutions and economic activity were deeply influenced by social and cultural norms, since previous economic arrangements were embedded in social relations, whether familial, kinship, social, religious or other interactions and obligations. Therefore, the rules of reciprocity, redistribution and communal obligation replaced independent market functions. However, Polanyi, in contrast to Weber, held a very positive attitude to the function of social relations: in his view, this substitute for imperfect institutions helped a society function well. But he assumed that the social networks would fade away with the emergence of capitalist society.⁵⁶

The social economists believe that institutions and economic activity used to be formed by inherited rules, beliefs and norms, whereas the new institutions are characterized by inherited cultural norms. Granovetter illustrated the “problems of embeddedness”⁵⁷. According to him, the economic relations between individuals and firms are embedded in social networks instead of in an idealised market. Furthermore, these social networks also generate generalised morality, which may be the self-enforcing mechanism in economic activity. Namely, these networks of

⁵³ North, Douglass C., *Institutions, Institutional Change and Economic Performance* (Cambridge, 1990), p.4.

⁵⁴ *Ibid.*, pp.38-39.

⁵⁵ *Ibid.*, p.40.

⁵⁶ Polanyi, Karl, *Great Transformation* (Boston, 1957); Weber, Max, *The Sociology of Religion*, translated by Ephraim Fischhoff from the German (Methuen, 1965); Weber, Max, *Confucianism and Taoism*, abridged by Morishima, Michino.; translated by Hunter, Janet (London, 1984).

⁵⁷ The term “embeddedness” can refer here to economic behaviour which is always located in networks of concrete relations. The theory of embeddedness is used to “designate how economic action, outcomes and institutions are affected by the actor’s personal relations”. Granovetter, Mark, ‘Economic Action and Social Structure: the Problem of Embeddedness’, *American Journal of Sociology*, vol.91 (1985), p.481.

personal social relations discourage malfeasance. People make their decisions on the basis of past interactions with other individuals and continue to deal with those whom they trust.⁵⁸ Consequently, Greif asserts that any enforcement institution “is a function of social, cultural and political factors”⁵⁹. Neither legal enforcement, nor trust or reputation alone can facilitate transactions.

Geertz, in agreement with Greif, stresses that the support of modern economic development (in the developing or underdeveloped countries in particular) requires responsive cooperation from the local culture. This can foster the process of economic development from two standpoints: (1) social values would enhance the decency of making a profit; and (2) local cultures could supply a specialized ethical code for economic activities, such as integrating commodity production and marketing strategies. These two points are not only connected with social and cultural norms, but also are essential conditions for economic development in the developing countries.⁶⁰

3-2. *The Role of Social Institutions in East Asian Post-War Economic Development*

Although the NIE and the social economists agree that culture and social rules facilitate economic activity, their research does not specify the types of culture and social rule that would tend to facilitate transactions and reduce uncertainty. Max Weber’s theory severely criticizes the reliance and the function of kinship networks in China, for instance, and imputes the backwardness of the Chinese economy to its culture, its kinship networks in particular. Nevertheless, Weber’s views were substantially challenged by the emergence of capitalism in the East Asian tiger economies during the 1980s; their rapid economic growth contradicted his theory of cultural barriers in Chinese societies. Polanyi’s argument that social networks would fade away with the rise of capitalist society also came into question. Some argued that during the 1980s the key element of the successful Chinese entrepreneurs in East Asian countries such as Taiwan, Hong Kong and Singapore was constructed on the basis of the Chinese family and Confucian ethics. Their success provoked an interest in analysing the influence of Chinese culture and social networks on economic development in these Chinese-based societies.

⁵⁸ *Ibid.*, pp.481-493.

⁵⁹ Greif, Avner, *Institutions and the Path to the Modern Economy: Lessons from Medieval Trade* (Cambridge, 2006), p.239.

⁶⁰ Geertz, Clifford, “The Integrative Revolution: Primordial Sentiments and Civil Politics,” in *Old Societies and New states: the Quest for Modernity in Asia and Africa*, ed. Geertz, Clifford (New York, 1963), p.138.

The cultural approach focuses on the use of social networks and the understanding of a Chinese-based social system. This explanation is similar to the approach of the social economists who view the economic system as a social order. The cultural approach highlighted the significance of the social order and shared values in Chinese business practice and structure. Luo argues that *the Chinese social networks* involve “the cultivation of personal relationships, networks of mutual dependence and the manufacturing of obligation and indebtedness”⁶¹. In other words, social networks are “a form of social capital which creates economic values”⁶². From the perspective of such writers, social networks are embedded in economic activities; they describe “the Chinese as deliberately and strategically manufacturing social relations for the purpose of economic gains”⁶³. Therefore, among the crucial functions of social networks, recalling North’s views on informal institutions, are overcoming uncertainty and facilitating business transactions.⁶⁴

The book edited by Chang et al. analyses Taiwan, Hong Kong and China from a socio-cultural standpoint.⁶⁵ They indicate that economic institutions are also socially constructed. In their opinion, interests play a decisive role in economic activity; thus economic activity is also a social activity. In other words, pursuing interests and allocating resources rationally are inseparable from the pursuit of power, status and social identity. Furthermore, economic activity is embedded in interpersonal social networks in three areas. Economic transactions usually take place between connected individuals or groups; therefore, economic activity usually represents the characteristics of social networks. Hence, in this book, they collect research papers concerning family networks, personal networks and group networks from these three countries; each story and analysis of social networks reflects a similar use of social networks in the business activities of the three societies. The analyses of Chinese social networks are composed of culture, language and an understanding of the way in which their society works. The literature shows the similarity of the societies: Chinese, Taiwanese and Hong Kong people operate businesses based upon similar

⁶¹ Luo, Yadong, *Guanxi and Business* (Singapore, 2000), p.4.

⁶² *Ibid.*, p.41.

⁶³ Keister, Lisa A, “Guanxi in Business Groups: Social Ties and the Formation of Economic Relations” in *Social Connections in China: Institutions, Culture and the Changing Nature of Guanxi*, eds. Thomas, Gold, Guthrie, Doug and Wank, David (Cambridge, 2002), p.79.

⁶⁴ Zhu Yenhua, “Xianggang jiazhu qiye: xiankuang yu qianjin,” in *Jingji yu shehui: Liangan sandi shehui wenhua di fenshui*, eds. Zhang, Weian and Zhu, Yenhua (Taiwan, 2001), pp.75-86.

⁶⁵ Zhang, Weian and Zhu, Yenhua, eds., *Jingji yu shehui: liangan sandi shehui wenhua di fenshui* (Taiwan, 2001).

social orders. Although the cultural approach analyses how social networks operate and facilitate business transactions in Chinese-based societies, it focuses only on the relations between social networks and the market without considering the relations between the state, the market and the social networks.

The sociological institutional theory, founded mainly by the three scholars, Orru, Biggart and Hamilton, seeks to explain the economic success of some East Asian countries by analysing the relations between their economic, cultural and social structures.⁶⁶ Based upon the theoretical framework of Granovetter and the socio-economists, social institutionalism explains how East Asia succeeded by analysing the dynamics of social networks which are embedded in the society. They highlight the point that, although the governments established functional institutions for economic activity, rapid economic growth required cooperation from society, namely, the dynamics of social networks. This idea extends the argument of the NIE that institutions reduce transaction costs and facilitate business operations. The difference is that, in addition to firms, organisations and government institutions, social institutionalism highlights the dynamics and functioning of social networks in the economic development of these countries. Influenced by North's view of the functions of formal and informal institutions, social institutionalism further explores the dynamics of social networks and the relations between state and society.

Vogel and Oshima clarify the significance of government policy and show how the Confucian ethics and system combined with these policies to lead to rapid economic growth.⁶⁷ Redding argues that business groups behave differently because culture matters. Economic culture based upon Confucianism has influenced the structure and the behaviour of Chinese business groups. In his analysis, he elucidates the impulses and constraints of the Chinese economic culture which provided stability for Chinese economic life.⁶⁸ Evans further argues that the relations of government and social capital can be understood as a 'state-society synergy'. The synergy relations

⁶⁶ Biggart, Nicole W., Hamilton, Gary G., Orru, Marco, *The Economic Organisation of East Asian Capitalism* (London, 1997), p. 15, pp.20-26.

⁶⁷ Oshima, Harry, *Strategic process in Monsoon: Asia's Economic Development* (Baltimore, 1993); Vogel, Ezra, *The Four Little Dragons: the Spread of Industrialisation in East Asia* (Cambridge, Mass, 1991).

⁶⁸ Redding, Gordon S., *The Spirit of Chinese Capitalism*, (New York, 1993).

include complementarity and embeddedness. The government establishes functional institutions in order to mobilise cooperation from social capital.⁶⁹

Similar ideas of ‘state-society synergy’ may be found in the work of Hamilton, who indicates that, during the Taiwanese development process, the government did not directly support the SMEs. The evidence shows that no specific government policies arose in support of SMEs. His research finds that the government provided them with infrastructure; the dynamics which supported the business operations of these SMEs lay in the functioning of the social relationships.⁷⁰ Unlike general cultural explanations or references to Confucian ethics, Hamilton indicates that social networks are the key to supporting economic development in East Asia. As he further argues, ‘how Asian economies actually develop and perform depends on the dynamics and effectiveness of the inter-firms networks themselves, rather than on the encouraging actions of government or on the entrepreneurial efforts of acquisitive individuals’⁷¹.

The strong relational structure constructs a sophisticated subcontracting system which is composed of numerous manufacturing SMEs. Within the subcontracting system, the SMEs often rely on their social networks for obtaining supplies with guaranteed quality and quantity; moreover, their social networks also play a principal role in expanding their client base. Most importantly, the subcontracting system has developed special cooperation and coordination networks: contractor networks, satellite plants and marketing strategies. The cooperation between factories and these contractors and satellite plants is a form of horizontal integration which is based on social connections, such as kinship, friendship or trade unions.⁷²

Similar views can be found in Skoggard. He argues that, although the government policy is the visible hand in the market, the dynamics in Taiwan for the development and growth of a labour-intensive export industry lie in the local realm.⁷³

⁶⁹ Evans, Peter B., “Development Strategies across the Public-Private Divide,” in *State-society Synergy: Government and Social Capital in Development*, ed., Evans, Peter (Berkeley, 1996), pp.1-10.

⁷⁰ Hamilton, Garry G., *Commerce and Capitalism in Chinese Societies* (London, 2006).

⁷¹ Hamilton, Gary G., “The Theoretical Significance of Asian Business Networks,” in *Asian Business Networks*, ed. Hamilton, Gary G. (New York, 1996), p.284.

⁷² Chen, Jiaying “Jiazu qiye yu Taiwan jinyan,” in *Jingji yu shehui: Liangan sandi shehui wenhua di fenxi*, eds. Zhang, Weian and Zhu, Yenhua (Taiwan, 2001), pp.37-50; Castells, Manuel, *The Rise of the Networks Society* (Cambridge, MA, 2000), pp.163-215.

⁷³ Skoggard, Ian S., *The Indigenous Dynamic in Taiwan’s Post-War Development: The Religion and Historical Roots of Entrepreneurship* (London, 1996).

The local realm he refers to is based upon Philip Huang's concept of 'the third realm'.⁷⁴ The third realm is 'the realm between local society and government, including local elites, low-level government officials, [and] merchants who cooperate and get the work done'⁷⁵. Unlike Hamilton, who highlights the significance of social networks between firms and organisations, Skoggard extends the social networks to the third realm which created the social dynamics for industrial development. Several works using the framework of social economics and social institutional theory confirm the strength and function of social networks in promoting Taiwan's economic success.⁷⁶ This research indicates the foundation of Taiwanese social networks, its origins, norms and rules and the way in which these networks facilitated and built up a subcontracting system for SME business operations which led to economic growth in Taiwan.

3-3. Institutional Changes and Culture in Historical Contexts

It is also worth noting that Biggart, Hamilton and Orru indicate that, although Confucianism plays a significant role in East Asian societies (mainly in the three countries which are the subject of their analysis: South Korea, Japan and Taiwan), there are many different factors in culture that contribute to the structure of social networks. Therefore, Hamilton and Feenstra comment that the social networks vary even in similar societies with similar cultural backgrounds and government-development policies. Their theory is applied to the cases of Taiwan and South Korea, the two most successful instances of economic development in the post war period.

The differences in the market hierarchies of these two countries were affected by history and geography. Moreover, these historical and geographical factors influenced the network structures within the market hierarchies.⁷⁷ Another comparison can be found in the banking structure in Taiwan and in Japan. The analysis shows that although the two societies are characterised by capitalism, Confucianism and strong family networks in business, differences in the inheritance systems have led to different types of business structure. In Japan, this difference has

⁷⁴ Huang, Philip C. C., 'Public Sphere and Civil Society in China: the Third Realm between State and Society', *Modern China*, vol.19, no.2 (1993), pp. 107-240.

⁷⁵ Skoggard, I., *op.cit.*, p.5.

⁷⁶ Redding, Gordon, Nish, Ian, Ng, Sekhong, eds., *Work and Society: Labour and Human Resources in East Asia* (Hong Kong, 1996).

⁷⁷ Hamilton, Gary, G. and Feenstra, Robert, C., *Emergent Economies, Divergent Paths* (Cambridge, 1997), pp.55-95.

meant that capital domination has been concentrated in the same families, explaining its Keiretsu and Zaibatsu (large corporation) systems. But in Taiwan, capital was distributed to male members of the family. This explains the small and medium sized enterprises in the Taiwanese economy.⁷⁸

The same cultural factors are also applied to explain the structure of the business networks of Taiwanese SMEs. The analysis shows that the satellite assembly systems of Taiwanese SMEs are founded on different social relations, including kinship and friendship. These social relations have constructed social networks based upon the norms and order which promote the mutual well-being of all the members.⁷⁹ A similar comparison can be found in Olsen. His comparison of the business value systems in Taipei and in Java shows that similar value systems based upon Chinese immigrant societies are nonetheless varied because they are influenced by different political and economic institutions.⁸⁰

The comparisons above show the significance of history and the changes of political and economic institutions which led to the changes in the social networks. North's model of path dependence clarifies the process with which institutions change over time. The model assumes that the growing influence of economic change induces institutional changes, motivating the need for new arrangements for easing transactions and lowering risk; these new arrangements include modifying property rights, contractual agreements and enforcement regulations. Then, during the process, people became aware of their changing environment and this activates their reaction to the changes. The ideology and recognition which influence people's reactions interact with morality or cultural values.⁸¹

In addition, institutional change is a circulatory and inherited system: the first round of change is formed by a model of institutional change (such as economic reform) and the respondent organizations (such as enterprises). The second round of change will in turn be confined to the first round model, due to the fact that the knowledge and skills of the subjective model will be accumulated and modified in

⁷⁸ Biggar, Nicole W. and Hamilton Gary G., "On the Limits of Firm-Based Theory to Explain Business Networks," in *The Economic Organization of East Asian Capitalism*, eds., Hamilton, Gary G., Orru, Marco, Biggart, Nicole W. (London, 1997), p.33-58.

⁷⁹ Biggar, Nicole W., "Explaining Asian Economic Organization: Toward a Weberian Institutional Perspective," in *The Economic Organization of East Asian Capitalism*, eds. Hamilton, Gary G., Orru, Marco, Biggart, Nicole W. (London, 1997), pp.3-32.

⁸⁰ Olsen, Stephen M., "The Inculcation of Economic Values in Taipei Business Families," in *Economic organisation in Chinese Society*, ed. Willmott, William E., (Stanford, 1972), pp. 261-295.

⁸¹ North, D., *op.cit.*, pp.34-58, pp.78-89.

response to the changing environment. Therefore, the relationship of institutions and organizations generates the locked-in impact. The path dependence model points out the inherited institutional changes and people's reaction to the changing environment.

Based upon the model of path dependence, the social institutional theory further elaborates the significance of embeddedness and path dependence combined, in shaping economic and social structures. It explains why the differing development of social networks in East Asia (more specifically, in Japan, South Korea and Taiwan) lay in historical contingencies and path dependence. According to the path dependence model, the changes of history are the external impact from which different political and economic institutions were constructed. The social structure is affected by the external conditions. Under the external impact, the social structure creates an economic system based upon early affinities in the social structure. The embeddedness here is similar to North's idea of people's reaction to the changing institutions based upon social values. Hamilton and Feenstra indicate that embeddedness does not have a specific feature: instead, it has 'provided direction to trajectories of economic development'⁸².

Jones more conceptually explored the interaction of institutional change and cultural adaptation. According to him, cultural practices are constructed on the needs of people in accordance with the living environment. Moreover, he assumes that the evolution of culture will be stimulated by the new forces which influence environmental change, such as competitiveness or the availability of access to information.⁸³ In other words, the cultural heritage is adapted to the changing system and substitutes for the shortcomings of newly-built market economies. By integrating these theoretical models, it is possible to conclude that every society develops its own unique social institutions although some societies have similar cultural values.

The cultural adaptation and the character of embeddedness can also be explained by the characteristics of Confucianism. Tu in his many works reveals the transformation of traditional Confucianism to Neo-Confucianism which is correlated with the economic emergence of the East Asian countries. Although Confucianism is closely connected to Chinese culture, it has not always been the whole or the only

⁸² Hamilton, G. and Feenstra, R., *op.cit.*, p.86.

⁸³ Jones, Eric L., *Cultures Merging: a Historical and Economic Critique of Culture* (Princeton, 2006), pp.47-63, pp.81-83.

focus of this culture. Tu emphasizes that cultural reorganization is not sealed, but diversified and open.

For example, Chinese culture is by tradition founded on three systems—Daoism, Buddhism and Confucianism. These never dominated one another, and other systems of belief were widespread in China, for example, Catholicism in the 17th century and Islam in the 13th century. Furthermore, he argues that Chinese culture is ‘dialog China’. A basic value of dialogue is tolerance which is also the core virtue of Confucianism. Confucianism, instead of dogmatism, highlights the value of “ru shi” (statecraft), as the significance of governance, participating in society and paying attention to culture. That is, there is no single classic tenet of Confucianism that can be taken as absolutely authoritative and without question.⁸⁴ This ‘dialog’ notion reverberates to the concept of ‘embeddedness’ which does has no specific feature and also to Jones’ idea of cultural adaptation.

Although the embeddedness approach and path dependence draw attention to the significance of history in bringing changes to institutions and causing the evolution of culture in the changing environment, few works in the existing literature have traced the historical continuity in institutional changes and cultural or social transformation. Kuznets, however, in his *Post-war Economic Growth*, points out the significance of the historical heritage in post-war economic development.⁸⁵ He explains that the historical heritage which created different political and economic institutions affected the pace of development in different countries. The historical heritage includes both external and internal factors which affected the course of Taiwan’s development.

The external factors are the hegemonies and the regional/world trade systems which these hegemonies dominated at different times. Howe traces the impact of external hegemonies on Taiwan’s long-term economic development. The analysis includes the impact of different hegemonies on Taiwan from that of Imperial China in the 17th century, the Japanese colonial power in the early 20th century and the US hegemony in the post-war period. He argues that because of the small scale of the Taiwanese economy, these external hegemonies had no difficulty in influencing Taiwan’s development. In addition to the hegemonies, the regional or global system

⁸⁴ Tu, Weiming, “Wenhua rentong yu ruxue chuang xin,” *Guoxue rentian*, Zhongguo renmin daxue, 2007, http://big5.china.com.cn/culture/txt/2007-01/23/content_7699636.htm. (accessed 13 February 2010).

⁸⁵ Kuznets, Simon, *Post-war Economic Growth* (Cambridge, Mass, 1964).

which these hegemonies dominated and how and why they ‘invited’ Taiwan into the system are also important.⁸⁶

A similar idea of the influences of these hegemonies on Taiwanese trade in the 17th century can be found in Hamashita and Cao. Hamashita argues that the East Asian trade system was the tributary system founded on the market system; it had its internal order, which ‘constituted a network of tribute trade of a multilateral type, absorbing commodities from outside of the networks’⁸⁷. For centuries, the Sino-centric system followed its internal order in the pursuit of trade. Cao further indicates that the emergence of Taiwan in the tributary trade system in the 17th century was related to foreign disturbance of the tribute trade order.⁸⁸

The hegemony of the Japanese Empire in the late 19th century and the early 20th century had considerable impact on the development of Taiwan’s economy. Sugihara analyses the intra-Asia trade and imperialism between 1860 and 1938. The analysis indicates that the role of Taiwan, as a Japanese colony, was to provide cheap food and raw materials for the development of Japan’s labour-intensive industry. At the same time, Japan created the market in Taiwan by establishing new institutions for its industrial exports. The needs of Japanese industrial development also created technological transfers from Japan to Taiwan. The pattern and the technology transfer, for Sugihara, can be found from rice cultivation and the sugar industry.⁸⁹

The historical heritage of Japanese colonisation on Taiwan’s modern development manifests itself in several ways. Kuznets argues that the primary foundation for Taiwan’s modern economic success lies in the historical legacy which enabled Taiwanese society to adopt new technology. When society accepted the new technology, it in turn would further change aspects of social structure, such as industrialisation and urbanisation. Howe explores the role of the Japanese colonial government in establishing a modern society in Taiwan. The establishment included the colonial government system, the public finance system, the sugar and rice industries, development of the private sector and improvement of education. It is also

⁸⁶ Howe, Christopher, ‘Taiwan in the 20th century: model or victim? Development problems in a small Asian economy’, *The China Quarterly*, no. 165(2001), pp.37-60.

⁸⁷ Hamashita, Takeshi, *Jindai zhongguo de guoji qiji: chaogong maoyi tixi yu jindai yazhou jingji quan* (Beijing, 1999); Hamashita, Takeshi, Grove, Linda, and Selden, Mark, eds., *China, East Asia and the Global Economy: Regional and Historical Perspectives* (London, 2008).

⁸⁸ Cao, Yonghe, *Taiwan zouqi lishi yanjiu* (Taipei, 1979).

⁸⁹ Wu, Congmin, ‘Colonisation and Growth: the case of Taiwan,’ conference paper in International Workshop on Modern Economic Growth and Distribution in Asia, Latin America and the European Periphery: a Historical National Accounts Approach (Tokyo, 2001).

worth noting that the colonial government put in place the necessary infrastructure for the development of the private business sector.⁹⁰ In other words, the Japanese colonial government led Taiwanese modernisation before the KMT government came to Taiwan. Howe's analysis shows that the modernisation process in Taiwan began in the colonial period.

In the post-war period, the hegemony which affected the rise of the Taiwanese economy was the US. Later, the global system dominated by the US significantly affected Taiwanese economic development. Based upon the world system approach, the rise of Taiwan in the post-war period began with its participation in the world capitalist system in the 1960s.⁹¹ This participation was invited in particular by the US and Japan, of the core countries. In the world capitalist system, Taiwan is on the semi-periphery. Since it is a small-scale economy and relies heavily on trade, the core countries by bringing it into the system could exploit its cheap labour. From the perspective of the world system, the Taiwanese political and economic structure had to change in order for it to join the system.

The external factor highlights the significance of hegemonies and the systems which they dominate. The hegemonies and the systems were significant factors in inducing the rise and the decline of the Taiwanese market. In addition, internal factor also affected the internal institutional changes which connected the Taiwanese market with the hegemonies and their subject systems. These internal factors are the political powers in charge of Taiwan and the institutions which they set up to connect Taiwan with the hegemonic systems.

The hegemonies, the systems under them, the political regimes in Taiwan and the institutions which they established together created the historical heritage for Taiwan's post-war economic development. However, the historical heritage approach mainly focuses on political and economic institutions. Although Kuznets and Howe set the scene for social changes and people's adaptation to new technology, the approach still lacked the significant factor which facilitated trade and accommodated to the changing political and economic institutions. This analysis of historical heritage misses the fact that it was the heritage and transformation of social institutions that facilitated trade and business in Taiwan's economic history.

⁹⁰ Howe, C., *op.cit.*, pp.43-45.

⁹¹ For further details regarding the world system approach, see Wallerstein, Immanuel M., *Historical Capitalism; with Capitalist Intervention* (London, 1996); Wallerstein, Immanuel M., *World-Systems Analysis: an Introduction* (Durham, 2004).

3-4. *Political Transformation and Its Impact on the Trade and Investment Policy*

The existing literature indicates that the authoritarian system was significant in Taiwan's economic development because it made sure that only limited interest groups were able to influence the making of the policy. This allowed the KMT to implement the development policies successfully. At the same time, the authoritarian system also implies that the state was able to monopolise the sources for development. It was able to allocate sources, control the finance system, protect the SOEs and LEs in the domestic market and manage the export market. However, there was significant political reform and political movement in Taiwan from the late 1980s. As the existing literature argues, the authoritarian system was important in post-war economic development; the changes in Taiwan's political system would have been likely to influence the formation of economic policy and state-society relations after the late 1980s.

There are three types of authoritarian regime: one-party systems, military regimes and personal dictatorships. Taiwan before the 1990s was usually classified as a one-party system. Huntington calls the origin of one-party systems as 'the product of the efforts of a political elite to organise and to legitimate rule by one social force over another in a bifurcated society'⁹². The bifurcation may be between social-economic groups or between racial, religious or ethnic ones. Within a one-party system, only the chosen groups are allowed to take part in politics; other groups are excluded from political action. In this way, the chosen groups monopolise political power (as well as economic power) in a society.⁹³ Huntington in his later book, *The Third Wave: Democratization in the Late Twentieth Century*, placed Taiwan in the category of Leninist party states. States in this category are characterised by a strong and complicated relationship between them and the ruling parties, in particular in terms of physical and financial assets.⁹⁴

Close connections between party and state can be further elaborated from the totalitarian syndrome. Friedrich and Brzezinski define totalitarianism as a syndrome consisting of six interrelated characteristics: a single party typically led by one individual, a secret police force, the monopoly of mass communications, monopoly of

⁹² Huntington, Samuel P., "Social and Institutional Dynamics of One-Party Systems," in *Authoritarian Politics in Modern Society: the Dynamics of Established One-Party Systems*, eds. Huntington, Samuel P. and Moore Clement H. (New York, 1970), p.11.

⁹³ *Ibid.*, pp.3-47.

⁹⁴ Huntington, Samuel P., *The Third Wave: Democratization in the Late Twentieth Century*, (Norman, 1991).

armaments, and state control of the economy.⁹⁵ Before 1990, the KMT regime, even though its political ideology clearly indicates democracy, was indeed totalitarian: the KMT was the only political party (before 1987) and was led by the Chiang family (Chiang Kai-shek and Chiang Ching-Kuo); it had the Taiwan Garrison Command (a secret police security organisation); all the mass communication was run by the government (namely the KMT); the armaments were the KMT armaments from China; and the economy was controlled and planned by the KMT government.

Some Taiwanese scholars, basing their work upon the theory of the Leninist party states and the theory of the totalitarian syndrome, further analyse the KMT and argue that the KMT regime in Taiwan (more specifically, this regime from 1949 to 1988), was 'Party-State Capitalism'. Chen in *Analysing the KMT Party-State Capitalism* shows how the KMT built up a party-state institution in Taiwan; it not only monopolised political power, but also established the KMT business empire which dominated the Taiwanese economy and made large profits for the party.⁹⁶ This party-state capitalism monopolised economic power in the country by controlling not only the SOEs but also the LEs which were owned by the KMT (or those owned by the KMT's subsidiary companies). The SOEs and LEs dominated the sources and materials for economic development; the finance system was also under the strict control of the party-state. This authoritarianism and the party-state capitalist system formed the basis for a strong state to influence the formation and the transformation of the Taiwanese economy. Before the late 1980s political power of the KMT was supported by its monopolisation of economic power.

How an authoritarian system is transformed into a democratic system has always been an important question in political science. In the late 1980s, political reform gradually began in Taiwan. Huntington analyses the transformation process by comparing different countries. He points out three types of democratic transformation: transition through transformation, transition through replacement and transition through transplacement. Huntington categorises Taiwan's democratic process as transition through a transformation in which the democratic transformation was led by the elites and intellectuals in power.⁹⁷

⁹⁵ Friedrich, Carl and Brzezinski, Zbigniew, *Totalitarian Dictatorship and Autocracy* (Cambridge MA, 1965), p.8.

⁹⁶ Chen, Shimong, ed., *Jiegou dangguo ziben zhuyi* (Taipei, 1991).

⁹⁷ Huntington, S., *op.cit.*, 1991, pp.23, 72-75,104, 120-1134, 275, 302-305.

A number of factors affected the political transformation from authoritarianism to democracy. Huntington analyses several significant factors that tend to affect the transformation in most countries in the third wave of democratisation. The most significant factor is economic development and growth. According to the analysis, an increase in wealth is correlated with democratic transformation. The increase in wealth improves the standard of education and fosters the popular understanding of a civil society and the rise of a middle class. What is more important is that most countries, in order to boost economic growth, then adopt a more open policy for trade, investment, technology transfer and tourism. The open policy has different impacts on different societies in encouraging the formation of a civil society.⁹⁸

A similar argument can be found from the analysis of Taiwanese scholars. They point out that rapid economic growth in the 1980s promoted Taiwan's democratic transformation. In addition to economic development, the changing international relations and the changing cross-strait relations had considerable impact on the political reform in the 1980s because of the special political situation of Taiwan.⁹⁹

However, the analysis of patterns of political transformation takes no account of the impact of the struggle in the process of political transformation between interest groups and dictators (or leaders in the one-party system). Wintrobe explores how dictators monopolise political power. This reference may also be applied to Chiang Kai-Shek in Taiwan.¹⁰⁰ Wintrobe comments that although dictators may have a monopoly of political power, their policies are constrained by other actors, such as bureaucrats/administrators, the military and support or opposition from their subjects. These actors can be considered to form different interest groups, each with its own interests. These benefited from receiving a monopoly privilege or other rent from a political party and therefore immediately have some reason to believe that the political party will look after its interests in the future. Because rents can be

⁹⁸ Huntington, S. *op.cit.*, 1991, pp.66-68.

⁹⁹ Ge, Yongguang "Chiang Ching kuo de zhuanxinglindao: Taiwan minzhu de tuishou," in *Chiang ching guo xiansheng yu Taiwan mingzhu fazhan*, ed. Ge, Yongguang (Taipei, 2008), pp.18-19.

¹⁰⁰ Wintrobe, Ronald, *The Political Economy of Dictatorship* (Cambridge, 1998), p.4.

withdrawn in the future, politicians justify their belief that the favoured group will provide the politicians with loyal support in return.¹⁰¹

Wintrobe argues that a dictator does not own the regime and does not have an inalienable right to transfer power.¹⁰² Thus, some challenges may appear during the process of power transformation. These interest groups may organise together to oppose dictators. It is this collective action problem in dictatorship that Wintrobe addressed. The best solution to prevent the collective action of the interest groups is to keep the groups numerous and unorganised.¹⁰³

3-5. *The Impact of the Changing Political System*

According to Huntington and Wintrobe, a one-party system or an authoritarian system is one of five kinds: personalistic actors (such as dictators and political leaders), traditional actors (the church or the monarchy), bureaucratic actors (administration, the police and the military), parliamentary actors and functional social-economic groups.¹⁰⁴ As noted above, the authoritarian or one-party state usually excludes other social groups from taking part in politics; only the chosen groups are allowed to do so.

Political transformation has different impacts on society in different fields.¹⁰⁵ One of the significant differences is elections. In the authoritarian system, there are no elections and only the chosen groups wield political power. Democratic transformation raises the significance of elections themselves, as well as including other social groups as participants in politics. When the 'not-chosen' groups acquire political power through elections, the political balance in a society changes. Before the political transformation, dictators, administrative officials and members of parliament monopolised political power. After the transformation and open elections, the political power which they used to monopolise is weakened.

Huntington describes the relations between authoritarianism, democracy and elections: 'elections are not only the life of democracy; they are also the death of dictatorship'¹⁰⁶. In addition to the decline of dictatorship and the rise of democracy, what is more important in the rise-decline transformation process is that the

¹⁰¹ Wintrobe, R., *op.cit.*, pp.5-15, 29-32, 48-49, 148-170, 248-300.

¹⁰² Wintrobe, R., *op.cit.*, pp.334-342.

¹⁰³ Wintrobe, R., *op.cit.*, pp.106-108.

¹⁰⁴ Huntington, S., *op.cit.*, 1970, p.7.

¹⁰⁵ Huntington S., *op.cit.*, 1991, p.189.

¹⁰⁶ Huntington, S., *op.cit.*, 1991, p.174.

monopolised political power should be shared by other social-economic groups in society. In other words, political transformation not only changes the political system and society, but also re-distributes power in society.

The significance of the re-distribution of political power in society lies in both political and economic issues. In the past, both political and economic issues were dominated by a single political party and therefore the party always considered its own interests first. The considerations included how to maintain their power and how to distribute benefits equally to the chosen groups. After a political transformation, there is no longer a one-party system in society; competition and challenges by other political parties emerge. Under the new challenges, the political parties need to consider the interests of different social-economic groups if they want to win the next election and remain in power.

3-6. The Impact of the Changing Political System on the Trade and Investment Policy

The relations of trade and politics have always been a classic issue of political economy. Hocking and McGuire remark that the problem of trade cannot be ascribed to any single factor that affects the adaptation of trade policy. The adaptation of trade policy is instead affected by various factors from different interest groups. A similar argument can be found in Dixit, who argues that in the policy-making process many different participants attempt by different means to influence the work of the policymakers.¹⁰⁷ The participants who tried to affect the policy-making process in Taiwan in the era before its political transformation were not the same as those who had the same ambition afterwards. In the pre-transformation period, the participants included only the chosen groups. They tried to affect the policymakers by trading their support and loyalty to political leaders or dictators. In the post-transformation period, the participants now include the various social-economic groups who have the right to vote. The mechanisms for affecting the policy-making process thus became complicated. The most direct way to affect policymakers is by elections.

Elections with an economic basis can be analysed by the theory of economic voting. According to Bell, the theory of economic voting occurs when an economic performance influences an incumbent's chances of being re-elected. Higher growth, larger incomes and lower inflation in the months before an election boost popular

¹⁰⁷ Dixit, Avinash K., *The Making of Economic Policy: A Transaction-Cost Politics Perspective*, (London, 1996).

support for the serving government, party and individual politician.¹⁰⁸ It is clear that why these things should affect voters' behaviour. Therefore, it may be asked, what voting behaviour do people exhibit when considering which party or individual politician to vote for?

Before clarifying voting behaviour, Bell assumes that voters are rational. Bell, Doyle and Firdmuc discuss in their articles the "rational voter hypothesis"¹⁰⁹. Assuming that the individual voter is rational and is encouraged by his self-interest to vote for parties which best serve his maximum benefit, there are, according to these hypotheses, two types of voting behaviour in terms of economic issues. On the one hand, when voters consider economic issues, they may make national economic performance their priority because they take the "business cycle, economic issues of national importance and managerial competence of parties" more seriously than their personal financial situation.¹¹⁰ This type of voting behaviour is called 'sociotropic'.¹¹¹ On the other hand, for others higher employment and the increase of personal income are the key factors influencing their decisions. Such voters pay more attention to their own wallets than to national economic performance. Hence, this is referred to as "egocentric" voting behaviour.¹¹² However, whether 'sociotropic' or 'egocentric', it is undoubtedly unemployment and changes in real income that are the crucial points for elections.¹¹³

Voters' behaviour is affected by the economic situation. Thus, the government has two ways to increase national income and wealth during election years in particular, in order to win more votes. The long run policies include "technology change and population growth", both of which require a long development period. That is, it is difficult for any party in power to generate income and wealth with these long-term policies.¹¹⁴ More importantly, the effects of long-term policies do not mature in time for the next elections.

¹⁰⁸ Bell, Janice, *The Political Economy of Reform in Post-Communist Poland* (London, 2001), pp.5-107.

¹⁰⁹ Bell, Janice, 'Unemployment and Voting Patterns', *Europe-Asia Studies*, vol.49, no.7 (1997), p.1264; Firdmuc, Jan and Doyle, Orla, "Anatomy of Voting Behaviour and Attitudes during Post-Communist Transition: Czech Republic 1990-1998," the Centre for Economic Research (CEPR), discussion paper, no.3801 (2003), p.4.

¹¹⁰ Bell, J., *op.cit.*, 2000, p.1265.

¹¹¹ Firdmuc, J. and Doyle, O., *op.cit.*, p.3.

¹¹² Firdmuc, J. and Doyle, O., *op.cit.*, p.3.

¹¹³ Bell, J., *op.cit.*, 1997, pp.1265-1266.

¹¹⁴ Mueller, Dennis C., *Public choice II*, (Cambridge, 1989), p.277.

However, as the elections approach, most incumbent parties adopt short run macroeconomic policies to boost their reputation. The incumbent parties sometimes change the inflation rate in order to reduce unemployment or manipulate the use of transfer payments. This may include increasing compensation and welfare for the unemployed, to make people feel that their living standards have improved. These strategies are considered the most frequent short run economic policies for governments to introduce in order to win elections. The implementation of these strategies indicates some concealed meanings. First, the economic situation of a country influences people's electoral decisions and this is why governments try to apply policies to enhance economic performance. Second, the influence of the inflation rate, unemployment and income seems to be an index both of government policies and of voters' preferences.¹¹⁵ As McGillivray, Pahre, Mclean and Schonhardt-Bailey argue indicate, politicians usually adopt the policies and allocated resources which would increase the welfare of the majority of voters in order to maximise their political support. They adopt the trade policies which reduce political cost and benefit their political survival.¹¹⁶

Several researchers have analysed the factors affecting the 1996 Taiwanese presidential election and indicated that party identification, the character of the candidates and national security were significant. Such research focuses only on political and social factors and pays less attention to economic ones. However, even the analysis of party identification and character of candidates is related to some economic factors. Chen analyses the factors affecting the success of Lee in the 1996 election. His model shows that Lee's ability (and also the KMT's ability) to maintain Taiwan's economic prosperity gained the support of a majority of uncommitted voters.¹¹⁷ This factor includes both the political and economic concerns of voters. Moreover, further research by Hsieh, Lacy and Niou indicates that in the prospective voting model, voters' evaluation of Lee's ability to manage the economy in the future was significantly correlated to their choice.¹¹⁸

¹¹⁵ *Ibid.*, pp.277-277-286.

¹¹⁶ McGillivray, Fiona, Pahre, Robert, Maclean, Iain and Schonhardt-Bailey, Ceryl., *International Trade and Political Institutions: Instituting Trade in the Long 19th Century* (Cheltenham, 2001).

¹¹⁷ Chen, Luhui, 'Taiwan 1996 nian zongtong xuanju zhi fenxi', *Xuanju yanjiu*, vol.5, no.1(1998), pp.139-160.

¹¹⁸ Hsieh, John, F.S., Lacy, Dean, and Niou, Emerson M.S., 'Retrospective and Prospective Voting in a One-Party-Dominant Democracy: Taiwan's Presidential Election', *Public Choice*, no. 97 (1998), pp.383-399.

Assuming that the free investment and trade policy was beneficial to the Taiwanese economy and that the economic voting model confirms that economic issues are significantly related to voters' behaviour, the election results showed that voters were irrationally opposed to any new economic policy and that the economic issue was not as significant as the political conflict. The problem of the model of economic voting lies in the hypothesis that voters are rational and ignores the fact that there are different social-economic groups of voters who may have different incentives to support or oppose a certain economic policy. Different theoretical frameworks are used to explain the impact of different social-economic groups on government policy. These analyses particularly explore the incentives of different social-economic groups and explain how their self-interests affect their support and resistance to trade policy and economic reform policy.

Rodrik analyses the struggle of economic reform in some transition economies in the 1990s. He sought to explain why most voters opposed beneficial economic policies.¹¹⁹ In another work of Rodrik and Fernandez, they created a model to examine gains and losses by social groups both before and after economic reform. Their model shows that there are various factors which may lead different social groups to precisely calculate their actual gains and losses from reform because the transaction costs for different social groups vary. If the future gains cannot cover transaction costs or to bring a better life, most voters choose to retain the status quo. In other words, the uncertainty caused by transaction costs affects voters' behaviour and preferences for new economic policy.¹²⁰ Rodrik further notes that the institutions should try to cover the transaction costs for those who may lose from the reform. Nevertheless, these institutions do not always function properly and efficiently to cover the cost.¹²¹

Based upon the work of Rodrik and Fernandez, Adams creates a model which examines the struggle between different social groups by evaluating the political weights of different groups and their preferences for different policies. His model separates society into nine groups: the external factor, a ruling group, a group of opposite politicians, a group of capitalists, a group of workers, a group of government

¹¹⁹ Rodrik, Dani, 'The Positive Economics of Policy Reform', *The American Economic Review*, vol.83, no.2 (1993), pp.356-361.

¹²⁰ Rodrik Dani. and Fernandez, Raque, 'Resistance to Reform: Status Quo Bias in the Presence of Individual-Specific Uncertainty', *The American Economic Review*, vol.81, no.5 (1991), pp.1146-1155.

¹²¹ Rodrik, Dani, 'Understanding Economic Policy Reform', *Journal of Economic Literature*, vol.34, no.1 (1996), pp.9-41.

bureaucrats, students, rich farmers and the poor. His model gives each group different political weights and analyses their gains, losses and uncertainty in terms of three different economic reform policies. Finally, he concludes that a policy is postponed if it reduces the wealth of the majority social groups; that is, the larger the political weights that would gather if more social groups or powerful groups anticipated becoming worse off or were very uncertain about a new policy.¹²²

3-7. *Definitions of the Terminology*

Two terms in this dissertation need to be clarified. There are several different definitions of ‘small and medium-sized enterprises’. The different explanations lie in the qualitative and quantitative criteria for the enterprises. According to the World Bank and the Asian Development Bank, the definition of SMEs is based upon quantitative criteria—the number of employees—in the enterprises.¹²³ Any which has less than one hundred employees is defined as an SME. In Taiwan, the official definition includes both qualitative and quantitative criteria, including the number of employees and the authorized capital. The standards are adjusted over time with the changing development policies (see Table3-1).

In addition to the size of the SMEs, the present research mainly focuses on the manufacturing SMEs in traditional manufacturing industry. According to the definition of the Taiwanese government, manufacturing industry includes traditional industry, basic industry and skill-intensive industry. Based upon the Act to Encourage Industry, an upgrading programme in 1991 and 1999, the term ‘traditional industries’ includes three types of manufacturing industries as well as those which the Act explicitly supported, namely, precision electronics (including computer, communication and consumer electronics) and precision machinery.¹²⁴ The definition of traditional manufacturing SMEs covers the SMEs in traditional industries and is not included in the programme of the Act to Encourage.

¹²² Adams, Richard H., ‘The Politics of Economic Policy Reform in Developing Countries’, The International Bank for Reconstruction and Development(*IBRD*), vol.433, no.2443 (2000).

¹²³ World Bank, *Bank Financing to SMEs*, FPD Forum (2007); Asian Development Bank, *ADB Results Framework Indicators Definition* (2009).

¹²⁴ Laws and Regulations Database of the Republic of China, Act to Encourage Industrial Upgrading, <http://law.moj.gov.tw/LawClass/LawContent.aspx?PCODE=J0040016>. (accessed 13 March 2011).

Table 3-1. The Official Standard Definitions of Taiwanese SMEs in 1967, 1973, 1977 and 1995

Industry/Year	1967	1973	1977	1982	1995
Manufacturing Industry	Capital under NT\$ 5 million; and number of regular employees under 100 people.	Registered capital under NT\$ 5 million and total assets under NT\$20 million; or number of regular employees: (1) Shoe-making, garments and electronics : < 300 people. (2) Food processing : <200 people. (3) Others: < 300 people	Paid-in capital under NT\$ 20 million and total assets amount under NT\$ 60 million. And the number of regular employees: < 300 people.	Paid-in capital under NT\$ 40 million. and total assets under NT\$ 120 million.	Paid-in capital under NT\$ 60 million. Or number of regular employees under 200 people.

Source: Small and Medium Sized Enterprises Administration, Ministry of Economic Affairs, Executive Yuan R.O.C. (Taiwan), *The White Paper of Taiwanese SMEs* (Taipei, 2005), pp.261-262.

In order to clarify the dynamics of social institutions in a historical context, this dissertation should first define how it uses this term. Different approaches use different terminology when analyzing the dynamics of society. For example, the NIE approach calls it ‘the informal institution’ (North); the social institutional theory highlights the dynamics of social networks in society. However, on the one hand, the term ‘informal institution’ is very general. On the other, the term ‘social networks’ is too limited. Therefore, based upon the principles of these two approaches, the present research chooses the term ‘social institution’.

The foundations of social institutions have two aspects: the rules of the game and the structure of each social institution. According to Wells, the basic element of any social institution is its social structure, which consists of complicated social networks based upon social relations.¹²⁵ According to Knight, the basic level of social institutions is composed of social conventions, rules and norms. The principle of the social conventions, rules and norm, in the Taiwanese case, inclines to Confucianism.¹²⁶ There are two accounts of the functions of social institutions. The first account considers social institution as a collective activity aimed at solving collective action problems and providing benefits for collective activity. The second highlights the function of distributing the benefits of social institutions in collective activity. The benefits of social institutions which are agreed on by the two accounts include ‘efficiency (in terms of the allocation of resources or employment of scarce resources, social optimality (the maximization of social benefits), minimization of transaction cost, stability or the satisfaction of some other functional needs’¹²⁷.

In this dissertation, the principle, the elements, the structure and the function of social institutions cover both the NIE approach, with its ‘informal institution’ and the social institutional theory’s social networks. The dynamics of social institutions referred to here include the dynamics of the norms and values of Confucianism and the social networks which are constructed on the social relations. The aim of the social dynamics is to solve collective problems and the benefits thus include efficiency, social optimality, reduction of transaction costs and stability.

3-8. Methodology

The literature focuses on the political and economic institutions which influenced Taiwan’s economic development and the development of SMEs. However, similar political or economic institutions in other developing countries have not guaranteed economic growth. Moreover, research also confirms that the Taiwanese government did not directly support the SMEs. The social institutional theory goes further and explores the relations of the state, the market and social institutions. The social institutional theory explains how and why the dynamics of the

¹²⁵ Wells, Alan, *Social Institutions*, (London, 1970).

¹²⁶ Knight, Jack, *Institutions and Social Conflicts* (Cambridge, 1992).

¹²⁷ Knight, Jack. and Sened, Itai., “Introduction,” in *Explaining Social Institutions*, eds. Knight, Jack and Sened, Itai (Michigan, 1998), p.2.

society support the political and economic institutions to facilitate economic activity. Although both the NIE and the social institutional theory indicate the significance of the impact of external factors and the historical continuity of institutional changes, they do not trace the historical legacy of institutions. Attention to the historical legacy explains the impact of historical continuity on Taiwan's economic development. This impact includes the changes of political and economic institutions and the way in which these changes of institutions influenced economic development. However, the historical legacy approach fails to analyse the transformation of social institutions within the changing institutional framework over time. Therefore, the NIE and the social institutional theory are both included when analyzing the historical heritage.

The analysis includes three different periods within the theoretical framework which concerns the interrelation of the political, economic and social institutions. The first period covers Taiwan's trade and economic history from the 16th century to the early 20th century, in order to identify the continuing social dynamics through history. The second period re-examines the development policies before 1980 which were considered significant in supporting the rise and development of the SMEs. The third period then shows the evidence that the government gave only limited support to the rise of the SMEs in the post-war development period by analyzing the further development of the SMEs in China after the late 1980s during political conflicts and government restrictions.

The first period builds up a historical pattern in a historical context. The analysis first clarifies the political and economic institutions, the impact of the external hegemonies and the institutions, the demand and supply of the market which they dominated. The clarification of the institutional frameworks seeks to show the difficulties (or chances) for business and trade. After clarifying the institutional frameworks, the analysis focuses on the way in which business and trade operated in the institutional frameworks from the 16th century to the early 20th century and compares the impact of the hegemonies, the changing institutional frameworks and the ways in which the social institutions supported and facilitated business and trade in Taiwan. The historical approach is taken in order to show the similarity and continuity of social institutions adapted to the changing institutional framework in Taiwanese economic history.

The second period examines the role of the state policy, the market and the social institutions in the rise and the development of the SMEs during the period from

1950 to 1980. It first examines the political power structure of the KMT by tracing the foundations of its history. Based upon Wontrobe's theory on the characteristics of an authoritarian system, the analysis seeks to show the state's interest and the way in which this influences the formation of policies for economic development. In addition to the political power structure within the KMT, the distribution of the political power structure in Taiwanese society explains how the KMT remained in power for the following fifty years.

On the basis of the categories of dictatorship and democratic systems of Huntington and Wintrobe, I categorise the socio-economic groups as follows. In Taiwan the traditional actors do not play as significant roles as traditional actors have done in Catholic and Muslim countries.¹²⁸ Before the change of political system in the late 1980s, the chosen groups included dictators (political leaders), bureaucratic actors and parliamentary actors. The functional socio-economic groups, as Huntington defines them, comprise entrepreneurs, peasants, workers and intellectuals.¹²⁹ These functional socio-economic groups were the excluded ones who held no political power under the KMT Leninist party state system. This shows that the state's interest did not necessarily comply with the economic interests of other socio-economic groups because the excluded groups could not influence the formation of the state's development policy.

Based upon the analysis of the state's interest and the structure of political power, the section then examines the impact of the state's interest on the formation of the policies and the institutions created for the different stages of SME development and ask whether these policies and institutions gave significant support to the SMEs. The analysis mainly includes the development policies and the legal regulations concerning commerce, enterprises and trade. The existing literature usually ignores the analysis of legal regulations; the significance of the legal regulations is that they clarify the degree and extent of government support for the SMEs before the 1980s. The analysis of the policies and the legal regulations shows the support and the limits of the government policies as perceived by the SMEs. The support and its limits then

¹²⁸ The popular religions in Taiwan are Daoism and Buddhism, neither of which allowed monks or Buddhist nuns to participate in politics. Therefore, the power of the religions in politics is not as strong as that of Christians' and Muslims in other countries. However, the temples in Taiwan, notably in rural areas, have a significant impact on society. They have both economic and social functions and are usually run by local gentry rather than the monks and Buddhist nuns.

¹²⁹ Huntington, S., *op.cit.*, 1970, p.7.

identify the space for the support of the social institution; within this space, the analysis shows how the social institution supported SMEs' business operations.

The third period focuses on the further development of the SMEs in China after the late 1980s. There are three parts in the third period. The first part analyses the changing economic situation in the mid and the late 1980s; this part shows the needs and the interest of the SMEs in the changing economic situation. Here, the question is whether the state's interest complies with the economic interest of the SMEs. The second part analyses how the political transformation influenced state-society relations and how these changes affected the state's interest and the formation of the new economic policy towards China after the late 1980s.

The second part begins with the theories which explain the transformation of an authoritarian system to a democratic system. The focus is on the factors which induce change in the interest groups and socio-economic groups in an authoritarian/totalitarian system and in a democratic system. The significance of political transformation in a society from dictatorship to a democratic system lies in the general and presidential elections, when political power was re-distributed among the socio-economic groups. Based upon the model of transformation from an authoritarian to a democratic society, the thesis analyses how the transformation of the political system redistributed political power and created new socio-economic groups amongst which political power was shared.

The redistribution of political power explains the impact of the changing political system on the formation of new economic policy. The model of economic voting indicates that economic issues are significantly related to voters' behaviour. But it does not further clarify the different incentives and other details of different socio-economic groups which also significantly affect their voting behaviour. In other words, the economic voting model cannot fully explain why a new economic policy was opposed by a majority of voters. Based upon the model of Rodrik and Fernandez and Adams, the thesis calculates the political weights and traces the factors which may affect the amount of support or resistance to new economic policy from different socio-economic groups. It then accounts for the government's interest and examines whether the interest address the needs of the SMEs.

The third part examines the impact of the new economic cross-strait policy adopted, on the basis of the government's interest in SME investment and business operation in China after the late 1980s. It first examines this policy and its impact on

the SME investment and business operation across the strait. Then it explains how trade was operated and business was run across the strait by the support of the social institutions under the formal institutions.

In conclusion, the dissertation examines the state's interest and its impact on the formation of the development policies within the historical pattern. The historical continuity, discontinuity, similarities and differences form the relationship of the state, market and the social institution. The analysis questions the argument of Wade and Amsden and identifies how the social institutions provided support under the formal institutions.

3-9. Scope Limitation

The conventional view of Taiwan's post-war economic development usually focuses on the factors contributing to rapid economic growth: a free market and the role of the state have been considered significant in the process of catch-up in the post-war period. This research neither tries to explore the new factors contributing to Taiwan's economic growth nor tries to argue that the market and the state were insignificant. The focus is on the relation of the state, market and specifically the influences of the state and the market on the development of the manufacturing SMEs.

Moreover, the social institutions include several different aspects, such as culture and social networks. This research does not try to explain how or why these social and cultural elements of social institution support and facilitate business operations. The research regards the social institution as a whole and sees how it supported the manufacturing SMEs in the formal institutional framework.

The scope of the research on the Taiwanese SMEs is from 1950 until their entry into China before 2000. It does not try to evaluate the volume of cross-strait trade and investment because much research has already evaluated and analyzed economic cooperation across the strait. Moreover, it does not include the economic performance of the SMEs in China nor the SME contribution to the Chinese economy.

3-10. Notes and Data Sources

The primary data sources used in this dissertation are mainly from the government organisations in Taiwan, China and Hong Kong.

The primary sources used in this dissertation include government publications of the R.O.C. (Taiwan) and the newspapers. The government publications include

statistics, journals, press release, investigations, reports, white papers and government websites. The sources of government statistics include: (1) *Statistical Yearbook of the R. O. C.* is published by the Directorate-General of Budget, Accounting and Statistics, Executive Yuan, R. O. C. (Taiwan). Most of the data on the economic indexes are collected from various yearbooks. (2) The statistics on import and export is published by the Bureau of Foreign Trade, Ministry of Economic Affairs (MOEA), R. O. C. (Taiwan). The major import and export data is based upon this official publication. (3) Monthly/Yearly Statistics on Foreign Investment is published by the Investment Commission, MOEA. The Investment Commission is responsible for verifying investment (both inward and outward) cases. The statistics concerning Taiwanese investment and foreign direct investment in Taiwan is based upon this series of publications. (4) The statistics on the sources of financial capital is based upon the publications from Bureau of Economic Research, Central Bank of the R.O.C. (Taiwan). (5) Data and sources concerning cross-strait statistics are collected from the publications of the Mainland Affairs Council. The statistics is based upon the Cross-strait Economic Statistics Monthly and Preliminary Statistics of Cross-strait Economic Relations.

The sources of white papers mainly from *the White Paper on Small and Medium Enterprises in Taiwan* which is published by the Small and Medium Enterprise Administration, MOEA. The publication includes government's policies on the development of the SMEs, statistics, investigations and research on the history, current status and future development of the SMEs. Information regarding SMEs in this dissertation is primary, based upon successive editions of this publication.

The sources and data for the Taiwanese post-war development are based upon *Industry of Free China*. This official publication is edited and produced by the Council for Economic Planning and Development. It includes discussions and suggestions for development policies by government economic officials, debates on development policies within the administration and opinions from the public on development policies. The debates and critical opinions clarify the difficulties of the economic situation, government's interest, support and limits in the rise and development of the SMEs.

The sources for government policies and regulations are collected from the Laws and Regulations Database of the R.O.C (Taiwan). This on-line database includes all the policies, orders and regulations of the R.O.C. (Taiwan).

The data and sources regarding China's economic reform policy that is related to Taiwan and elections in Taiwan are collected from the National Chengchi University (NCCU). The Centre for China Studies at NCCU publishes the Journal of Economic Research on China, which includes some early economic situation in China in the 1960s and the 1970s. Since the late 1970s, the Centre has launched a series on China's economic reform and political situations. Its research focuses on an analysis of the reform policies and economic performance and the impacts on Taiwan during the period. The Election Study Centre at NCCU compiles and collects opinion polls concerning parliament elections and presidential elections. In addition, the Centre also compiles opinion polls regarding significant government policies. It also publishes investigations and research on government policies based upon data and statistics from the elections.

Sources for the history of the KMT are based upon its official publications and information on its official website. The official history of the KMT shows the power structure and the mechanism of the political party. Since Taiwan used to be a one-party state, the political history of the KMT represents Taiwan's political history before the late 1980s.

Sources of newspapers are mainly from the United Daily Newspaper and the China Times. Both newspapers were issued in the early 1950s (the China Times in 1950 and the United Daily Newspaper in 1951) and had the two largest volumes of circulations in Taiwan. The use of reports from newspapers and magazines aims to indicate what happened in Taiwan during the political transformation. Since there was severe media control, it is difficult to find from these reports any material dealing with the political struggle within the KMT before 1990.

The sources based upon Chinese government publications include statistics and policies. Statistics regarding China's economy, foreign investment and cross-strait are collected from *the China Statistical Yearbooks* and China's Customs Statistics (quarterly and monthly). *The China Statistical Yearbook* is edited and published by the National Bureau of Statistics of China; China's Custom Statistics is edited and published by the General Administration of Customs of the P. R. C.. In addition to the national statistical yearbook, some provincial statistical yearbooks for selected years (published by the local government) are also used. Sources of Chinese policies and regulations are collected from the Gazette of the State Council of the People's Republic of China (State Council Gazette), Orders of the State Council of the

P.R.C. and Yearly Working Reports of the State Council of the P.R.C.; these are published by the General Office of the State Council.

Sources based upon Hong Kong government publications mainly focus on the trade statistics it compiles from trade among Taiwan, Hong Kong and China. The data of transit trade between Taiwan and China are collected from *Hong Kong Merchandise Trade Statistics-Imports*, *Hong Kong Merchandise Trade Statistics-Domestic Exports and Re-exports* and *Hong Kong External Merchandise Trade*. These three statistical books are edited and published by the Census and Statistics Department, the Government of Hong Kong Special Administrative Region.

The statistics of Taiwanese FDI in China and cross-strait statistics are based upon sources from Taiwan, China and Hong Kong. The reason for using the data from these three places is that, before the Taiwanese government officially permitted Taiwanese investment in China, the statistics showed that small amounts were being invested there. Since there is no official record from the Taiwanese government, some FDI statistics from the Chinese government are used. Moreover, the statistics of Taiwanese FDI in China differ from the Taiwanese government's and the Chinese government's. This is affected by the Taiwanese restrictions on Taiwanese investment in China. In order to avoid government control, the investment usually transfers to some third place and thence to China. In these circumstances, the statistics compiled by the two governments differ. Similar problems exist in the statistics of cross-strait trade. Since direct transportation was prohibited, statistics from the two governments on imports and exports across the strait differ. The reason for using the trade statistics compiled by the Hong Kong government is that Hong Kong is the most popular transit place for cross-strait trade.

The secondary sources used in this research project include historical texts, historical archives, memoirs and the reports and investigation that the government organisations authorised to the private economic research centre. The sources of the historical pattern are based upon the historical texts mainly from Fairbank (1969), Chen (1997, 2006), Cao (1997), Lin (1997, 2002) and the historical archives edited by the Academia Sinica, Academia Historica and National Palace Museum. Sources regarding KMT history and the political transformation are based upon the memoirs of significant politicians and government officials and the historical texts. The memoirs of politicians and government officials are significant for exploring the political struggle within the KMT. In addition to memoirs, the historical texts are

based upon Zhang (2003), Wang (1987), Wang (2003, Lin (1994)) and the Cambridge history of China. Information concerning Taiwanese investment, information regarding Taiwanese enterprises investing in China and cross-strait trade are based upon the investigations and reports of the Chun Hua Institute for Economic Research. The Chun Hua Institute for Economic Research is one of the largest independent research centres in Taiwan. The research centre is usually responsible for investigations and reports of the government projects.

3-11. Notes on the Spelling of Chinese Names and Terms

The Pinyin system has generally been used throughout this dissertation. Exceptions have been made for names that are universally known in the old Wade-Giles spelling, such as Chiang Kai-Shek.

Part II. Constructing a Historical Pattern

The traditional view of the rise of Taiwanese trade usually begins with the Dutch domination in 1624. As Lin argues, the limited records of cross-strait trade before 1600 relate to the supply and demand of the market before 1600, because Taiwan lacked valuable products for trade. Did economic Taiwan emerge under the Dutch domination? Most of the existing writers mention the piracy in the region in sixteenth centuries, but few of them pay attention to the impact of the pirates on the emergence of Taiwanese trade. What was the impact of the pirates on the emergence of Taiwan? What were the factors which drew Taiwan into the trading system? How did these pirates operate illegal business at sea? Whatever the facts here, in 1684 Taiwan became part of the Qing Empire and in 1895 was colonised by the Japanese Empire. These two governments established different institutions for trade and business in Taiwan. What was the impact of the state policy on the formation of the market, trade and business operation? What was the pattern of trade and business during these two periods? What impact did the historical heritage have on the development of social dynamics in local society in Taiwan? The following chapter seeks a historical pattern, in order to identify the significance of market and social institutions for trade and business under different political institutions in Taiwan's past.

Chapter 4. Market, Trade and the Historical Heritage of the Social Institutions, 1522-1945

This chapter traces the history of the rise of Taiwan and the beginning of cross-strait trade in order to identify the dynamics which have sustained trade and business operations in Taiwan and across the strait from the 16th century to the early 20th century. The focus is on the impact of the formal institutions on the market and the role of social institutions in supporting and facilitating trade and business. The analysis has three sections: the first covers the three periods between 1522 and 1864 when the political status of Taiwan remained uncertain. The first section identifies the dynamics of the market and the social institutions by tracing the pattern of the rise of Taiwan in the regional and international trade systems. The second and the third sections cover the periods when Taiwan was dominated by the Qing Empire and the Japanese empire.¹³⁰ The second and the third sections contrast the state policies of the two empires and look at the impact of these policies on the market, trade and business society in Taiwan and across the strait. The comparison then leads to a question on the dynamics which supported businessmen in making their investment and trade under different institutional arrangements. Finally, the chapter proposes a historical pattern in order to identify historical similarities and a historical heritage which continuously facilitated business operations in response to the changing environment.

4-1. The Tributary System and the Rise of Taiwan

The sea bans are usually considered the main factor inducing pirate activity in the Ming dynasty. However, sea bans were merely one part of the system by which the imperial court managed trade and national security. The monopolisation of the sea trade was indeed operated under the Chinese tributary system. According to Fairbank, tribute was a China-barbarian institution. It had been jointly created on the Sino-barbarian frontiers of China and jointly operated as the medium for Sino-foreign

¹³⁰ The uncertain political status implies that there was no solid and integrated political regime over Taiwan. Both the Dutch and the Ming Zheng controlled only parts of Taiwan. In 1624, the Spanish ruled North Taiwan and the Dutch the South. Not until 1642 did the Dutch defeat the Spanish from North Taiwan. The Dutch were then defeated by the Ming Zheng in 1647. The main territory of the Ming Zheng was in South Taiwan, where the Dutch had ruled. During the Ming Zheng period the Dutch continued to conduct trade in North Taiwan. In the periods of the Qing dynasty and of Japanese colonisation, the two governments set up enforcement mechanisms and controlled the whole island. Therefore, compared with these two periods, we may say that the political situation in Taiwan before the Qing invasion was uncertain.

intercourse over the centuries'¹³¹. From the 8th to the 13th century, the tributary system was no longer politically oriented; various trade activities usually accompanied the paying of tribute. During this period, some of the coastal ports prospered because international trade brought profits.¹³² In the Ming dynasty, the imperial court continued the tributary system in order to manage foreign relations and increase tax revenue.¹³³

The Ming imperial court further systematised the tribute, including the exchange of envoys, the reception of diplomatic missions, regulation of trade and extradition procedures; all these activities were regulated, controlled and supervised by the imperial court.¹³⁴ The court asked the envoys and the merchants (both private and official) to disembark only at the open ports. Then the envoys headed to Peking (Beijing) and presented themselves to the court. The merchants stayed at the ports to trade with local merchants in the authorised markets. The envoys who went on to Peking were allowed to trade there with authorised merchants at authorised markets. These trade regulations were designed to manage national security and to make sure that the profits of foreign trade went to the court. The foreigners complied with the Chinese tribute system for the sake of their strong trade interests in China. The imperial court was aware of the profits brought by trade; yet consolidating political power was far more important to it than trade interests. In these circumstances, the tributary trade system was the best way to manage international relations and trade.¹³⁵

However, the monopolisation of international trade threatened other people's living. From the 8th to the 13th century, sea trade prospered in the coastal areas. For

¹³¹ Fairbank, John K., *Trade and Diplomacy on the China Coast: the Opening of the Treaty Ports 1842-1854* (Harvard, 1969), p23. The idea of the Chinese tributary system was politically oriented and can be traced back to the Shang dynasty (1766 BC). In this era, the structure of the nation consisted of the Son of Heaven (the emperor) in the middle and his vassals in subordinate relationships beyond the centre. The centre was the royal domain, the second circle was feudal lords, the third circle was called the pacified zone and the outer two circles was wholly barbarian. The concept of Chinese foreign relations is based upon this idea of a national structure and is still divided into five concentric zones.

¹³² The Silk Road and Sea Silk Road began in the 1st century and brought about the prosperity of seaports in South China, such as Quanzhou in Fujian.

¹³³ By the 13th century, the tribute trade system including the trade ports and taxation rates had been systematised. For further details, see Fairbank, J., *op.cit.*, 1969, chapter 3.

¹³⁴ The ports which were opened for tribute trade were the same as those used by the previous dynasties: Canton, Quanzhou (Chuan-Chou) and Ningpo. Viraphol, Sarasin, *Tribute and Profits: Sino-Siamese Trade 1652-1853* (Harvard, 1977).

¹³⁵ Fairbank, John K., 'On the Ch'ing Tributary System', *Harvard Journal of Asiatic Studies*, vol.6, no.2 (1941), pp.135-246; Deng, Kent, *Maritime Sector, Institutions and Sea Power of Premodern China* (London, 1999); Lin, Taocong, *Manchurian Trade and Tribute in the Ming Dynasty: a Study of Chinese Theories and Methods of Control over Border Peoples* (Nankai, 1937); Mancall, Mark, *China at the Centre: 300 Years of Foreign Policy* (New York, 1984); Stuart-Fox, Martin, *a Short History of China and Southeast Asia: Tribute, Trade and Influence* (Crows Nest, 2003).

centuries, the Fujian traders relied heavily on sea trade because of their geographical location and history. From the 10th century, Quanzhou (a city port in Fujian) had been used as one of the international trading ports (the customs) for the imperial dynasties. The Italian merchant, Marco Polo, in his *Travels*, recorded the prosperity of Quanzhou in the 13th century. Various merchant ships from different countries, including India and Arabia, came and went through this port.¹³⁶ Before the Ming dynasty, both the Sung and Yuan imperial courts established international sea trade systems in Fujian.¹³⁷

The prosperity of sea trade in the previous century and the geographical location were responsible for the foundation of sea trade guilds in Fujian, which before the Ming dynasty were very active.¹³⁸ However, the sea bans affected their way of life, because the imperial court prohibited all private sea trade. Despite prohibitions, smuggling was widespread in the late 16th century according to historical records as a large illegal sea trade with foreigners in the Fujian coastal area.¹³⁹ The first and primary foreign trade partners were the Japanese pirates; the rise of the Japanese pirates was related to Japan's internal political conflicts and the changing attitudes of the Ming imperial court towards trade with it.

The Ming imperial court conferred on the Japanese Muromachi Bakufu the title 'the Kingdom of Japan' and permitted official trade with its official merchants. The official trade with Ming China was controlled and managed by specific families in Japan. In 1467, internal disturbances weakened the power of the Ashikaga Shogunate; other families then tried to carve up the huge profits of trade with China.¹⁴⁰ Different families then sent their own envoys to China in order to claim legitimate

¹³⁶ Archaeological research has shown that there was a group of Arabian merchants living in Quanzhou; some of them married Chinese women and never went back to Arabia. Their staying was related to the Yuan imperial court's policy, which treated these foreign merchants in China with respect. For further details, see Lo, Xianlin, *Pu Shougeng zhuan* (Taipei, 1955).

¹³⁷ Gerritsen, Anne, *Ji'an Literati and the Local in Song-Yuan-Ming China* (Leiden, 2007); Levathes, Louise, *When China Ruled the Seas: the Treasure Fleet of the Dragon Throne 1405-1433*, (Oxford, 1996); Reid, Anthony, ed., *Southeast Asia in the Early Modern Era: Trade, Power and Belief* (Cornell, 1993).

¹³⁸ In modern China, extensive research has been carried out on the 10 biggest merchant guilds in Chinese history. For further details, see Ding, Yanmo, *Zuolu youjia: Anhui ban* (Anhui, 2001); Ding, Yan cuan and Ding, Yanmo, *Bainan shenlu: Ningbo ban*, (Guangdong, 2001); Hwang, Shan, and Guan, Qiong, *Sihai Chao ren: Chaoshan ban*, (Guangdong, 2001).

¹³⁹ For details of illegal private sea trade, see Matsura, Akira, *Dongya Haiyu yu Taiwan Haidao* (Taipei, 1996); Zheng, Guangnan, *Zhongguo haidao shi* (Shaohai, 1996); Dai, Yixuan, *Mingdai chialong jian de woko haidao yu zhongguo ziben de mengya* (Beijing, 1982).

¹⁴⁰ The period from the mid 15th century to the early 17th century was the Warring States period (Sengoku period) in Japan. The Shikaga shougunate was not able to control the Daimyo (the territorial

status as representatives of the Kingdom of Japan. The domestic political conflicts extended to foreign trade. In 1523, two Japanese envoy ships (sent by different families) fought each other in Ningbo, before the Japanese envoys were killed by Ming officials.¹⁴¹ After the Ningbo skirmish the Ming imperial court strictly controlled Japan's tribute trade in China. Yet similar skirmishes over tribute trade continued. In 1557 the Ming imperial court refused to receive Japanese envoys and halted both official and private trade with Japan.

The significance of Formosa emerged under the tributary system and the economic interests of the Fujian merchants and the Japanese merchants. In addition to the demand and supply which provided trade incentives for both the Japanese and the Chinese pirates, the geographical location of Taiwan also significantly affected the pirates' activity. Moreover, Taiwan was a barren island without a strong integrated political power to dominate trade; this prevented piracy from yet another political power. However, incentives and geographical locations alone were not enough to bring successful trading, least of all when the trading was prohibited by law. The successful operation of illegal trade was founded on the organisation of the Chinese pirates.

The dynamics of the Chinese pirate/merchant networks can be traced back to the development of piracy in the early Ming period. Indeed, it is inadequate to describe these Fujian pirates as organised criminals only; in fact, most of them were originally merchants. They broke the state law and, without the state's protection, they established their own armed forces to protect their private trade. As Jiang and Fang write, 'pirates and merchants are all the same people; when markets are open, pirates become merchants and when markets are closed merchants become pirates'¹⁴². The fine line between pirates and merchants was also closely bound up with the structure of these pirate organisations.

According to historical sources, most of the pirate organisations were supported by the local gentry, the powerful and wealthy families and even the local officials. Some of these big families and local gentry accumulated their wealth by sea trade. But the Ming sea bans reduced their profits. These influential families and

lords in pre-modern Japan) and these Daimyo also competed for trade with China. For further details, see Bryant, Anthony J., *Sekigahara 1600: The Final Struggle for Power* (Praeger, 2005).

¹⁴¹ So, Kuanwei, *Japanese Piracy in Ming China during the 16th Century*, (Michigan, 1975); Wang, Yitung, *Official Relations between China and Japan, 1368-1549*, (Cambridge, 1953).

¹⁴² Jiang, Zuyuan and Fang, Zhiqin, *Jianmin Guangdong shi* (Guangdong, 1993), p.263.

gentry then became the main financial backers of the pirate organisations. Such support was crucial, since the pirates required money to build ships and buy firearms for trade. Moreover, the role of local officials was significant since it was they who let these merchants loose to trade at sea. The local officials were basically shareholders of the organisation; the organisation offered them shares in exchange for protection. The final tier of the organisation was the people who were conducting trade at sea. These people were originally sailors, fishermen or merchants who had lost their employment through the sea bans. Joining a pirate organisation would enable them to make a living and they were familiar with the work before the bans were enforced.¹⁴³ The dynamics of pirates' organisations continued to play a significant role when the European forces tried to join in the tributary trade system.

4-2. The Tribute Trade and the European Forces

For centuries, the Chinese imperial courts and their subordinates complied with the tribute rules in order to maintain security and trade. However, newcomers were ambitious to join the system and share in the trade profits. These newcomers came from Europe; their thirst for trade began with the Age of Discovery in the 15th century.¹⁴⁴ The pattern set for these Europeans' participation in the East Asian trade system can be found by examining how the Portuguese and Spaniards entered the trade system before the Dutch came to dominate Taiwan. This pattern further explains the impact of the tributary system on the rise of Taiwanese trade in the Dutch period.

During the Age of Discovery, the Portuguese were the first Europeans to come to China (in 1514) to trade with the Ming dynasty. Although the Ming imperial court initially prohibited direct trade with the Portuguese, from 1557 the Portuguese joined the Chinese trade system, taking Macau as their trading base.¹⁴⁵ From 1557 to 1578 the Portuguese were allowed to trade with Chinese merchants at the border. Not until 1578 did the Chinese court officially permit the Portuguese in Canton (Guangdong) to

¹⁴³ Fitzpatrick, Marilyn, 'Local Interests and the Anti-pirate Administration in China's South 1555-1565, *Chin Shi Wenti Ti*, Vol.4-2 (1979), pp.1-50; Geiss, James, "The Chia-Ching Reign 1522-1566," in the *Cambridge History of China*, vol.7: *The Ming Dynasty, 1368-1644*, eds. Mote, Frederick W. and Twitchett, Denis (Cambridge, 1988), pp.440-510. Deng, Kent, *Chinese Maritime Activities and Socioeconomic Development* (Connecticut, 1997).

¹⁴⁴ For further details of the Age of Discovery, see Arnold, David, *The Age of Discovery* (London, 2002).

¹⁴⁵ Since 1554 the Portuguese had dominated Macau; but the Ming court did not officially permit their staying in Macau for trade until 1557. For further details, see Chen, Guodong, *Mingdai chuqi dongya haiyu yichen nian: Lishi shan de haiyang zhongguo yu duiwei maoyi* (Jinan, 2006).

trade directly. The changes of policy towards the Portuguese ensued after the Ming imperial court halted Japanese tributes in 1557. This special authorisation to trade was related to China's need for silver. Although the Ming halted Sino-Japanese trade, the requirement for silver continued. Therefore, the Chinese used the Portuguese as brokers to continue trade with Japan.¹⁴⁶ The need for silver and the changed policy towards Japan gave other Europeans the opportunity to enter the Chinese trade system as well.

During the Age of Discovery, the main competitors with the Portuguese were the Spaniards. Before these two nations arrived in the East Asian seas, they had competed with each other in the Americas and they continued to compete in East Asia. Both nations tried to negotiate with the Ming imperial court so that they could engage in direct trade with Chinese merchants. As in the Portuguese case, the Ming court did not promise the Spaniards anything. Obstacles were set to direct trading and the Spaniards followed the Portuguese to set up a trade base in Manila in 1565 in order to comply with this Sino-centric system. The Manila Galleon trade began with the Spanish domination of Manila and lasted until 1815.

The Manila Galleon trade was the most famous silver trade route in history. The Spaniards transported South American silver and traded it with the Chinese merchants. According to historical sources, the Spaniards were not sure what kind of trade products would be most useful at the beginning when they conquered Manila. They were thinking about cinnamon; but cinnamon production was insufficient and unreliable.¹⁴⁷ They were certain only that they ought to trade with China in order to obtain silk, porcelain and other valuable products. However, they had at this point neither ideal export products nor connections with the Chinese. In the early stages, the Spaniards did not make a profit. After 1572, however, these difficulties were ironed out when the Spaniards built such good connections with the Chinese merchants who traded in Manila that the Spaniards made profits.¹⁴⁸

¹⁴⁶ The Japanese government allowed the Portuguese to trade in Japan for the Chinese products that they needed, such as silk. It was not until 1641 that the Japanese government enforced Sakoku and permitted trade only with the Dutch and the Chinese.

¹⁴⁷ For further details, see Schurz, William L., *The Manila Galleon* (New York, 1939).

¹⁴⁸ In the early 15th century, the famous 'Zheng He to the Western Ocean' increased trade between South China and South East Asia. Manila was one of the significant ports in South East Asia where the South China merchants traded. During Zheng He's expedition, many Fujianese and Cantonese immigrated to South East Asian countries. Hence, in the 16th century, the South China merchants had established connections and trade networks. For further details, see Deng, Kent, 'An Evaluation of the Role of Admiral Zheng He's Voyages in Chinese Maritime History', *International Journal of Maritime*

The Spaniards followed the Portuguese in establishing a trade base and transiting different products among different countries to earn profits. It is worth noting that neither the Portuguese nor the Spaniards produced merchandise for trade. They operated a transit trade by transiting commodities within the regional trade system. It is also significant to notice the pattern of their trade with China: they needed to find a third place as their transit point to trade with China because the Ming imperial court did not allow foreigners to stay in Mainland China. Further, geographical locations and trade connections mattered. The Portuguese dominated a good position (Macau) located just next to the Chinese border. This gave them easier access to the Chinese merchants. The Spaniards had a more distant base which made it more difficult for them to link to the trade connections in the beginning. After establishing the connections with the Chinese merchants, they made trade profits. Both locations and the Chinese merchants played a crucial role in bringing these Europeans into the trade system.

The pattern of participation by the Portuguese and the Spaniards in the tributary system indicates two significant factors for the European forces who wanted to join the trade: the location, which was either permitted by the Chinese imperial court or did not belong to the imperial court; in the latter case, it had to be open for trade without the restrictions or controls of any other political power. Second, the connections with the Chinese merchants were the channel for acquiring Chinese luxuries. These two significant factors also influenced the Dutch domination of Taiwan and the rise of Taiwan in the trade system.

The Dutch first occupied Penghu Island in order to participate in the Sino-trade system. The Fujian officials negotiated with the Dutch to move from Penghu to Formosa and promised to provide them with a quantity of silk and porcelain for trade.

¹⁴⁹ Given its geographical location, the Dutch then turned to Formosa and traded

History, vol.7, no.2 (1995), pp.1-29. Zheng, Hesheng and Zheng, Yijun, eds., *Zheng He xia xiyang ziliao banhui* (Beijing, 2005); Qianzhou Gangwu Ju, *Qianzhou gan yu haishan sichou zhilu* (Beijing, 2005).

¹⁴⁹ One of the reasons for the Dutch to occupy Penghu and Amoy was related to another competitor in Northern Taiwan—the Spaniards. The Spaniards occupied north Formosa (Keelung) in 1626. According to the sources, the Spanish missionary, Bartolome Matinez, who joined in and planned the Spanish occupation of Keelung, suggested that the Spanish King should take over Formosa. The significances of occupying Formosa come from its geographical location, openness, independence from the Chinese imperial court and the need to oppose the Dutch who were trying to block Spanish trade with China. In order to protect Spanish trade interests, they established San Domingo (Tanshui) in northern Formosa. However, the Spaniards did not manage their business as successfully as the Dutch in south Formosa did. In 1642 the Dutch expelled the Spaniards from North Formosa. For further

according to the system there. Although it is not clear whether the Ming imperial court expelled the Dutch from Penghu Island by military force or whether the Ming officials negotiated with the Dutch and asked them to leave, their departure indicates that the political status of Taiwan was uncertain. The political uncertainty also implies that there was no solid and integrated power in charge of Taiwan during this period. This implies that Taiwan was open for trade without restrictions or control by any political power.

However, the Dutch still found it hard to acquire Chinese products in the early period of their rule in Taiwan. Although the Dutch traded with the Japanese merchants and pirates for Japanese and Chinese products, the Dutch still did not have the permission from the imperial court to trade directly with the Chinese merchants.¹⁵⁰ This limited the chances for the Dutch to acquire Chinese products. Therefore, the Dutch decided to occupy Penghu and Amoy again. However, in 1633 they were defeated by Zheng Zhilong in Liaoluo Bay. This defeat obliged the Dutch in the following decades to rely heavily on Zheng's trade groups for Chinese products (and even Japanese products).¹⁵¹ The Chinese business connection with the Dutch was founded on Zheng's supply of Chinese products. The power of Zheng Zhilong and the success of his pirate trading were related to the constructions of business networks in Fujian.

4-3. *The Dynamics for Zheng's Trade and the Continuing Support for Ming Zheng Trade in Taiwan*

At the end of the 16th century, piracy was rampant and the Ming imperial court gradually lost control of it.¹⁵² From 1600 onwards, the court began to offer some of the powerful pirates an amnesty, together with the opportunity of enlistment. The

details, see Chen, Qinan, "Taiwan and the World in the 17th Century," in *Formosa Maritime Taiwan and Spain*, eds., Li, Zining, Wu, Bailu and Shi, Wencong (Taipei, 2006), pp.11-16; Alvarez, Jose Maria, *The Spanish in Taiwan, 1626-1624*, trans Li, Yuzhong and Wu, Mengzhen (Taipei: 2006); Borao, Jose Eugenio, *The Spanish Experience in Taiwan, 1626-1642*, trans. Nakao Eki (Taipei: 2008).

¹⁵⁰ The Dutch was kind of edged out of the business between the Chinese and the Japanese and did not make huge profits in Taiwan in the early period. For further details regarding the trade difficulties of the Dutch and the competition among the Dutch, the Chinese and the Japanese, see *De Missiven van de VOC-Gouverneur in Taiwan aan de Gouverneur-Generaal te Batavia, 1622-1626*, trans. Chiang, Shusheng (Taipei: SMC Publishing, 2007).

¹⁵¹ Chen, Guodong, "Helan Shichi Maoyi yu Chanye," in *Ilha Formosa: The Emergence of Taiwan on the World Scene in the 17th Century*, ed., Shi, Shaoqian (Taipei, 1997), pp. 52-74.

¹⁵² The Ming imperial court also faced invasion from the north, including the Mongolians and the Jurchens. With such troops in the north and the pirates in the south, the imperial court repeatedly deployed soldiers in battle. For further details, see Academia Sinica, ed., *Mingqing shilau*, (Taipei, 2008).

imperial court usually offered such people official positions locally in order to use them to control and manage the coastal areas where they had once used dominated. This policy was not, unfortunately, altogether effective in reducing illegal sea trade. What changed was that this illegal trade (which was controlled by the pirates) became legal, but these pirate-officials were still in charge of it. Some of them made a fortune from their dual status, in particular Zheng Zhi-Long, a pirate who became a Ming official in 1628. The Ming imperial court relied on him to stabilise the coastal area. Before submitting to the court, Zheng Zhi-Long was already in control of most of the South China and Japanese private trade. In other words, he not only had a monopoly of the Fujian coastal trade but also traded directly with the Japanese.¹⁵³

Zheng Zhilong organised his own trade organisation Wushang (the five commerce). The Wushang was separated into 'mountain routes' and 'sea routes'; each route was composed of five branches. The mountain routes consisted of five main wholesale departments, which were responsible for purchasing for export silk, porcelain and other valuable products from the Chinese mainland. These wholesale branches were located in Jiangnan. The sea routes were protected by five merchant fleets. These took charge of exporting products, purchasing foreign merchandise, a labour agency (bringing in people to work in the countries of South East Asia), passenger transport and even collecting the taxes levied on the private sea trade.¹⁵⁴ The base of the sea routes was established in Amoy. The foundation of the Wushang organisation strengthened Zheng's power in both trade and armed men because it dominated the sources of the export products and controlled the sea routes for transporting them. This also explains why the Dutch tried to attack Penghu and Amoy; they were not able to make more profit under the domination of Zheng's family in the South China coastal areas.

¹⁵³ Zheng Zhilong's wife was Japanese and he had good relations with some Japanese pirates and merchants. These connections continued when his son, Koxinga, inherited his position, since he was half-Japanese. Of course Zheng Zhilong's direct trade with Japan was illegal, but since he dominated the Fujian coastal area in terms of wealth and armed forces, the Ming imperial court could neither attack him nor restrict him. Chen, Wende, *Zheng zhilong dazhuan* (Taipei, 1998). Chen, Fulang, *Haixia xiaoxiong: kaitai xian chu Zheng zhilong* (Beijing, 2007).

¹⁵⁴ After the Battle of Lailuo Bay in 1633, Zheng Zhilong became the overlord of the South China Sea (as a result of his strong navy and profits from the sea trade). He and his corporation (Wushang) monopolised the trading with Japan, Taiwan and South East Asia. All the ships sailing on the South China Sea (and the routes to Japan) were required to pay protection money. If they did, they would receive Zheng's banner which they displayed in order to avoid attacks. This was called the banner system. For further details, see Guo, Hongbin, *Zhengshi wanchao jiqi dui Taiwan de tongzhi* (Taipei, 2004).

The golden age of Zheng Zhi-Long began after he defeated the Dutch in 1633. When the Dutch were defeated, they had no choice but to rely on his trading groups for Chinese and also some Japanese products (the Spaniards relied on Zheng's trading groups, as well). The rise of Zheng Zhilong was significant for the history of Taiwan, since his son (who was also his successor) Zheng Chenggong (Koxinga) continued to dominate the Fujian coastal area for decades. The fortune collected by Zheng Zhilong from the coastal trade and what Koxinga added to it supported their sea forces against the Qing dynasty for many years. The trade area ruled by Zheng's family in the Ming dynasty included the Fujian coastal area (in particular Amoy and Quanzhou), the Taiwan Strait, Formosa, Japan and even the Philippines and other South East Asian countries.¹⁵⁵

In 1644 the Manchurians took over Beijing and dominated China proper. The change of dynasties in China in 1645 caused military opposition between the Qing dynasty and Ming Zheng that was based in Amoy and Taiwan. After the leader of Ming Zheng, Koxinga, lost a significant battle and retreated to Taiwan, the domestic political conflicts in China extended across the Taiwan Strait. In 1661 Koxinga expelled the Dutch and took over Zeelandia; this was the beginning of the Ming Zheng in Taiwanese history. Zheng's government first opened up a series of uncultivated areas by using troops to enlarge the arable land and increase the yields of rice.¹⁵⁶

In addition, to obtain the necessary goods and materials and, in particular, to acquire military supplies, they needed to trade. Some difficulties were experienced by Ming Zheng's merchants (these merchants belonged in one way or another to Zheng's family and were officials of Ming Zheng). In the past they had carried Chinese products from mainland China and traded with foreigners at sea. However, after the change of dynasty, the sources of their Chinese products (particularly Chinese silk) on the mainland were cut off by the Qing court.¹⁵⁷ To make matters worse, Formosa

¹⁵⁵ For details of the trade networks in the 17th century in Taiwan, see Chen, Guodong, "Jindai chuqi dongya de maoyi wanlu," in *Ilha Formosa: The Emergence of Taiwan on the World Scene in the 17th Century*, ed., Shi, Shouqian (Taipei, 1997), pp.17-24.

¹⁵⁶ The Ming Zheng dispatched the troops to open up ground for rice-growing. A proportion of this newly cultivated land was taken into government ownership and the remainder distributed to the soldiers who cultivated it. These cultivation policies effectively increased productivity. For more details, see Liu, Ninyan, ed., *Taiwan kaifa shihua* (Taizhong, 1985); Xue, Huyuan, *Taiwan kaifa shihua* (Taipei, 1999).

¹⁵⁷ The Qing imperial court, at an earlier stage, had enforced the negative policy (Great Clearance): forcing the coastal residents to move 25 kilometres inland as they did in several provinces, such as

required certain articles, such as cloth for daily use. In the circumstances, the Ming Zheng regime dealt with the difficulties in two ways.

One way in which it could obtain the products from mainland China was through connections (particularly the Wushang organisation). An alternative way was to cooperate with the Europeans. In 1661 Koxinga expelled the Dutch from south Formosa (Anping), but the Ming Zheng allowed the Dutch to stay in Northern Formosa (Keelung) for trade. In 1670 when Zheng's troops took over Amoy and other small islands in the Fujian coastal area, they allowed both the Dutch and the British to set up trading companies in Amoy. Zheng's government also signed business contracts with the Dutch and the British in order to ensure military supplies for the Ming Zheng.¹⁵⁸

By using these alternatives, the Ming Zheng in Formosa also enlarged the Formosa trade networks in the late 17th century. The trade connections with Japan had for decades been dominated by Zheng's family. According to the historical records, after Zheng's family left Amoy, the number of Chinese trade junks operating from the mainland to Japan was sharply reduced. By contrast, the number of Chinese junks coming from Formosa and South East Asia increased. This trade route with Japan, again, was almost monopolised by Zheng's family during the period. In addition to the northern routes, the Ming Zheng also extended the trade networks to the south, in particular to Manila. In the late 1660s the Spanish governor in Manila sent envoys to Formosa in order to discuss trade between his people and Formosa. In the 1670s many Formosan junks and Chinese junks (from Fujian and Guangdong) traded in Manila. The extension of the Manila trade networks created another source for Chinese products.¹⁵⁹ The prosperous trade with different countries in the region demonstrates that Taiwan was at the time very open to this activity because the political power of Ming Zheng required support from trade.

Guangdong, Fujian and even Shandong, which is in the northern coastal area). The evacuation of the residents also implied the loss of Qing's control of the sea trade during the Ming Zheng period. Hence Koxinga and his people continued to dominate the seas as they had before. Bureau of Economic Research, Bank of Taiwan, ed., *Taiwan tongzhi* (Taipei, 1962).

¹⁵⁸ Cao, Yonghe, "Yingguo dongyingdu gongsi yu taiwan zhengshi zhengquan," in *Zhongguo haiyan fazhanshi lunwenji*, ed., Zhang, Xianya. (Taipei, 1997), pp.389-405.

¹⁵⁹ Cao, Yonghe, 'Taiwan as a Centre of East Maritime Traffic in the Seventeenth Century', *Itinerario*, vol.XXI, no. 3 (1997), pp.94-114.

4-4. *The Impact of the Qing Policy on Taiwanese Trade and Business Society, 1684-1985*

In 1684 the Qing Empire absorbed Formosa into its territory, although the imperial court was not interested in running the island.¹⁶⁰ Its political purpose was uppermost. In the early Qing period, the imperial court forbade immigration to Taiwan and also blocked the coastal areas to sea traffic and sea trade. Therefore, trade in Taiwan shrank at this period because of the restrictions on immigration, traffic and trade across the strait. In the late 18th century, more Han Chinese emigrate to Taiwan because of the imperial court's relaxation of the sea bans. These immigrants (Hoklo people) came mainly from the province of Fujian, but some came from the border of Fujian and Guangdong (Hakka people). With the increase of population in Taiwan, the need arose for a number of products. Since Taiwan was still an immigrant society, most of the labour force was still engaged in the cultivation of rice and sugar, with little development of handicrafts. Therefore, the Taiwanese economy looked to China for such things.¹⁶¹

The products exported from Taiwan during the mid-Qing period were mainly rice and sugar. These were first exported to Fujian and then transported to the central or northern provinces (in particular Shanghai and Tianjin) where they were in demand.¹⁶² The need for rice and sugar in these places resulted from an increase in the Chinese population and the incidence of famines in the 18th century.¹⁶³ In these conditions, cross-strait trade prospered in the mid Qing period. Yet, unlike the Dutch and the Ming Zheng periods, this time Taiwan's only trading partner was Mainland China. Before 1860 (the year when the European powers forced the Qing imperial

¹⁶⁰ This was the first time since the 2nd century (when Taiwan first appeared in Chinese history) that political power in the hands of Mainland Chinese (more specifically, it was now Manchurian political power) actually dominated Taiwan. Even during the Ming dynasty, the Ming imperial court did not recognise Formosa as part of its territory. This may explain why the Fujian officials suggested that the Dutch should go to Formosa instead of staying on Penghu Island. Moreover, according to the Spanish missionary's written reports, Formosa was not part of Ming China. Chen, Q. N., *op.cit.*, p. 11-16.

¹⁶¹ In 1683 the Qing imperial court took over Taiwan; however, the Kanxi emperor originally did not include Taiwan in the Qing Empire. In 1684 the General Shi Lang (who defeated Zheng's forces in Taiwan), strongly recommended that the Kanxi emperor should take Taiwan into Qing territory in order to secure the safety of the South China coastal areas (Guangdong, Fujian, Jiangsu and Zhejiang provinces). For further details, see Teng, Emma Jinhua, *Taiwan's Imagined Geography: Chinese Colonial Travel Writing and Pictures, 1683-1895* (Cambridge, MA, 2004).

¹⁶² Bureau of Economic Research, Bank of Taiwan ed., *Taiwan chaishi lu* (Taipei, 1967).

¹⁶³ There were famines in Sichuan in 1778 and in Shandong in 1786. For further details, see Zhao, Erxun ed, *Qingshi gao*, (Beijing, 1977).

court to open trade ports), the export market of Taiwan had dwindled to the Chinese market alone.¹⁶⁴

The re-emergence of trade across the strait was founded on the supply and demand of the Chinese and Taiwanese markets. Taiwanese guilds (which were called 'Jiao Shang') were formed to meet the needs of both the Taiwanese and the Chinese markets. Jiao Shang was groups of people who operated cross-strait business. Both the social structure and religion influenced the structure of the Taiwanese Jiao Shang. The social structure was based upon kinship groups. In the mid-18th century, the two largest immigrant communities in Taiwan were from Quanzhou and Zhangzhou (both located in Fujian province).¹⁶⁵ Within these two communities, different clans were identified by their surnames. The places from which they had come and their surnames formed the first classification of the Taiwanese Jiao Shang. In addition to their places of origin and their kinship groups, various lines of business categorised the different guilds. What is interesting is that the guilds usually set up their head offices in the temples. They were usually headed by the chief celebrants at religious ceremonies.¹⁶⁶

The Taiwanese guilds at this time had several functions. As mentioned above, the Qing imperial court did not have an established local government in Taiwan. The guilds managed the market and dealt with security by themselves. Most of the guilds monopolised the lines of business they were in. The monopolisation let them manipulate market prices. Moreover, these guilds cooperated to set up standard weights and measures for their lines of business. In this way they tried to facilitate

¹⁶⁴ In 1757 the Qing imperial court further limited one of the trading ports for foreign trade.

¹⁶⁵ The Quanzhou and Zhangzhou immigrants fought each other with weapons after the Qing imperial court permitted immigration to Taiwan in the mid-18th century. The disputes were caused by the seizure of land and of irrigation sources. The conflict was severe and lasted for more than 100 years (from 1751 to 1865). In modern Taiwanese society the impacts of the conflict are still perceptible. Certain families do not allow intermarriage with certain others with particular surnames. This type of taboo is related to the conflict in the 18th and 19th centuries. People believed that intermarriage with the enemies would bring misfortune for the whole family. Lin, Wenshang, *Qingdai taiwan shehui yu fenlai xiedo* (Taipei, 1993); Wong, Jiaying, 'Dongluan yu jiego: cong fenlai xiedo tanchi', *Zhongguo luntan*, vol.31, no.11(1991), pp.54-56; Xu, Wenxiong, 'Xiedo yu qingchao taiwan shehui', *Taiwan: a Radical Quarterly in Social Studies*, vol.23 (1996), pp.1-75.

¹⁶⁶ The combination of business and religion was related to the type of business. Most of these guilds were occupied in sea trading (trading between China and Taiwan). The sea trade itself was risky, since it was not possible for the merchants to master the weather and sea conditions without advanced technology. The Taiwan Strait was named the 'black trench' in ancient times, which implied that many immigrants lost their lives before reaching Taiwan. Therefore, because of the risks of doing business on the Strait, these merchants looked for religious protection. Most of the old Taiwanese temples are dedicated to sea gods and goddesses (who originated from Fujian province, since most of the Fujian people made their living at sea). The setting up of the guilds' head offices in the temples suggests that the guild members prayed to the gods and goddesses for protection against marine hazards.

business transactions in the Taiwanese market. The guilds also established their own board of arbitration. The board was responsible for dealing with business disputes and had the right to decide and enforce punishments.¹⁶⁷ Finally, the guilds were also the channel of communication with the local government.¹⁶⁸ During the mid-Qing dynasty, trade across the strait was operated on the basis of the Jiao Shang system and the needs of the Taiwan-China markets. In the late Qing dynasty, foreign forces impelled the changes in Taiwan's trading and business society.

In 1860, the Qing imperial court was forced to open trading ports in Taiwan. Between 1860 and 1863 Tamshui, Takao (Kaohsiung), Keelung and Anping (Tainan) became international trading ports. Foreigners and foreign companies were now allowed to invest and trade freely in Taiwan.¹⁶⁹ These changes in international relations brought Taiwan back into the world trade system. According to Ling's research, the policy of opening ports transformed the rice-sugar economy into a tea, sugar and camphor economy.¹⁷⁰ This transformation was, as Lin argues, market-oriented. The market was no longer limited to China; the transformation was affected by the needs of an international market.

Although Lin's research clarifies the changes to the Taiwanese economy, it did not highlight the continuity of social dynamics which competed with the foreign forces in the Chinese market or the foreign market, either. The dynamics of social institutions persisted up to the late 19th century when the local Taiwanese traders competed with the foreign companies. The competition in the open market reveals two significant strengths of the social dynamics.

There is clear evidence of the strength of the business connection shown by the sugar industry in the late 19th century. Foreigners could not enter the sugar market in China, since the Taiwanese Jiao Shang dominated the market for decades with strong business networks. The other clear evidence is the dynamics of financial sources which can be found from the investment of these Taiwanese merchants and compradors in the tea trade in the late 19th century. The money which the foreign

¹⁶⁷ For further details, see Zhuo, Kehua, *Qingdai taiwan de shanzhan jituan* (Taipei, 1990).

¹⁶⁸ The local government in Taiwan before 1885 did not support these guilds very well. On the one hand, the local officials were junior officials and could not make any significant changes. On the other hand, the imperial court did not pay attention to the development of Taiwan.

¹⁶⁹ The Qing Imperial Court was forced to open Taiwanese ports for international trade under the Treaty of Tianjin which was signed in 1859 because the Qing was defeated in the Second Opium War (1856-1860) by the Western powers.

¹⁷⁰ For further details, see Lin, Man-houng, *Tea, Sugar Camphor and the Social Economic Transformation in Taiwan 1860-1895*, (Taipei, 1997), pp.19-104.

companies loaned tea producers came from their banks in China. The Amoy merchants, local guilds and local compradors had sufficient capital in hand. According to the sources, most tea production loans did not come from banks but from the purchasers of the products.¹⁷¹ This implies that the local guilds and compradors dominated the source and process of production and marketing.¹⁷²

Indeed, the evidence of the tea and sugar industries implies that both financial capital and business connections were to the advantage of these traditional Chinese/Taiwanese businessmen in their competition with the foreign banks and enterprises. This competition was, as Lin points out, affected by the demand-supply of different markets. What was more important was their business connections with the market. This, for the case of the Chinese and Taiwanese merchants, was related to the social dynamics which supported them and let them prevail in international trade.

In addition to the changes of the trade market induced by the foreign forces, these changes also led to the rise of new types of merchant who were rivals of the Taiwanese Jiao Shang. The foreign merchants began new business in Taiwan and planned to compete with the Chinese and local Taiwanese merchants in the sugar and camphor trade. Their competitors included the local guilds and the Taiwanese compradors whom they hired. These Taiwanese compradors first worked for the foreign companies, charged with finding the sources for products, then purchasing them and arranging for their transportation. Once the compradors had made a certain amount of money they started their own business. Since they were familiar with the whole process, it was easy for them to run businesses of their own. These compradors then became the main competitors for the local guilds.¹⁷³ The rise of the new compradors shows the significant impact of an open market on social changes. Before trade was opened to foreigners, the market was dominated by Jiao Shang. When trade opens, more participants were allowed to participate in the market.

¹⁷¹ *Ibid.*, pp.144-145.

¹⁷² *Ibid.*, pp.105-145.

¹⁷³ *Ibid.*, pp.117-119.

4-5. *The Impact of the Japanese Colonial Policy on Taiwan's Trading and Business Society*

The Japanese empire created several new market and trade systems in Taiwan in order to assist Japanese industrialisation and establish the market for the resulting industrial products. Under these established institutions, Taiwan, as Lin argues, was modernised under Japan's colonial development policies. One of these policies aimed at reducing the amount of Chinese capital in Taiwan, because it derived from the cross-strait business connections in the Qing dynasty. The tea and sugar industry in Taiwan was dominated by Taiwanese Jiao Shang, whose financial capital depended on business connections from Amoy or Fujian. The Japanese colonial government tried to dominate primary industry in Taiwan, the sugar industry in particular, in order to import capital from the Japanese Zaibatsu. Under this policy, the level Chinese capital in the Taiwanese market gradually declined and was replaced by capital from the Japanese Zaibatsu. Another factor affecting the decline of Chinese capital in Taiwan was related to the collapse of the Chinese guilds in the early 20th century.¹⁷⁴

Despite this action by the Japanese government, considerable Taiwanese investment in China began in the early 20th century. The largest amount of Taiwanese investment was focused on Fujian province. These investments were made in several industries. Moreover, close trade between Taiwan and Japan showed that the Taiwanese businessmen operated well despite the sensitive relations between China and Japan in the 1920s and 1930s. Lin's research clearly indicates that cross-strait trade did not decline under the colonial regime; on the contrary, trade across the strait showed only changes of comparative advantage between Taiwan and China and the transformation of the Taiwanese economy during the colonial period.

However, one question may be asked about the economic transformation. If the main financial sources for the Taiwanese businessmen were cut off, what were the other financial sources that supported their investment and trade in Fujian in the early twentieth century? When the colonial government cut off Chinese capital, it established several modern financial institutions in Taiwan. However, the modern banks only did business with privileged Taiwanese businessmen and the Japanese enterprises. Although the Japanese colonial government did not provide significant financial support for the Taiwanese investors, Lin's research explained it by insisting

¹⁷⁴ Zhu, Delan, "Riju shichi chanqi Taipei maoyi: yi chanq huashan taiyi hao yu san jia taishan weili," *Zhongguo haiyang fazhan shi lunwen ji*, vol.4, (Taipei, 1991), pp.115-157.

that the Taiwanese businessmen had collected sufficient funds from international trade since 1860.

More clear evidence can be found from the early years when the Japanese colonial government allowed the Taiwanese to choose whether to stay in Taiwan. Before the enforcement of the citizenship policy, the colonial government allowed two years for the Taiwanese to choose to remain there or else move back to China. After two years, most of the Taiwanese moved back to China. The first factor affecting the Taiwanese who moved back was the difficulty of integrating and adaptation in Fujian. Archival evidence shows that some of the Taiwanese merchants were not familiar with their original homes. Although they had Fujian business partners and no problems with the language, it was still difficult for them to integrate in the local society.

The evidence can be found from the family letters of Taiwanese merchants which shows their wish for Taiwanese food (such as pickled cucumbers or other dried and preserved food) and their prayers for the local temple in Taiwan (instead of Fujian temples). The second factor was related to the location of their significant assets. The property and money capital of these Taiwanese guilds was in Taiwan, rather than in China. What they possessed in China were some business branches. Their business letters confirm that the Taiwanese businessmen possessed sufficient funds during this period. Yet Lin's research does not clarify the dynamics of the financial sources from the social institution. The financial capital which enabled the Taiwanese to invest and trade in Fujian was not dominated by individual families; some of the investment was in heavy and capital intensive industries which required large amounts of financial capital.¹⁷⁵

Not until 1920s did the local Taiwanese big families set up their own modern banks. The shareholders of these banks had in common strong kinship relations. These banks supported and made possible large amounts of investment in China. Before the set up of local Taiwanese banks which were operated and owned by the local Taiwanese, the common Taiwanese businessmen relied heavily on the credit cooperative associations. Until the colonial government institutionalised the credit cooperative associations, similar types of credit union existed in Taiwan. The associations were informal financial organisations operated by their own members,

¹⁷⁵ Lin, Yuru and Lui, Xufeng, eds., *Lugang jiao shang hsu zhihu yu dalu de maoyi wenhsu 1895-1897* (Taipei, 2006).

who usually came from similar industries, such as agriculture or fishing. These members saved their money in the organisations and the elected members used the savings to make loans to other members. The interest earned by the organisations was shared every year among the members.

In 1913 the colonial government issued the regulations of an Industrial Corporation, which aimed to formalise credit cooperative associations and to encourage business development in Taiwan. The credit cooperative associations did not prosper until World War II. Before and after the institutionalisation of the credit cooperative associations, the characteristics of the associations were similar. They were characterised by particular industries and geographical locations. These characteristics were similar to those of the Jiao Shang and the business groups in the late 19th century in Taiwan.

The local Taiwanese banks, the credit cooperative associations and Taiwanese investment in China imply that, although the Japanese government set up formal institutions, such as the market and the financial system, to develop the Taiwanese economy, the social dynamics still played a significant role in facilitating and supporting business development in Taiwan and business transactions across the strait. Without the supply of financial capital from the social institutions, the development of business in Taiwan and business across the strait could have suffered.

4-6. Conclusion

The tributary system is usually ignored when analysing Taiwanese economic history in the early period. Based upon the tributary system and its pattern and rules, this chapter clarifies that Taiwan's political status was uncertain. This was important since the beginning of trade across the strait was affected significantly by the tributary system even though it was founded on the demand-supply of the market. In other words, the emergence of Taiwan as a trading base for the pirates and the Dutch was thanks to its exclusion from the tributary trade system. The exclusion from the tributary system implies that there was no solid and integrated political power dominating Taiwan and paying tribute to the Chinese empire in exchange for permission to trade.

There is absence of evidence showing whether the aboriginal kingdom of Taiwan paid tribute to the Chinese Empires. The uncertain political status also demonstrates another significant factor in the rise of Taiwanese trade in the region.

Since there was no integrated political power to manage trade, Taiwan was open for trade. Therefore, the factors inducing the rise of Taiwan in trade were its geographical location, unclear political status and free trade.

Another factor is the role of Chinese pirates/business connections. The Portuguese, Spaniards and the Dutch were able to operate the business because the Chinese pirates and merchants traded with them instead of through the formal tributary trade system. This implies that under the impact of the existing institutional framework (the tributary system), the crucial dynamic which supported and facilitated illegal trade across the strait was the Chinese pirates/merchants business connections. Under the control of the Ming Zheng in Taiwan, international trade in Taiwan prospered. This was related to the Ming Zheng's need for the profits and supplies from trading to support its army and its resistance to the Qing imperial court. The success of Zheng's family relied on the structure of the old-pirate organisation, free trade, their familiarity with sea trading and with foreign merchants. Therefore, the closing of the Chinese coastal area did not damage Zheng's trade. On the contrary, the loss of the Chinese coastal market provided Zheng with a new opportunity to enlarge the profits from the sea trade. Given the economic interest and political concerns, trade played a significant role in supporting the subsistence of the Ming Zheng.

According to the analysis of trade history from the 16th century to the 17th century, the rise of pirates' trading and the Dutch participation in the regional trade system brought Taiwan into the regional trade system. Trade further prospered when the Ming Zheng dominated Taiwan. One important similarity can be found shared by the trade and business of the pirates, the Dutch and the Ming Zheng. Under the constraints of the tributary system, it is essential to enlarge business connections in order to increase trade opportunities and profits. Therefore, during the early period, Taiwan was very open for trade. This is also related to the fact that there was in the early period no strong political power to integrate and take charge of trade in the local Taiwanese society.

It is also worth noting that the people who operated business in Taiwan did not comply with the formal institutional rules. On the contrary, under the influence of the system, their business was supported and facilitated by the social dynamics through business networks. The success of the Dutch business and the success of Konxinga's trade in Taiwan both relied on Zheng Zhi-Long's business connections. This explains how these political regimes were able to continue to trade when they were prohibited

from trading with China. The key point is that if they had not been able to acquire valuable Chinese luxuries by trading with China, the operation of their business could not have been profitable because of the demand and supply in the regional market. Moreover, it is worth noting that these significant business connections were founded on social institutions which were characterised by close geographical and kinship relations in the earlier period of the Fujian sea merchant groups and the pirate groups.

There were three developmental stages for Taiwanese trade during the Qing dynasty. The Taiwan market stagnated in the early Qing period because of political concerns. The changes of policy in the mid-Qing era revived the market. The policy increased the population, induced the market and formed the South-China type guilds in Taiwan. The Taiwanese/Fujian guilds played a significant role in the Taiwanese economy and trade with China. It established a system which operated business in different industries; this system included weights and measures for business transactions, price controls in the market, transportation and dispute settlement. Yet the trading partnerships during this period were limited to China.

The joining of foreign forces in the Taiwanese market in the late Qing period not only induced a market transformation, but also restored the open trade system in Taiwan. The transformation and the links with the world trade market also created new groups of Taiwanese compradors. The rise of new compradors in Taiwan also indicates that more open trade allows new participants in the market. It is worth noting here that the power of the Chinese/Taiwanese guilds and compradors was greater than the power of these foreign companies. This also shows that more open trade did not necessarily weaken the competitiveness of the traditional business groups.

Another important dynamics to identify from the Qing period was the bans and the opening up of trade. In the early period when the Qing imperial court prohibited emigration to Taiwan, the market was closed and trade shrank. In the mid-Qing period when the Qing imperial court once more allowed immigrants to Taiwan, trade increased and the local market gradually developed. In the late Qing period when the Qing imperial court was forced to open the ports for foreign trade, business prospered. This shows that the state had a significant impact on the opening of the market and trade. The more Taiwan opened for trade, the more the Taiwanese economy prospered.

During the Japanese colonial period, trade continued despite the hatred between China and Japan. Although the Japanese colonial government constrained the level of Chinese capital in Taiwan, in terms of Taiwanese trade with China and other countries in the region, the colonial government was prepared to open up trade channels and Taiwanese outward investment. Although there was no specific policy to encourage or support Taiwanese investment in China, a large amount of investment went to Fujian. This implies that the dynamics of the open market facilitated investment and trade across the strait.

Although cross-strait trade prospered and the largest proportion of Taiwanese investment went to Fujian, some significant social transformation occurred. The business connections between Taiwan and China became more business-oriented: on the one hand, intensive kinship relations between Taiwan and China diminished after generations. On the other, after generations and the development of Taiwanese market, some valuable assets remained in Taiwan rather than in China. The accumulation of capital strengthened the trade power of the local Taiwanese business groups over time. These local business groups showed that the social institutions played a significant role in collecting financial capital to support and facilitate business for these Taiwanese businessmen. This evidence also indicates that the formation of Taiwanese local society strengthened. Although the kinship relations between Taiwan and China diminished, some Chinese social characteristics continued to support business in Taiwanese society. These characteristics can be surmised from the financial sources for business operations in society during the colonial period. The transformation of import-export of financial capital which they indicate not only changed the trade relations and economic structure, but also Taiwan-China social relations.

The Qing government, as compared with the Japanese colonial government, was reluctant to encourage economic development in Taiwan. Although it can be blamed for the lack of formal institutions, the market, trade and strong business groups were founded during the Qing dynasty. In contrast, the efficient Japanese colonial government can be credited with establishing some institutions in Taiwan which enabled the Taiwanese to invest in China. The comparison of the actions of the governments in the Qing dynasty and the colonial period shows that whether the governments were efficient or inefficient at setting up institutions to benefit business operation, trade prospered as long as Taiwan was open for trade. It indicates that

government played a significant role in opening or prohibiting markets and trading. The more Taiwan was open for trade, the better Taiwan's economy fared. The comparison also demonstrates that the social dynamics supported businessmen by facilitating their investment and trade, whether the formal institutions were underdeveloped or well-established, as long as the state did not block trading.

The historical pattern shows that the significant impact of the state on the Taiwanese economy lay in its power to open up or clamp down on trade. Despite the restrictions or the arrangements of the formal institutions, as long as the demand and supply of the market existed and Taiwan was open for trade, the business groups in Taiwan could rely on the social dynamics (mainly the business networks) to support and facilitate their business within the grey areas created by the formal institutions. Furthermore, the history also shows that the foreign forces and the changes in China significantly affected the market and the trade environment in Taiwan. Regardless of the intended or unintended consequences created by the government policies, the social dynamics continued to support and facilitate business transactions in different ways with the changing environment. Finally, the changes in the Japanese colonial period clearly indicated that solid social institutions had been established in local Taiwanese society.

Part III. Where Did the Support Come From? The Rise and Development of Manufacturing SMEs, 1950-1980

The relaxations on the control of imported materials, the foreign exchange system and the export-oriented industrialisation policy of encouraging exports have always been considered significant in speeding up Taiwan's economic growth. The beginning of the EOI policy and other later policies in the 1970s and 1980s are usually considered successful government interventions in the process of development. The government support and guidance to the development of private enterprises (including LEs and SMEs) are regarded as the key to economic growth. In terms of the development policies for assisting SMEs, most of the existing literature highlights the indirect impact of these successful policies on the founding and development of the SMEs. Did these direct or indirect supports based upon the state's development policies encourage the foundation of the SMEs and facilitate SME business transactions? What was the state's interest in implementing these development policies? If the state's interest was not in developing the SMEs, to what extent did these policies provide support for them? If the government support to the SMEs was limited, what played a greater part in supporting the founding and business transactions of the SMEs? Finally, in what circumstances did this other support emerge?

Chapter 5. The Role of the State in the Rise of SMEs, 1950-1970

The authoritarian system was considered significant in making Taiwan's post-war economic development possible. The argument mainly focuses on the power of the government to control the institutions and to implement development policy efficiently. Since the government dominated both political and economic power in Taiwan, its development policies played an important role in inducing the rise and the development of the SMEs. Taiwan's export-oriented industrialisation policies, including the EOI policy, have always been considered significant in leading the successful growth of the exporting SMEs. In terms of the specific government support to the SMEs, most of the existing literature highlights the indirect impact of these successful policies on the foundation and development of SMEs.

Instead of examining how powerful the state was at dominating and controlling the institutions in line with its development plans, this chapter looks at the way in which the state's interest influenced the formation of the development policy and how far these development policies supported (both directly and indirectly) the rise and the development of the SMEs from 1950 to 1970. It begins with an analysis of the political power structure in order to explore the state's interest from the perspective of political power. Although the KMT government was able to avoid disruptions from local Taiwanese interest groups, the party itself contained several different interest groups. The interests of these internal groups influenced the nature of the development policy.

The second section sub-divides to focus on an analysis of the policies and the impact of these policies on the SMEs. The development policies are divided into two categories. Before the mid-1960s there were no specific regulations aimed at supporting the SMEs. The first category of the development policies comprises general development policies, which do not specifically aim at supporting the SMEs. However, the second category consists of the policies which particularly focus on assisting the SMEs' development. The first period begins with the government's policy change from ISI to EOI. Some economic difficulties occurred in the mid-1950s which forced the government to adjust the ISI policy. The first sub-section discusses the economic problems and examines how the government's changing attitudes towards them influenced the later development policies and the rise of the SMEs. In 1959 the government launched a series of new policies in order to change the direction of economic development. This second sub-section examines the impact of

the second period of policy changes. In the first two periods of policy change, most of the disputes regarding government development policy mainly focused on encouraging the development of the private enterprises, the liberalisation of foreign trade and encouragement for foreign direct investment in Taiwan. These policies are usually considered a significant indirect influence on the rise of SMEs in the 1970s and the 1980s. Therefore, the first two periods examine the extent to which these general policies contribute to the rise of the SMEs.

The third sub-section then focuses on the specific programmes, policies and government organisations assisting the development of the SMEs. The government's assistance was given in several ways; the examination of this period focuses particularly on tax exemption, export promotion and financial assistance from the state. Finally, the chapter explores the way in which the state's interest influenced the formation of the development policies; this explains why the development policies with an indirect or direct influence on the rise of SMEs were to some degree limited. Moreover, the analysis and evidence also demonstrate that the significant impact of the state policies on the development of the SMEs lay in its power to open or restrict the market. Yet the market which the government controlled and created did not provide important financial support to the SMEs in their business operations.

5-1. The Rise of Chiang Kai-shek and the Construction of the Party-state Institution

The period of strong influence from the KMT's political power on Taiwan began in 1949, when Chiang Kai-shek was defeated by Mao. The foundation of Chiang's power within the KMT was considered significant since the model of his power structure persisted in Taiwan until 1975. Regarding the rise of Chiang Kai-shek, one must look at the political situation several years before and after the death of Dr. Sun Yat-sen. According to the Cambridge History of China, the KMT in 1923 was not a well-organised political party. Apart from its headquarters established in Guangzhou, there was only one branch in Shanghai. The number of KMT members was not clear. The historical sources point out two difficulties for Dr. Sun in establishing a well-organised and powerful party. First, the KMT lacked stable financial sources with which to run. Second and in consequence, it could not build up a powerful army. Finance and the army were two significant pillars for maintaining political power in China in the 1920s. For one thing, different warlords were

dominating the Chinese regions. Without powerful military support, the KMT could easily have lost its political power in South China (mainly in Guangdong).¹⁷⁶

In 1924 Sun published new party regulations to set up the power centre of the KMT, namely, the Central Committee. The core of the Central Committee was the Political Committee. Moreover, the KMT set up in 1924 a military school, Whampoa Military Academy, to train its own army. After setting up these bodies, the regulations also reformed the management of the military and finance. After Sun's death in 1925, Chiang Kai-shek was not assigned a place in the Political Committee. He was merely a member of the Military Committee and the Principal of the Military Academy. In 1926, when the political committee appointed Chiang Kai-shek as commander for the Northern War, the rise of Chiang in the KMT began.¹⁷⁷

Since the control of the military was the most significant element in gaining political power, Chiang Kai-shek had an advantage, as the principal of Whampoa and the commander for the North War. For the duration of this war, Chiang Kai-shek dominated Shanghai, because it yielded greater tax revenue to support his army.¹⁷⁸ In 1927, he married Soong May-Ling whose family was influential in business and finance dealings in Shanghai. This marriage brought Chiang Kai-shek stronger financial support and also initiated his relationship with the U.S. government.¹⁷⁹

In addition to these external relations, Chiang Kai-shek established several groups to support his own power within the KMT. The first group considered significant for Chiang Kai-shek's rise in KMT was the Whampoa clique. His political power was thus founded on his military power. The second group was the 'C.C. clique' which was named after two significant members of the KMT: Chen Kuo-fu and Chen Li-fu. The Chen brothers organised the KMT, dominating the party and established significant financial foundations for KMT to operate. The cooperation of Chen's brothers and Chiang Kai-shek was founded on the need to have military power and control over the party. The third group was the elite. They had no power over the

¹⁷⁶ Wilbur, Martin C., "The Nationalist Revolution: from Canton to Nanking, 1923-28," in *Cambridge History of China*, ed. Fairbank, John K. (Cambridge 1983), p. 527-721.

¹⁷⁷ *Ibid.*, pp.620-621.

¹⁷⁸ Eastman, Lloyd E., "Nationalist China during the Nanking decade, 1927-1937," in *Cambridge History of China*, eds. Fairbank, John K. and Feuerwerker, Albert, (Cambridge, 1986), pp.116-167.

¹⁷⁹ Soong May-Ling's wealthy family in Shanghai educated her in the U.S.. Her U.S. educational background connected the KMT with the U.S. government and parliament. She was named the mother of the air force of the Republic of China because of her contribution to the modernisation of this service. Moreover, in 1935 the Republic of China became the largest country to import U.S. weaponry and military planes. With the help of Madame Soong, Chiang Kai-Shek not only obtained support from Chinese capitalists, but also significant supports from the U.S. See further Wilbur, M., *op.cit.*, p.683.

KMT and had no close relations with the Whampoa and C.C. cliques; but they worked in the administrative systems. Chiang Kai-shek's political power within the KMT was founded on and supported by these three main cliques.¹⁸⁰

With the help of different groups, Chiang Kai-shek's power within KMT was consolidated. In 1928 China was united and the Nationalist government was established in Nanking. The infrastructure of the nationalist government in Nanking was the foundation of the KMT government in Taiwan after 1949. The party-state institution was significantly affected by Sun's idea of establishing a new China. According to the *Fundamentals of National Construction* written by Dr. Sun Yat-sen, China had to be led to a democratic and constitutional nation in three stages. The first would involve military rule. This stage (from 1926 to 1928) aimed at unifying China despite the warlords dominating different regions of the country. The second stage would be political tutelage. During this period, the KMT would have to lead and guide the people to practise using political power and participating in democratic politics. The final stage would be constitutional government. The construction of a new China relied on the leadership of the KMT.¹⁸¹

When the Nationalist government was set up in Nanking, it was the second stage of the National Construction. During this period, five principles were employed in the running of the country. First, the KMT national representatives stood for the national assembly and led people to practise using political power. Second, the national assembly asked the KMT Central Committee to exercise administrative power in China. Third, the administrative organisation was under the control of the nationalist government. Fourth, the KMT Central Political Committee supervised the nationalist government. Fifth, the KMT Central political Committee was responsible for legislation. Finally, the aim in this period was to train people to practise political power. According to these five principles, the administrative system was supervised by the party and the parliament was dominated by party members. To sum up, these principles constructed the foundation of the KMT as a party-state institution.¹⁸²

¹⁸⁰ Eastman, L., *op.cit.*, pp.161-165; Wang, Weili, *Chiang Kai-Shek's wenchen wujiang* (Henan, 1987); Wang, Fong, *Wozai Chiang Kai-Shek fuzi shenbian de rizi* (Beijing, 2003) ,pp.97-102; Yang, Zhesheng, *Guoyintang jiaofu Chen Guo Fu* (Shanghai, 2010); Chen, Lifu, *Chengbai zhijian: Chen Lifu Huiyilu* (Taipei, 1994).

¹⁸¹ Zhongguo guomindang dangshi weiyuanhui, ed., "Guomin zhengfu jianguo dagang," in *Teachings left by Sun Yat-sen* (Taipei, 1988).

¹⁸² Wu, Jingxiong, *Zhonghua minguo xunzhen shiqi yuefa shiyi* (Nanjing, 1927).

Some findings can be drawn from this history. First, the rise of Chiang Kai-shek was related to the support of various interest groups as head of the army. These interest groups cooperated with Chiang Kai-shek and gave him their loyalty because he satisfied different interests. Second, the party-state institution was the product of China's particular situation. It integrated the state with the party. Since the party was dominated by the small circle of people (such as Chiang Kai-shek and the C.C. clique), it was this small group of people that dominated the country. These factors made dictatorship the characteristic of the KMT. Third, although Chiang Kai-shek was the leader within the KMT, without the supports of these groups, Chiang Kai-shek's political power would have been unstable.

5-2. Chiang Kai-shek and the KMT in Taiwan, 1949-1975

When the KMT came to Taiwan in 1949, some party members asked for the re-organisation of the party because of its defeat in China by the Chinese Communist forces. The reorganisation of the party excluded from its power centre its main members from the C.C. clique. According to the membership list of the Central Committee in 1952, the Whampoa clique controlled seven seats out of thirty-two. The elites from different fields controlled thirteen.¹⁸³ The list of committee members implies that the Whampoa clique and the Political Study clique dominated the centre of the KMT. This was not only related to the internal power struggle within the KMT, but also reflects the need for the KMT to restore its reputation and to control Taiwan. Thus, in the early period, the military and elites who operated the administrative system were considered crucial.

The government structure in Taiwan was almost the same as that of the KMT government in Nanking.¹⁸⁴ However, the clear separation of political power and governance and the well-organised administrative system did not function as a democratic system in Taiwan before the 1990s. On the one hand, the KMT in Taiwan still maintained the period of political tutelage. In other words, the administrative system was in the charge of the KMT Central Committee. Its operation and supervision were controlled by the party. On the other hand, since the KMT dominated the government system, some special regulations restricted or excluded

¹⁸³ Appendix 5-1.

¹⁸⁴ Appendix 5-2.

political power from the people. Two significant regulations ensured the KMT's sovereignty in Taiwan.

As a result of the Chinese Civil War in 1945, the KMT enforced the Temporary Provisions Effective during the Period of National Mobilisation for Suppression of the Communist Rebellion in Nanjing (10 May, 1948). The aim of the provision was to extend the powers of the President (vice president) to deal with emergencies, such as wars and economic crises, by simplifying the administrative procedures of the Constitutions.¹⁸⁵ In addition, the Temporary Provisions have been considered significant in strengthening the KMT's domination, for Chiang Kai-shek in particular. The provision allowed the President (vice president) of the Republic of China to be exempted from the two-term limit. Chiang had five times been re-elected President by the National Assembly between 1948 and 1975. In addition to the presidential terms, the general elections for the National Assembly were suspended. In 1951, the Judicial Yuan decided to defer the parliamentary election since Taiwan and China were still in a state of war; it then announced that the elected members could remain in office until an election could be held on the mainland.¹⁸⁶ In other words, the representatives of the National Assembly remained in power from 1948 to 1991.

There were two significant impacts of the Temporary Provisions on Taiwan's politics. On the one hand, the suspension of general and parliamentary elections ensured Chiang Kai-shek's political power in both the KMT and the government. On the other, the suspension of general and parliamentary elections maintained the KMT's political power in Taiwan. In terms of population structure, the KMT and the mainlanders who came to Taiwan after 1949 (called 'Waisheng ren') formed only 13% of Taiwanese population. The Hoklo and Hakka people (called Bensheng ren) provided 85%. The KMT's concern to suspend elections was also related to the ethnic conflicts between the Waisheng ren and the Bensheng ren in 1947.

¹⁸⁵ Laws and Regulations Database of the Republic of China, Temporary Provisions Effective during the Period of National Mobilisation for Suppression of the Communist Rebellion, <http://law.moj.gov.tw/LawClass/LawContent.aspx?PCODE=A0000005>. (accessed 20 March 2011).

¹⁸⁶ Directorate-General of Budget, Accounting and Statistics, Executive Yuan R.O.C. (Taiwan), *Statistical Yearbook of Republic of China*, (Taipei, 1991), pp.2-5.

The ethnic problem came to a head in the 2/28 Incident in 1947.¹⁸⁷ This incident, in the conditions of civil war, was seen as a riot. The Taiwanese provincial governor, Chen Cheng, enforced martial law (19 May, 1949) in order to quell the anti-government rising. During periods of martial law, people were not allowed to form associations or political parties, publications were supervised by the police and military organisations; and citizens who broke the law were brought to trial under military law rather than under civil criminal law. The strict control under martial law constrained people's freedom, in particular freedom of speech and freedom to participate in political activity. Not until 1987 did President Chiang Ching-Kuo lift martial law.¹⁸⁸ Under the Temporary Provisions and martial law, the Waisheng ren dominated Taiwan's politics until political reform in the 1970s.

In addition to the control of the party, politics and military, the KMT was considered successful in running party-state enterprises. The monopolising of party-state enterprises aimed at supporting the KMT's political power. Indeed, the construction of investment relations for state enterprises and party enterprises had already begun in China by 1947.¹⁸⁹ The party and these large state enterprises set up joint ventures, which are now recognised as a cover for party-owned enterprises. Because of their links with the party, these joint ventures usually undertook the contracts from the state enterprises and most of their profits went to the party. Critics of the party point out that when the KMT took over property and capital from the Japanese colonial government, a considerable amount of land, property, capital and other enterprises came to be run by the party but not the government.¹⁹⁰

¹⁸⁷ Several factors caused the 2/28 Incidence, such as economic problems (severe inflation in 1947) and the government's monopoly of tobacco, wine and other commodities. The ethnic conflicts began with the 2/28 Incidence when waisheng ren police officials shot a female vendor for selling cigarettes illegally. The Bensheng ren gathered on the street in protest. The highest official in Taiwan at that time shot and arrested people in the demonstration. This was also the start of the 'white terror' in the 1950s and 1960s.

¹⁸⁸ Laws and Regulations Database of National Defence, Martial Law, <http://law.mnd.gov.tw/scp/Newsdetail.asp?NO=1A007000002>. (accessed 20 March 2011).

¹⁸⁹ In 1945 the KMT government launched several plans for establishing and operating party businesses whose profits might strengthen the party's power. The fields of party business included several different industries: cultural, cinematic, in transport, finance, insurance and agriculture. After the end of World War II, the KMT government took over several factories and firms from the Japanese empire and established its own party enterprises. There is some evidence that the KMT took most of the prosperous industry as party enterprises to make profits for the party. For further details, see Liang, Yonghuang and Tian, Xiru, *Paimai guomintang: dangchang da qingsuan* (Taipei, 2000), pp.29-31.

¹⁹⁰ "Shetuan faren zhingguo guomindan danchan zong shuomin," *Central Daily News*, Taipei, 23 August 2006; "Guojia zichan jingying weiyuanhui danchan chuli zhuanan xiaozu," press release of the Ministry of Finance, Executive Yuan R.O.C. (Taiwan), Taipei, 31 August 2004, <http://www.mof.gov.tw/fp.asp?xItem=18666&ctNode=407>. (accessed 20 March 2011); "Guojia zichan

From 1949 to 1975, when Chiang Kai-Shek died, the political power structure within the KMT and the Taiwanese government were both dominated by the core members of the Central Committee. It is worth noting that the KMT government launched local elections in the 1950s. However, the local elections include only representatives below county level and in every county hall. These elections in the local areas had no impact on local governments, not to mention the central KMT government. The head and chairman of the county assemblies were appointed by the central government. These local elections and the representatives for whom people voted had no authority over the local governments, because the local governments were directly responsible to the central government rather than to the local voters. In other words, these local elections were toothless, because they could not affect the authoritarian power. The political power structure in the first period of KMT domination in Taiwan can be separated into nine groups with different political weights. The given political weights are based upon the degree of each one's influence through elections on the country's decision-making system.

Table 5-1 shows the political power structure in Taiwan from 1949 to 1970. The first group is the ruling elites in the country, during the Chiang Kai-shek period those on the KMT Central Committee. They wholly dominated the military, politics and economy of Taiwan and have 10 points of political weight. The second group is the government bureaucrats who were responsible for implementing policies. This group of people, under the regulations of the Fundamentals of National Construction, was under the control of the KMT Central Committee. Therefore, they have 7 points of political weight. The third group was the urban capitalists who were the entrepreneurs. They had limited influence on government policies. This can be ascertained from the fact that of the members of the Central Committee there were

jingying weiyuanhui danchan chuli zhuanan xiaozu yu guomintang xieshan danchan chuli shiyi," press release of National Property Administration, Ministry of Finance, Executive Yuan R.O.C. (Taiwan), Taipei, 12 October 2004, http://www.mofnfb.gov.tw/NewsLetter.php?page=NewsScriptDetail&New_ID=160#t1. (accessed 20 March 2011); "Guomintang Dangying Shiye Zichan yu Jiuqianyi," *Economic Daily*, Taipei, 19, September, 1993; "Jiekai dangying shiye miansha," *United Daily*, Taipei, 26 December, 1999; "Dangying Shiye: Guomintang zuida jinzhu," *United Daily*, Taipei, 8 August 1994; Liang, Yonghuang, "Guomintang shi quanguo zuida de caituan," *Wealth Magazine*, Taipei, December, 1991, pp.109-114; Liang, Yonghuang, "Caiweihui zhixia de shijia dangying qiye poxi," *Wealth Magazine*, 1988, pp.120-124; Zhang, Wenquan, "Guomintang Dangying Shiye Jituan," *Excellence*, Taipei, September, 1993, pp.158-159.

few (almost no) members who were entrepreneurs. Therefore, they had 0 points of political weight. The fourth group was the urban politicians. The anti-KMT movement, called the Tangwai movement, began in the 1950s; it opposed the KMT's authoritarianism. However, under martial law, people were not allowed to organise opposition political parties nor to take part in politics. Therefore, although opposition forces existed, they had limited (or almost no) influence on Taiwan's government. Other socio-economic groups, such as students, workers, the poor and peasants, were all excluded from politics because the Temporary Provisions suspended elections. The political weight of these socio-economic groups was zero.

Table 5-1. Political Weight of Different Social Groups in Taiwan 1949-1975

Social groups	Political weights
KMT ruling elites	10
Government bureaucrats	7
Entrepreneurs	0
Urban politicians	0
Urban workers	0
Urban students	0
The poor	0
Farmers	0

The history of the foundation of the KMT constructed the political power structure of Chiang Kai-shek. His rise depended on the support of different interest groups, both within the KMT and outside. This political power structure and the membership list of the central committee indicate the interests of the KMT after they fled to Taiwan. The military and the elite groups held a majority in the central committee. This implies that, under the threat of the CCP, the national security and the political stability in Taiwan were the primary interest of the KMT. But the party-

state system established in China before 1949 also influenced the outlook of the KMT in the formation of its early development policy. The party-state system had to wield great economic strength in order to support the KMT; the concern of economic support was related to the early foundation of the KMT when it could not afford to raise its own army.

Concerned by the conflict with the CCP and the need for political stability, the KMT needed support from the SOEs and the LEs which were owned by or related to the party. What is more important is that the KMT legitimated its political power without general elections by enforcing the Temporary Provisions and martial law. These two regulations prohibited other social groups from participating in politics. For this reason, other groups in Taiwan's society could not influence the formation of the government's policy. In these circumstances, it can be argued that the formation of the economic development policy was mainly attuned to the interests of the KMT in order to maintain political stability by developing the SOEs and the KMT-related LEs. Its party-state capitalism also implies that the KMT had great control over the Taiwanese economy.

5-3. The Changing of Development Policies: from ISI to EOI, 1954-1959

The principle of the ISI policy was to develop local industries to produce the country's basic requirements. Under this principle, the Taiwanese government strictly controlled and allocated imported materials to chosen industries, giving priority to the SOEs in the early ISI period. For other private enterprises, the government in the 1950s issued regulations concerning the allocation of industrial raw materials. The conference record of the Development Hall of Taiwan, the provincial government, specified its control of the allocation of raw materials for private enterprises. In principle, the allocation of raw materials was based upon production and business achievements but did not lose its sense of free competition, since the private enterprises were permitted to import raw materials from abroad. However, the amount of the imported raw materials was controlled by the government.¹⁹¹

It is also worth noting that Taiwan lacks natural resources and had at this time too little foreign exchange to import raw materials; these significant difficulties forced

¹⁹¹ The Construction Hall of the Taiwan Provincial Government, 'Taiwan gongye zhengce wenti gongye guanli zuotanhui diwuci huiyi jilu', *Industry of Free China*, vol.1, no. 5 (1954), pp.26-28.

the government to control the raw materials for industrial production. Economically, the control on the import quota for private enterprises and the protection for them in the domestic market were reasonable steps in the foundation and early development of enterprise. Yet it is also possible to argue that the KMT's support for the SOEs was an attempt to stabilise politics by controlling the economy.

Meanwhile, under the principle of the ISI, the government in 1951 also issued regulations on foreign direct investment in Taiwan. The regulations focused on attracting funds from U.S. and overseas Chinese investors. According to the investment guarantees signed by the U.S. government and the Taiwanese government, the profits of U.S. investors could be transferred to the U.S. embassy in Taiwan and the U.S. government in turn would pay the profits to the designated payees. This regulation implies that the foreign exchange system was tightly controlled by the Taiwanese government. In other words, the U.S. investors could not transfer their money freely. Moreover, the U.S. Security Council guaranteed the U.S. investors in Taiwan against damage and loss. Meanwhile, the overseas Chinese investors did not benefit from any parallel agreement.¹⁹²

However, in the 1950s Taiwan's policy attracted very little FDI. Newspaper editorials in 1954 and 1955 indicate that the failure of the policy was related to the severe control and restrictions on the foreign exchange system, restrictions on the import of raw materials, higher prices for local raw materials, taxes and obstacles to impede exporters.¹⁹³

The ISI policy, with its high level of controls caused economic difficulties in Taiwan in the mid- and late 1950s. Figure 5-1 shows the trade deficit from 1950 to 1970. There were trade deficits in each of these twenty years (except for 1963, 1964 and 1970). In particular, there was a severe trade deficit in 1954. The slump from this trade deficit was related to the changing U.S. policy which would gradually reduce the aid to Taiwan. Figure 5-2 shows U.S. aid as the financial source for imports. With the reduction of U.S. aid as the imported financial source, the KMT government had to deal with the trade deficit on its own. The newspaper editorials of the time discussed the impact of the reduced U.S. aid and most of them suggested to the

¹⁹² 'Statute regarding Foreign Investment in Taiwan', *Industry of Free China*, vol.1, no.1 (1954), p.17.

¹⁹³ Xia, Qiyue, 'Fan ren guli qiaobao huiguo touzi', *Industrial of Free China*, vol.3, no.6 (1955), p.16; "Ruhe cucheng waizi shuru," *Central Daily News*, Taipei, 23 November 1953, source: *Industry of Free China*, vol. 1, no.1 (1953), p.16; Yin, Kongyong, 'Taiwan xishou waizi wenti zhi shangque', *Industry of Free China*, vol.1, no.1(1954), p.17.

government that in addition to cutting budgets, it was significant to attract foreign investment and encourage exports to withstand the financial deficit and shortage of foreign exchange.¹⁹⁴

Amid these increasing economic problems and the failed FDI policy, in 1954 Yin Kongyong, a high-level economic official in the government, published a discussion on industrial policy for Taiwan. This discussion concentrates on the restrictions on the development of private industry. It points out that the most effective way to solve the problems of a trade deficit and shortage of foreign exchange is to enhance industrial development in order to increase production.¹⁹⁵ The KMT high officials had long been reluctant to promote the development of private enterprise under the principles of the Constitution, which in Article 142 restricts private capital. Although in Article 145 it indicates that the state respects private property and enterprises; still, ‘the state shall restrict them by law if they are deemed detrimental to a balanced development of national wealth and people’s livelihood’.¹⁹⁶ The General Secretary of the Council for International Economic Cooperation and Development, Tao Sheng-Yang, finds that the attitudes of government officials towards private enterprise adjusted gradually and only after the mid-1960s.¹⁹⁷

Many people considered Yin a liberal economist because he strongly encouraged the development of private industry and the establishment of a free market. The critics of Yin’s policy suggestion focused mainly on governmental controls. The newspaper editorials argued that these sound policies for industrial development and the significant role of government to create the environment were indeed ‘plans’, ‘controls’ and ‘restrictions’. The government decided the type of investment, allocated the raw materials for production and controlled the import of raw materials and the foreign exchange system. Under these policies, the government

¹⁹⁴ “The editorial of caizheng jingji yuekan,” *Caizheng jingji yuekan*, Taipei, 11 May 1957, source: *Industrial of Free China*, vol.7, no.12(1957), p.15; “The editorial of China Times,” *China times*, Taipei, 03 December 1957, source: *Industrial of Free China*, vol.7, no.12 (1957), pp.15-16; “The editorial of Xinshen Daily News,” *Xinshen Daily News*, Taipei, 24 November 1957, source: *Industrial of Free China*, vol.17, no.12 (1957), pp.16-17; “The editorial of United Daily,” *United Daily*, Taipei, 27 November 1957, source: *Industrial of Free China*, vol.7, no.12 (1957), pp.17-18.

¹⁹⁵ Yin, Kongyong, ‘A Discussion on Industrial Policy for Taiwan’, *Industry of Free China*, vol.1, no.5 (1954), pp.1-14.

¹⁹⁶ Laws and Regulations Database of the Republic of China, Constitution of the Republic of China, Act 142 and Act 145, <http://law.moj.gov.tw/LawClass/LawContent.aspx?PCODE=a0000001>. (accessed 20 March 2011).

¹⁹⁷ Tao, Shengyang, ‘Fostering New Attitude towards Private Enterprises’, *Industry of Free China*, vo.23, no.6(1965), pp.28-30.

decided on behalf of private enterprises what and how much to produce. This was not a free economy.¹⁹⁸

Yin's discussion of industry policy is not against government intervention in economic development. Indeed, he supports government intervention. At the end of the discussion paper he clarifies his strong advocacy of the role of government:

"...the Government should take steps to determine the direction, types and extent of industrial development, to draw a line between public and private enterprises, to coordinate the policies of protection, controls and free competition, to renovate equipment, technique and enterprise management and to improve the industrial environment".¹⁹⁹

The new policy suggests a different direction for the government's control and planning. The new direction is to create a market system controllable under the government. Yin's suggested policy also implies that the market in the 1950s was mainly monopolised by the SOEs and a few LEs; in other words, the remaining private enterprises were unable to compete in the market. On the one hand, the SOEs and certain LEs were protected in the domestic market; but, on the other, the control on the imported resources and the foreign exchange system blocked the access to imported resources for production. Although the state did not deliberately stifle the private sector of the market, the development of the private sector was impeded by the protection and encouragement of the SOEs and LEs.

Although the government was aware of the problems caused by the ISI, the government was slow to adjust the restrictions. As reviewed in Chapter 1, in the late 1950s, the economic situation deteriorated and the unemployment rate increased. The newspaper editorials commented that 197 private enterprises went bankrupt in 1957-8. They indicated that the problems causing these frequent bankruptcies were related to the shortage of circulating capital (turnover funds), the small scale of the market and the heavy taxes.²⁰⁰ In the late 1950s, most critics of the government economic policy again focused on the restrictions on imported materials for industrial production and the control of the foreign exchange system and export trade system,

¹⁹⁸ "Ping Yin Kongyong xianshen de gongye zhengce," *United Daily*, Taipei, 01 February 1954, *Industry of Free China*, vol.1, no.5 (1954), p.24.

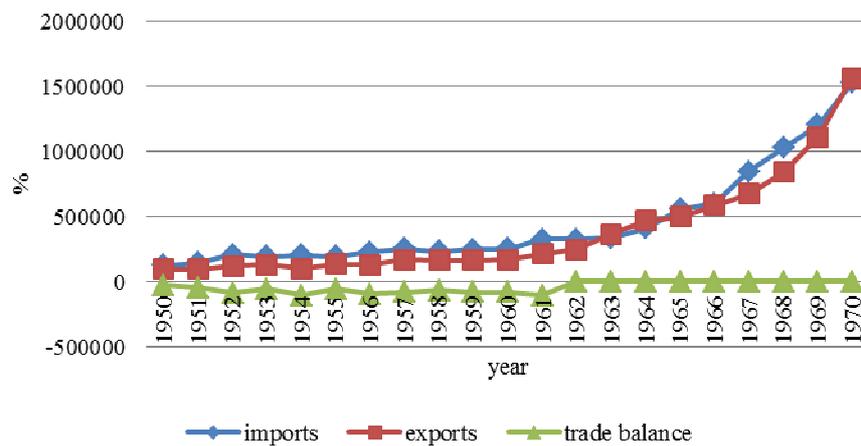
¹⁹⁹ Yin, K.Y., *op.cit.*, p.14.

²⁰⁰ "Jiejiu zijing kunnan de shishi cuoshi," *The China Post*, Taipei, 25 July 1958, source: *Industry of Free China*, vol.10, no.2 (1958), pp.14-16.

because these constraints led to the problems of frequent bankruptcy and an increasing unemployment rate.²⁰¹

Finally the government launched new policies. In 1959 the ‘Nineteen Points of Financial and Economic Reform’ was promulgated. Within these nineteen points, some policies, such as encouraging investment, developing privately-owned enterprises, improving the investment environment, freezing the national defence budget, improving the tax system, adjusting the foreign exchange system and encouraging exports were considered significant in creating export-led growth in Taiwan. The Nineteen Points of Financial and Economic Reform was considered to have changed the policy from ISI to OEI.²⁰²

Figure 5-1 Value of Imports, Exports and Trade Balance (USD\$ 1,000), 1950-1970

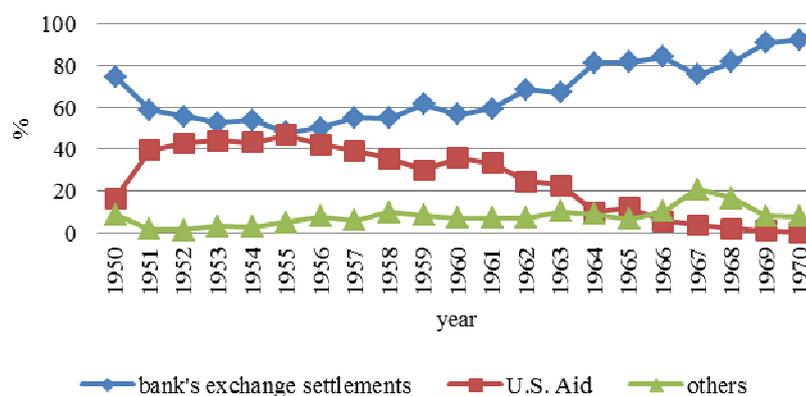


Source: Economic Research Centre Council for U.S. Aid , Executive Yuan R.O.C.(Taiwan), *Taiwan Statistical Data Book* (Taipei, 1962, 1971) , p.111, p.130.

²⁰¹ Gongye fazhan weiyuan hui, ‘Guanyu maoyi gaige’, *Industry of Free China*, vol.9, no.5 (1958), p.10.

²⁰² Wu, Meicun, ‘Women ruhe guli touzi’, *Industry of Free China*, vol.25, no.3 (1966), pp.6-12.

Figure 5-2. Percentage Distribution of Financial Sources of Imports in Taiwan (%), 1950-1970



Source: Economic Research Centre Council for U.S. Aid, *Taiwan Statistical Data Book* (Taipei, 1962, 1971), p.112, p.132.

Among these development policies, the ‘Act Encouraging Investment’ was first enforced in 1960 in order to encourage private investment and speed up economic development. This Act was implemented for around thirty years and was abolished in 1991. By the Act, the government encouraged production in various types of corporation, including manufacturing, agricultural processing industries and machinery and construction, etc. The preferential mode of the Act on the types of industries encouraged by the government was exemption from taxes. This initiated the government’s support for privately-owned enterprises in Taiwan.²⁰³ In addition to the encouragement for private enterprises, the government in 1965 issued the ‘Statute for the Establishment and Administration of an Export Processing Zone (EPZ)’. The Statute was targeted at attracting investment and expanding international trade in the export processing zones by providing preferential and tax exemptions for exporting enterprises. The policy of the EPZs is considered successful, since foreign investment increased in the 1960s.²⁰⁴ In addition to these two new policies and the encouragement of the FDI regulations, other policies, such as export loans, depreciations of NTD against U.S.D., tax exemptions for exports and the simplification of export processes were implemented, together with the nineteen-point

²⁰³ Laws and Regulations Database of the Republic of China, Statute Encouraging Investment, <http://law.moj.gov.tw/LawClass/LawContent.aspx?PCODE=J0040010>. (accessed 07 May 2011).

²⁰⁴ Laws and Regulations Database of the Republic of China, Statute for the Establishment and Administration of an Export Processing Zone, <http://law.moj.gov.tw/LawClass/LawContent.aspx?PCODE=J0050001>. (accessed 07 May 2011).

reform policies, in order to speed up industrial development and to encourage exports.²⁰⁵

The government's report showed how the government assisted the development of private electrical enterprises in Taiwan in the early 1960s in the reform policy framework. In the early 1960s, the foreign companies (mainly from Japan and the U.S.) provided Taiwanese electrical factories with electrical components; the Taiwanese factories assembled these components and exported them back to Japan and the United States. Later, the government encouraged FDI in Taiwan and connected the industrial relations of foreign investors with the local factories. The establishment of EPZs enhanced the connections. With the increase in foreign investments, exports gradually increased.²⁰⁶

Although the export of electrical products increased from USD 10,000 to USD 700,000,000 in the period 1963-1968, the newspaper editorials disagreed with the government's strong support for the development of the electrical industry. The evidence can be found from import taxes and the administrative process for tax exemption. In addition to the complicated nature of the latter, it required a large deposit. The import tax on finished products and electrical components was 15%; in contrast, the import tax on raw materials for producing electrical components was 30%.²⁰⁷ The details in practice of implementing the policy were not as helpful as the government described.

Moreover, the newspaper editorials criticised the government's 'encouragement' and the 'principles' of EOI strategy. The original goal of these was to remove some restrictions and facilitate business procedure. However, they usually stood as exceptions to the existing rules; in other words, the encouragement and principles were exceptional. There were few qualified private enterprises within the exceptions and only a limited minority benefited from them. This was against the spirit of free competition. The fundamental problem was the restrictions of the laws

²⁰⁵ Staff report of the Ministry of Economic Affairs, 'Export promotion in the Republic of China' *Industry of Free China*, vol.29, no.1(1968), pp.34-43; Industrial Law Book, 'Measures for refund of taxes and duties on export products', *Industry of Free China*, vol.18, no.5(1962), pp.31-36; Liu, Taiying and Chen, Heli, 'Xin waixiaoping chongtui shuijuan banfa gaijin zhi jingwei', *Industry of Free China*, vol.32, no.2 (1969), pp.3-12.

²⁰⁶ Jinhe Hui Tozi Yewuchu, 'Taiwan de dianzi gongye', *Industry of China*, vol.29, no.3 (1968), pp.2-6.

²⁰⁷ "Fazhang dianzi gongye de fanxian ji wenti," *Economic Daily News*, Taipei, 16 October 1968, source: *Industry of Free China*, vol.31, no.4 (1968), pp.11.

themselves. Adding encouragement and principles did not solve the problem; instead, it created other privileged groups.²⁰⁸

The evidence of the critics can be found from the cases of SMEs which were difficult to help by these means. For example, although the Act Encouraging Investment had been implemented for thirty years in order to promote the development of private-owned enterprises (not SMEs in particular), most SMEs were not benefiting from the encouragements because they were identified as corporations, even though, according to the government statistics, over 65% of SMEs were sole proprietorships rather than corporations. This excluded them from the tax exemptions of the Act to Encourage.²⁰⁹

The evidence shown in this section suggests that the environment created by the government was not a 'free market' economy in which to compete. In the light of different political and economic concerns, the government gradually seemed to relax its restrictions by launching encouragement policies and principles. But, given the framework of controls, encouragement policies and principles, only certain groups benefited and went on to engage in competition. The evidence here also demonstrates the significant impact of the state on the openness of the market. Although the export market was open and the foreign exchange system was adjusted, protections and preferential terms for the SOEs and LEs still existed. In these circumstances, the policy adjustment to allow the general private enterprises to develop still depended on the state's interest in supporting the SOEs and selected LEs.

5-4. Direct and Indirect Support for the Development of SMEs

In 1966 the first official organisation 'Workshop for assisting SMEs' aimed at assisting SMEs was set up. The aim of the workshop was to provide small-scale industrial loans and revolving business loans. In 1968 and in 1970, the small workshop expanded into an assistance bureau and set up a unified service for the SMEs. The assistance bureau provided technological aid and consultancy services. The service centre established a research centre for technology management. The

²⁰⁸ "Rang quanmin zai tongyi falu xia jinzheng," *China Times*, Taipei, 18 May 1966, *Industry of Free China*, vol.25, no.6 (1966), pp.19-20.

²⁰⁹ Cheng, Hangsheng, 'An Analytical Study of the Result of Enforcement of the Statute for Encouragement of Investment', *Industry of Free China*, vol.33, no.6 (1970), pp.31-44.

function and programme of these organisations focused on assisting techniques and technology for the foundation of SMEs.²¹⁰

Nevertheless, the primary problem was not technological or to do with management support; instead, for the SMEs the primary difficulty lay in obtaining loans from formal financial institutions. The borrowing difficulties for the SMEs can be analysed from three points of view. The first is related to the banking system and the government's development policy which excludes SMEs from loans. In the 1950s the KMT government set up different state-owned banks for the Taiwanese financial system. From 1950 to the early 1970s, the highly centralised control of banking operations was in the hands of the KMT government.²¹¹

Meanwhile, some reports do not strongly support any encouragement for the development of SMEs in the late 1960s. Lin and Yang argue that the advantage of cheap labour could not last long in the international market; the focus of a government's development policy had to be on the development of LEs because of their economy of scale and the accumulation of capital for further investment. Government's support for SMEs should focus on certain industries which might assist the development of LEs.²¹²

A similar idea can be found in Warmelo's research on Taiwanese industries during this period. He argues that what the government should have done was help SMEs to improve their production techniques to increase production and raise quality.²¹³ These reports and suggestions were published in government industrial journal which suggested what direction government should take to assist the development of SMEs. Under the principles of the development policy, only state-owned enterprises and special LEs could receive loans from these public commercial banks. The loans for these large private enterprises were part of the protectionist policy aimed at establishing Taiwan's modern industrial sector.²¹⁴

²¹⁰ Small and Medium Enterprise Administration, Ministry of Economic Affairs, Executive Yuan R.O.C. (Taiwan), <http://www.moeasmea.gov.tw/ct.asp?xItem=554&CtNode=553&mp=1>. (accessed 20 June 2011).

²¹¹ For more details concerning the banking system, see Zhang, Shaotai, *Taiwan jingrong fazhan shihua* (Taipei, 2005); Lai, Yingzhao, *Taiwan jingrong bantu zhi huigu yu qianzhan*, (Taipei, 1997); Yu, Zhongxian and Wang Jinli, *Taiwan jingrong tizhi zhi yanbian* (Taipei, 2005).

²¹² Lin, Haida and Yang, Zongze, 'Zhongxiao qiye zai Taiwan jingji fazhan zhong zhi diwei', *Industry of Free China*, vol.28, no.2 (1967), pp.10-13.

²¹³ Warmelo, W. Van, 'The development of Taiwanese SMEs', *Industry of Free China*, vol.28, no.4 (1967), pp.15-20.

²¹⁴ Some argue that the protectionism policy and the financial policy to make loans to these large private enterprises were influenced by political power. In other words, politics dominated the

At the same time, the local banking systems (the credit cooperative associations) did not to any great extent help the SMEs, either. The local credit cooperative association was embedded in complicated local social networks and political forces which might bias the direction of their granting loans to enterprises which had good social connections or strong political relations rather than to enterprises which would make larger profits. For example, in the research of Zhou and Chen, a local SME owner whom they interviewed argues that it would be easier to borrow loans if one were running a campaign and were elected councillor. The quota of loans for a councillor is fifty million.²¹⁵ The statement shows that political connections and power were believed to help in obtaining loans. The evaluation of the amount of loans was determined by political and social power rather than by the profits made by the SMEs. The structure of the formal banking system, including the commercial banks or the local banking system, shows that SMEs were required to be among the 'privileged' ones in order to receive a loan from the formal banking system.

The second problem was that the SMEs usually lacked what banks would count as valuable collateral; this issue made it difficult to grant them loans because of formal regulations and market perspective. Li Kuo-Ting states that the Civil Law restricted the ability of the banks to grant business loans and reduced the chance for private industry to obtain them. The restrictions came from the regulations that only real estate can be mortgaged; there was no chattel mortgage. Moreover, even though the government encouraged exports, the machinery imported for private enterprises were not accepted as security for instalments of customs duties.²¹⁶ Although Li does not focus particularly on SMEs, the difficulties which he indicates apply more to SMEs than to LEs.

In another article, Li suggests what government should do to create a favourable environment for the development of private enterprises. This includes two main recommendations: the simplification and liberalisation of government controls and the removal of restrictions, while increasing the available funds for investment

development and financial policies independently of the market mechanism. For further details, see Park, Hun Joo, 'Small Business in Korea, Japan and Taiwan: Dirigiste Coalition Politics and Financial Politics Compared', *Asian Survey*, vol.41, no.5 (2001), pp.846-864.

²¹⁵ Di, Benrui and Chen, Jieying, *Taiwan shehui yu jingju lunji* (Taipei, 1995).

²¹⁶ Li, Kuoting, 'Law and Economic Development', *Industry of Free China*, Vol.15, No.5 (1961), pp.7-10.

and credit facilities.²¹⁷ The latter suggestion refers in fact to another restriction of the financial market in Taiwan. The restrictions lie in the small size of the stock and bond market and the government's intervention in controlling prices in the financial market. The controlled financial market hindered the free flow of capital. Therefore, the financial market could not provide financial support for the SMEs.²¹⁸ Meanwhile, government strictly controlled the foreign exchange system. The strict control on the foreign exchange system closed access to the foreign capital market and hindered firms seeking loans from overseas.

The restrictions thus hampered the attempts in the 1960s of the private enterprises to raise funds from the market and the development of an investment market in Taiwan. Evidence can be found from the low percentage of domestic investment in GDP in 1967; it was only 22.5 percent of GDP.²¹⁹ From the business perspective, equally, the lack of valuable guarantee increases risks for banks which grant loans to SMEs. Most of the SMEs could only raise short-term loans from banks. The strategy of short-term loans was also profit-oriented, because banks earn higher interest rates from them.

Under the restrictions of the banking system and the formal regulations, from a business perspective, the press suggested that the government should set up an insurance fund in order to support SMEs which sought bank loans as capital.²²⁰ This indicates the difficulties for such SMEs. The Ministry of Economics, in order to assist the SMEs to get credit and insurance funding, set up the Credit Guarantee Fund, but with limited functions. Newspaper editorials indicated that although the government had had a policy to grant loans to SMEs since 1954, in the next 16 years fewer than 1000 SMEs had been eligible to benefit from this policy.²²¹ The report and the editorials indicated the difficulties of raising the necessary capital to start and operate as an SME. In other words, the direct support of government in financial capital was restricted.

²¹⁷ Li, Kuoting, 'Development of private enterprises', *Industry of Free China*, Vol.23, No.5 (1965), pp.13-17.

²¹⁸ For further details, see Caldwell, Alexander J., 'The Financial System in Taiwan: Structure, Functions and Issues for the Future', *Asian Survey*, vol.16, no.8 (1967), pp.729-751.

²¹⁹ "The editorial of United Daily," *United Daily*, Taipei, 16 October 1967, source: *Industry of Free China*, vol.28, no.6 (1967), p.20.

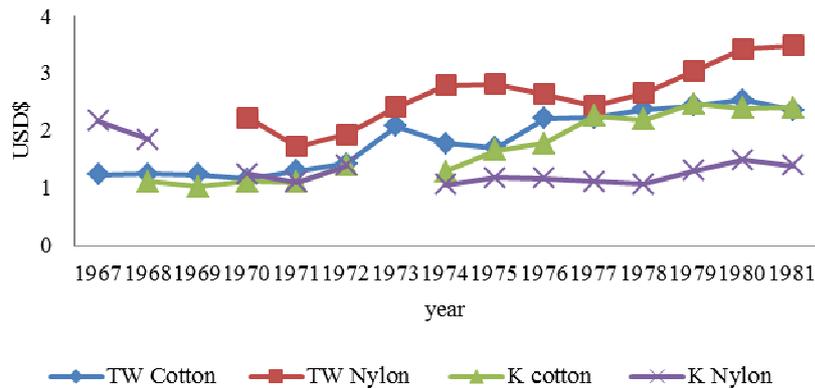
²²⁰ "Jiejue zhongxiao qiye zhouzhuan zijing zhidao," *United Daily*, Taipei, 24 May 1967, source: *Industry of Free China*, vol.27, no.6 (1967), pp.21-22; Meng, Mongmin, 'Some Aspects of Financing SME Industries in Taiwan', *Industry of Free China*, vol. 27, no.5 (1967), pp.2-15.

²²¹ "Fudao zhongxiao qiye lianhe jingying," *Central Daily News*, Taipei, 19 September 1970, Source: *Industry of Free China*, vol.34, no.3 (1970), pp.21-22.

The SMEs were not only restricted in obtaining loans from the formal financial institutions, but also found it difficult to secure revolving business loans from banks. Since financial capital plays a significant role in starting and operating a business, some indirect support from government policy was assumed to be helpful in lifting some of the financial difficulties of the SMEs. According to the existing literature, the business credit loans from the SOEs and LEs played a major part in assisting the SMEs' business operations and reducing the stress over cash flow. However, the impact of the business credit loans on SME financial support was not as profound as it was described.

The SOEs were privileged in borrowing and importing raw materials and were protected from competition in the domestic market. In principle, the SOEs were able to assist the development of SMEs by supplying cheaper raw materials to lower production costs and business credit loans to facilitate business transactions. Figure 5-3 and Figure 5-4 below show a comparison of the estimated wholesale price of selected raw materials in Taiwan and in Korea. The selected raw materials are the important raw materials for the popular industries in which the SMEs engaged. Cotton yarn, nylon filament fibres and polyester were the main raw materials for garment manufacturing; PVC powder and PVC resin were the main raw materials for manufacturing shoes and toys. The comparison demonstrates that the wholesale prices of these raw materials in Taiwan were generally higher than in Korea. This contradicts the argument that the SOEs indirectly helped the SMEs by reducing production costs through their cheaper raw materials. In other words, the government did not get the relative price altogether wrong in terms of providing raw materials and intermediate goods to the SMEs in these main manufacturing industries.

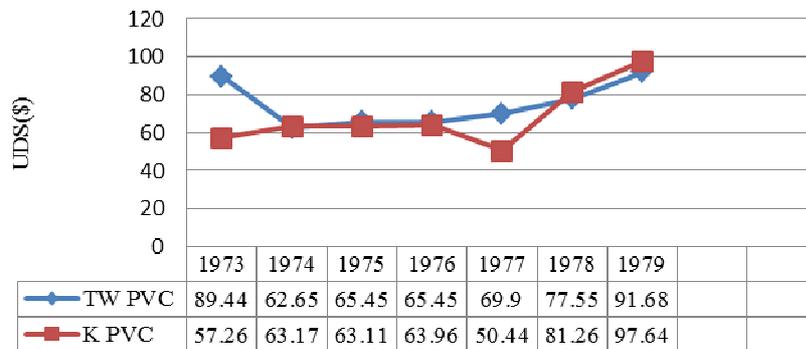
Figure 5-3. Estimation of the Price of Cotton Yarn and Nylon in Taiwan and in Korea (USD\$), 1967-1981



Sources: Council for Economic Planning and Development, *Industry of Free China*, vol.42, no.1(1974), pp.164-168; vol.43, no.4 (1975), pp.160-166; vol.45,no.2 (1976), pp.166-172; vol.55, no.6(1981), pp.186-192; vol.65, no.4 (1986), pp.204-214; Economic Planning Board, National Bureau of Statistics, ROK, *Monthly Statistics of Korea*, 1971, vol.7, pp.78-80; 1975, vol.7, pp.81-84; 1980, vol.1, pp.110-112; 1981, vol.7, pp.110-112; 1986, vol.1, pp.118-120.

Note: The original data of the price of Taiwanese cotton yarn (20 counts/180 kg) and nylon (70 denier) were recorded in NTD. The price of Korean cotton (23 counts/100kg) and nylon (70 denier) was recorded in Korean won. The estimation of the price in Figure 4 was converged from the NTD and Korean won into USD. based upon the foreign exchange rate per year from 1967 to 1981. The price of Taiwanese cotton yarn was divided into 100 kg in order to compare it with Korean cotton yarn. There were no records in the original data of the price of Korean nylon in 1969 and in 1973.

Figure 5-4. Estimation of the Polyvinyl Chloride (PVC) in Taiwan and in Korea (USD\$) 1973-1979



Sources: Council for Economic Planning and Development, *Industry of Free China*, vol.42, no.1(1974), pp.164-168; vol.43, no.4 (1974), pp.160-166; vol.45,no.2 (1975), pp.166-172; vol.55, no.6(1981), pp.186-192; vol.65, no.4 (1986), pp.204-214; Economic Planning Board, National Bureau of Statistics, ROK, *Monthly Statistics of Korea*, 1971, vol.7, pp.78-80; 1975, vol.7, pp.81-84; 1980, vol.1, pp.110-112; 1981, vol.7, pp.110-112; 1986, vol.1, pp.118-120.

Note: The original data of the price of the Taiwanese PVC (meter ton) and the Korean PVC (meter ton) was recorded in NTD and in Korean won. The price is converted into the U.S.D. based upon the foreign exchange rate each year against the USD PVC= Polyvinyl Chloride.

In terms of business credit loans, this programme is usually implemented with the Credit Guaranteed Fund. The SOEs did loan SMEs through business credit or

trade credit under the insurance of a Credit Guaranteed Fund. Nevertheless, the process of entering or engaging in a business/trade credit loan is more complicated. Usually the SOEs recommend a SME which is qualified to grant business/trade credit loans to banks and insurance companies. Then the banks and the insurance company evaluate the qualification of the SME. Guaranteed by the insurance company and the banks, the SME is granted a business/trade credit loan by the SOEs. The business/trade credit loans are usually short-term, ranging from three to six months. It is worth noting that the 'qualified' SMEs are those which have purchased raw materials or intermediate goods from the SOEs for a certain period. In other words, these SMEs must accumulate business credit from their business transactions with the SOEs for several years. During this process, the SMEs cannot enjoy any business/trade credit loans; they usually pay the SOEs in cash. This process again endorsed the criticism that the encouragement or principles of the government tended to create a new privileged group.

Therefore, before the SMEs became eligible for borrowing from the SOEs, how did these SME candidates raise funds and manage the cash flow for their turnover funds? According to Liang, most private enterprises in the 1960s borrowed chiefly from the private free market; interest rates on such loans were nearly fifty percent per year. The shortage of available financial funds can be traced to the government deficit and therefore the SOEs were privileged to grant limited loans from the formal financial institutions.²²² Analysis of the evidence demonstrates that the market which the government controlled and established did not provide significant finance support to the setting up and operation of the SMEs in business.

5-5. Conclusion

The analysis of the government's policy in the early 1950s is usually ignored; in particular the government's interest in the development of the private enterprises. The structure of political power within the KMT in the 1950s identifies the state's interest. Most of the members of the central committee belonged to the military or administrative elites. During the struggle with the CCP, national defence and political and economic stability were the main concern of the state. The state's interests and the structure of the KMT's party-state capitalism influenced the early formation of

²²² Liang, Chinghou, 'On the Source of Loanable Funds for Taiwan 1951-1961', *Industry of Free China*, vol.25, no.3 (1966), pp.30-42.

development policy. The evidence shows clearly that with the state's interests, the government was reluctant to support private enterprises at first, for both political and economic reasons. The economic reasons were related to the shortage of funds and the scarcity of natural resources in Taiwan. The political concerns were related to the KMT's control on the SOEs and LEs, a control which supported and stabilised its political power in Taiwan. In these circumstances, the market was monopolised by the government and the priority for resource allocation was held by the SOEs and LEs.

In the mid- and late 1950s the government relaxed some restrictions regarding tax refunds, controls on imported materials and the foreign exchange system in order to attract FDI to Taiwan. However, many restrictions still remained. Evidence shows that from 1954 to 1968 the critics still focus on the heavy taxes, the controls on imports and the foreign exchange system. The case of the tax on imported materials for electronics in the 1960s indicates that these were still taxed highly. This demonstrates that the government did not relax the restrictions much in the 1950s; the policy adjustments were still composed of many controls and restrictions. Therefore, it is difficult to argue that most of the policy adjustments regarding export encouragement were made in the 1950s and the early 1960s.

Although the state did not prohibit private enterprises from trading, the protections and encouragement policies for the SOEs and LEs hindered other enterprises in the market. In other words, the protections and encouragement for the development of the SOEs and LEs restricted the development of the private sector, because the market was monopolised by the SOEs and LEs. Therefore, it can be argued that the changes of policy in the 1960s focused only on relaxing some restrictions (or reducing the level of protection for the SOEs and LEs) for the sake of solving the economic problems. The relaxation of the restrictions on the market gradually included certain private enterprises qualified to participate in the market.

From this point of view, the opening of the export market in the 1960s should be considered in the light of a partial restoration of the market mechanism rather than a move to establish a free market. In particular, the domestic market had been controlled by the government until the 1980s and the competition in the domestic market was not within the framework of a free market. The protection of the SOEs and LEs in the domestic market during the EOI period shows that the state's interest still focused on developing the SOEs and LEs. The aim of the government was to

build up a controllable market economy. Under these principles, the impact of the 'liberalisation' policies created only limited space for the development of private businesses. This also implies that the state held most of the control over the openness of the market; and this openness significantly influenced the rise of the SMEs.

In addition to the limited space for the development of the private business, in the 1960s not many private enterprises, let alone SMEs, that could qualify for the category which enjoyed preferential treatment. The existing literature usually ignores the details of the encouragement policy and generalises the effect of it on the rise of the SMEs. The evidence shows that the implementation of the policies was more complicated than this literature might suggest.

In the mid-1960s the government launched a series of support programme to develop the SMEs. The evidence indicates that the interest of the government in supporting the SMEs was that it would support the SOEs and LEs to do so. Therefore, the support mainly focuses on technology and quality control. However, the evidence demonstrates that the primary difficulty of the SMEs was their inability to raise the first round of money capital to start up; they found it difficult to access turnover funds for business transactions. Moreover, the indirect support from the SOEs and the LEs was not as sound as it appears in the literature. Evidence shows that the SOEs and LEs did not necessarily provide the SMEs with materials at cheaper prices. Yet in order to borrow from the SOEs and LEs, the SMEs needed to develop long-term business credit with them. In other words, SMEs needed to survive on their own before they get support from the SOEs and LEs. This implies that the market which was controlled and created by the state did not provide significant financial credit to the SMEs.

This chapter analyses the power structure of the KMT in order to clarify its interests and the impact of them on the formation of the development policy. Evidence shows that the state's interest sustained the development of the SOEs and LEs for both political and economic reasons. Meanwhile, the policies implemented to protect and sustain the SOEs and LEs hindered the early development of private businesses in the market. Under the subsequent economic challenges, the government gradually relaxed the restrictions entailed by protecting the SOEs and LEs. Its relaxation policies created some space for the rise of the private business and the SMEs; and the relaxations included newly qualified participants in the market. This

evidence also highlights the significant power of the state to open, restrict and block the market; when it opened the market, it allowed the development of the SMEs.

Apart from their influence on the market, the policies considered important in encouraging and supporting the SMEs had certain limits. On the one hand, the early relaxations and policy adjustments to tax exemptions, the control of imported materials and the foreign exchange system did not entirely relax the controls in the 1950s and the early 1960s. Evidence shows that until the mid-1960s the criticism of these three aspects of policy remained. This demonstrates that the policy was adjusted but with many conditions. On the other hand, evidence shows that the encouragement policies and the direct and indirect support were given only to the eligible SMEs (a minority); hence the support of the state to the SMEs was limited. Therefore, the increase of government investment to subsidise tax refunds and export growth, or the policy of 'getting the relative price wrong' made no difference did not matter to the SMEs because they either derived no benefit from the 'getting the relative price wrong' or else the price was not relatively 'wrong' for the SMEs. In addition, the major difficulty of the SMEs lay in problems of finance. The evidence presented in this chapter demonstrates that the market established by the government did not provide financial support to the SMEs because they could receive financial support only after becoming eligible to do so. The question then is 'How did the SMEs start up in business and survive before they became qualified to enjoy preferential treatment and obtain the support of the SOEs and LEs?

Chapter 6. The Role of the Market and the Social Institution in the Rise and the Development of the SMEs, 1950-1980

The evidence of the previous chapter shows that the general development policies and the particular policies to assist the SMEs gave limited support to the capital formation of the SMEs. In particular, it was difficult for the SMEs to receive loans from banks and the SMEs were not qualified to access the financial support from markets which were governed by the state. If the state, the formal financial institutions and the government-controlled market had little input in the capital formation of the SMEs, what was the source of this capital formation until the SMEs could obtain support from the state? Instead of examining the policies and support that the government provided for such capital formation, this chapter explores the institutional framework in which a space was made for the social institutions to enable capital to be found for the SMEs. This chapter begins with an analysis of the industrial structure and the legal regulations based upon the state's interest in sustaining the development of the SOEs and LEs. In the institutional framework, the following two sections then show how social institutions supported the foundation and business operation of SMEs. The evidence presented in this chapter demonstrates that the SMEs did not rely on government support for most of their capital formation.

6-1. The Formal Institutions and the Development of the SMEs

The state's interest was to accelerate the development of the SOEs and LEs in order to build up Taiwan's industries. The industrial structure was founded upon this principle. Table 6-1 shows the units of selected industries and commerce in Taiwan before 1954 by type of ownership and the size of unit. In the textile industries, there were no SOEs in the towel-weaving mills, knitting mills and the industries' bleaching, dyeing, printing and finishing units. Moreover, there were no SOEs in apparel processing, repairing and other fabricated products. These manufacturing industries were seen in the industrial structure as downstream. The upstream industries in these manufacturing industries, such as textile fibres and cotton, silken and woollen products, contained numerous SOEs.

In addition to the textile industry, there were 87 SOEs in the chemicals and allied products industry. There were numerous SOEs in the machinery manufacturing and repairing industries; but the electrical machinery and appliances manufacturing and repairing held few. The domination of the SOEs in these three industries was

important. Comparing the industrial structure with the FDI industrial structure in the 1960s, it is clear that most of the FDI investment focused on the downstream industries, where Taiwanese SOEs were able to provide materials or intermediate goods from upstream. The industrial structure and the FDI investment structure created a small market for the small private businesses.²²³

At the same time, the completion of the commerce statistics also points to the registration law which facilitated the foundation of the SMEs. During this period, it is difficult to ascertain the number of SMEs in Taiwan. In Table 6-1, the statistics come from the government-compiled numbers of ‘enterprise units’ and ‘established units’ in the industry and commerce census. ‘Enterprise units’ can be defined as corporations composed of several different branches operating in one or several different businesses, while the definition of ‘established units’ indicates ‘one factory’ or ‘one branch’ and covers both individually-owned enterprises and branches of corporations.

The statistics do not classify enterprises by size. The investigation of private enterprises was affected by the early commercial law in Taiwan. According to the Commercial Law, before 1958 factories which had more than 30 employees and a net capital greater than 10,000 NTD were required to register and apply for the ‘registration certificate’ from the government of their province. Other factories without these qualifications needed only to apply for a ‘production certificate’ from the local council. After 1958 the registration regulations adjusted the amount of net capital to 100,000 NTD.

Table 6-1. Industry and Commerce Census in Taiwan: Units for Industry and Commerce, 1949-1956

	State-owned			Private-owned		
	enterprise units	establishment units	technical units	enterprising	establishment	technical
Manufacturing						
textile industry						
textile fibres	0	6	6	11	13	14
yarn mills	3	8	8	9	11	11
thread mills	0	1	1	88	93	101

²²³ For more details regarding FDI structure in Taiwan, see Chapter 1.

cotton silken woolen products	3	14	14	358	416	417
towel weaving mills	0	0	0	24	26	26
knitting mills	0	0	0	159	174	177
bleaching, dyeing, printing, finishing textiles	0	0	0	67	75	77
cordage, rope and net products	0	2	2	78	89	92
miscellaneous. textile products	0	2	2	1213	1218	1230
apparel processing, repairing and other fabricated products	0	0	0	5030	5078	5216
rubber products	1	1	1	319	333	338
chemicals and allied products	7	35	45	1261	1343	1457
machinery manufacturing and repairing (ex electrical machinery manufacturing and repairing)	1	15	17	1043	1058	1113
electrical machinery and appliances manufacturing and repairing	0	3	3	729	751	886

Source: Directorate-General of Budgets, Accounting and Statistics, Executive Yuan R.O.C. (Taiwan), *Statistical Abstract of the ROC* (Taipei, 1957), pp.108-119.

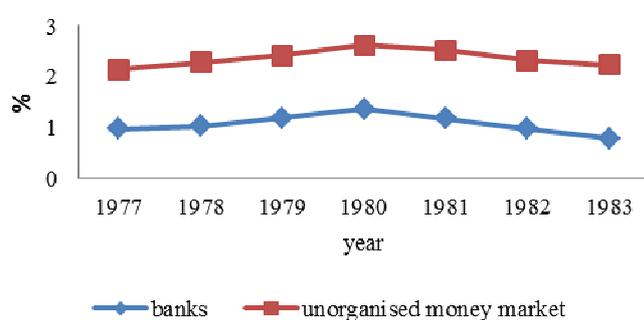
The data of the industrial structure shows that the space made for the SMEs lay in the downstream industries. These downstream industries, such as processing factories, required low skills and low technology, requirements which made it easy for the SMEs to participate in the processing business. Moreover, the government regulations to do with factory registration and the completion of statistics implied that the government paid little attention to the SMEs; this neglect facilitated the establishment of small and medium-sized processing factories in rural areas. The Commercial Law stipulating registration reveals the unintended consequences of an industrial policy which made space for the development of the SMEs. The simplified registration process and the industrial policy in the early period lowered the entry barrier for SMEs in Taiwan. The formal institutional framework, including the industrial structure, development policies and commercial laws, created space for the social institutions to function.

6-2. The Capital Formation of the Manufacturing SMEs

The evidence in Chapter 5 indicates that the major difficulty for the SMEs lay in sourcing the capital for themselves from the formal banking system and the state-

controlled market. Figure 6-1 below shows the cost of borrowing from the formal banking system compared with the cost of borrowing from the unorganised money market. It is clear that the latter was almost twice as high as the former. This shows that the government got the relative price wrong, in order to provide cheaper credit for the private sector. However, the question again is whether the SMEs relied on the cheaper credit from the government.

Figure 6-1. The Comparison of the Interest Rates on Unsecured Loans of Banks and in the Unorganised Money Market



Source: Directorate of Budget, Accounting and Statistics, Executive Yuan R.O.C. (Taiwan), *Statistical Yearbook of the R.O.C.* (Taipei, 1984, 1986), P.197, pp.199-200.

Note: 1. The original data did not record the interest rate in 1978. 2. The rates on loans of banks were recorded in per cent per annum; the per cent that presented in the table was divided by twelve months.

There are two significant parts to the structure of the source of capital for the Taiwanese SMEs. The first part is the internal capital, the entrepreneurs' own capital for setting up a business, together with the external capital, namely, loans from other organisations. The second part is the borrowing credits of enterprises, which are normally used as short-term turnover funds for business. These two parts composed the financial structure of the Taiwanese SMEs.

Figure 6-2 below shows an estimation of the internal structure of the source of capital for private enterprises in Taiwan from 1973 to 1990. The government statistics show that the capital formation came mainly from members of the founder's family, which includes relatives and friends. It is worth noting that the capital in this category accounted for more than 80% of the capital structure of manufacturing industry from the 1970s to 1990. The high and stable percentage of family capital in the total capital formation implies the weakness of public financial institutions in supporting manufacturing industry and the great strength of social institutions when it came to providing necessary capital for businesses.

Family capital includes funds from personal savings and from the informal financial system. Much research in development studies indicates that Taiwan has a very high savings rate compared with other developing countries. This rate also contributes to the initial capital formation for SMEs. This may also explain why so much capital for SMEs has come from the family. There are two types of informal financial system. The first type consists of rotating credit associations, known as 'Biaohui'²²⁴ in Chinese. The rotating credit system has been very popular in Taiwan.²²⁵ However, the 'Biaohui' have experienced many problems, since some members have absconded with large sums raised from other members (known as 'Daohui'). When 'Daohui' takes place, the victims cannot look to the law to have their contributions restored. The operation of the 'Baohui' system is based upon trust between the members.²²⁶

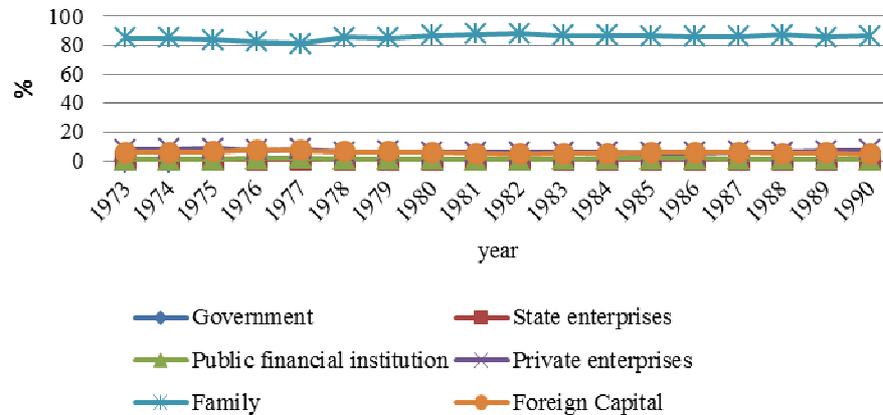
Another type is formed of local private financial groups or individuals who professionally lend capital to the SMEs or to individuals and make their profits from higher interest. This is, of course, related to the legal framework for private borrowing and lending. However, again, it is difficult to regulate and monitor private borrowing-lending behaviour when most of the informal financial organisations are not operated as corporations. These two types of informal financial system are also categorised under family capital, because the system of 'biaohui' is operated on the basis of relationships with family, neighbours or friends; borrowings from private financial groups or individuals are usually entered into by recommendation from relatives, friends or acquaintances.

²²⁴ Biaohui is commonly used as a system for saving, investing and loaning in Taiwanese society. For further details regarding the unregulated finance market in this society, see Kan, Hanzhen, 'Guanxi faze yu falu de bianyuan yunzuo: Taiwan xiaoxin qiye fezhengshi ronzi huodong de yangjiu', *Taiwan: a Radical Quarterly in Social Studies*, vol.17(1994), pp.1-40.

²²⁵ In 1985 an investigation showed that around seventy per cent of adults had experience of biaohui. For further details, see Lin, Rongyao 'Taiwan diqu minjian hehui xiankuang zhi yanjiu', Fawubu qishisan niandu yanjiu fazhan xianmu baogao (Taipei, 1985).

²²⁶ For further details, see Luo, Jarde, 'The Savings Behaviour of Small Investors: A Case Study of Taiwan', *Economic Development and Cultural Change*, vol.46, no.4 (1998), pp.771-788. However, the limitation of this evidence is that it is difficult to trace how much of the savings flowed to funds for setting up SMEs.

Figure 6-2. Estimation of the Internal Capital Structure of the Taiwanese Manufacturing SMEs by Financial Source (%), 1973-1990



Source: Bureau of Economic Research, Central Bank of the R.O.C., *Report on the Source of Capital of Public and Private Enterprises in Taiwan Area* (Taipei: Central Bank of the R.O.C., 1976, pp.4-6; 1978, pp.6-8; 1980, pp.13-16; 1983, pp.12-13; 1985, 10-13; 1987, p.59, p.77; 1988, pp.60-62; 1989, pp.59-61; 1990, 1991, pp.61-63).

Note: 1. From 1993 the categories in the statistics of the Reports combine 'government', 'state enterprises' and 'public financial institution' together as 'government and public financial institutions'.
2. The original government data list only the source of capital in manufacturing and various other industries. The estimation is calculated on the basis of the statistics of manufacturing industry, times 90% for the SMEs in manufacturing industry.

6-3. The Subcontracting System and the Social Institutions

The second part of the capital formation is the formation of external capital for turnover credit. This source of credit is closely related to the subcontracting system in Taiwan. The two main characteristics of the Taiwanese subcontracting system are a sophisticated division of labour and family- (kinship)-based social networks. Much has been written on these features.²²⁷ Here, it is worth noting that the subcontracting system was not led and integrated vertically by the SOEs and LEs. On the contrary, the subcontracting system was horizontally integrated among numerous SMEs. The foreign buyers and the trading companies placed their orders with the medium-sized factories and the medium-sized factories subcontracted the work to other, smaller factories. This is different from the type of Japanese subcontracting system which is vertically integrated by the LEs. This phenomenon is very important, since it shows that the relationship of the SOEs/LEs with the SMEs was of a more usual kind, such

²²⁷ Hamilton, Gary G., *Business Networks and Economic Development in East and Southeast Asia*, (Hong Kong, 1991). Ho, Samuel S. P. (1978) *Economic Development of Taiwan 1860-1970* (Yale, 1978), pp.186-211. For further details regarding the SME subcontracting system, see Chen, Jiexuan, *Bandi yu laoban: Taiwan qiye zuzhi nongli zhi fazhan* (Taipei, 2001); Chen, Jiexuan, *Xeli wanlu yu shenghuo jiegou: Taiwan zhongxiao qiye de shehui jingji fenxi* (Taipei, 1994).

as selling-buying raw materials and intermediated goods. The SMEs did not rely on the orders from the SOEs and LEs. Moreover, the horizontal integration of numerous SMEs questions how much support was offered by the SOEs and LEs to the SMEs. The following quotation from the manufacturing industry shows the functioning of the Taiwanese SMEs:

The Lee Wei factory is a medium-sized factory, which produces machines. It is a traditional Taiwanese firm, which was founded on a family basis and it has, of course, its own social networks from suppliers to clients. The owner of the Lee Wei factory shared one of his successful experiences concerning a valuable deal with a Japanese firm, which depended on the industrial structure of the factory and its social network: “This Japanese firm is a large enterprise in the lathing industry; they developed a plan which demanded lathes of a special standard. The Japanese executive manager came to Taiwan and paid an official visit to my factory during the day. To end an official day-time visit, it is routine for us to take our important clients for drinks and relaxation. Afterwards, the executive manager gave me his firm’s draft for the machines with the special standards they required. He hoped that I could provide a quotation for these lathes. When he handed me the draft, it was two o’clock in the morning; I submitted my quotation for these machines to him after seven hours—at nine o’clock in the morning, before he left the hotel to go to the airport. He was very surprised by our high-speed operating system, because other factories usually hand in their quotations after seven days; but we finished it quickly and comprehensively in seven hours. Of course, he was satisfied with our prices and plans and I won the business. What did I do during these seven hours? As soon as I got the draft in hand, I called my contractors and suppliers immediately. It was not easy to do this because it was two o’clock in the morning; nevertheless, most of these contractors and suppliers are my relatives or old friends with whom I have cooperated with for more than ten years. Accordingly, they came to my office in the middle of the night and we worked together until the morning. The reason why we could quote good prices within seven hours is that every one of them is experienced and is specialized in different parts of lathes.”²²⁸

²²⁸ Chen, Yizhong, ‘Jiating gongchan zuodao quanqiu disida’, *Jin zho kan*, vo.447, <http://www.businesstoday.com.tw/v1/content.aspx?a=W20050700152&p=3>. (accessed 18 May 2009). For further details of cooperation within the subcontracting system, see Xia, Linqin and Zheng, Cunqi,

As the example above shows, the Lee Wei factory specializes in assembling all the components of machines; other contractors have small-scale plants which specialize in producing designated components. Due to the closely-defined division of labour, every factory and every contractor is highly professional. It is worth noting that since each contractor is small and is specialized in certain particular components only, it would be highly unlikely for the small contractors to receive technological lenience from the SOEs and LEs. Moreover, these businessmen who were willing to get up and work in the middle of the night were basically motivated by two things: first, they were driven by money. Each one of them is the owner of a small or medium-sized plant; hence, every deal means profit for them. Second, as the owner of the Lee Wei factory pointed out, the crucial reason why he dared to call other people to his office to work through the night was that, regardless of their business relations, they have different degrees of social relationship.

The example of the Lee Wei factory is only one such success story in manufacturing industry in Taiwan. In fact, its manufacturing industry, in particular its machine production (instrumental tools, such as lathes and punching machines) is growing by nearly 20% a year. Furthermore, Taiwan has become the fourth largest producer in the world (after Germany, Japan and Italy) and exporter of these tools.²²⁹ The account above shows how the pattern and the subcontracting system of the SMEs function in Taiwan. It illustrates that, although the size and capacity of the SMEs are limited, cooperation enhances their competitiveness in the global market. What is more important is that the example shows the limited role of the government, the SOEs and the LEs in guiding or leading SME operations.

The sophisticated division of labour and social connections have been the two major dynamics within the subcontracting system; the hidden factors for these dynamics include economic profit and social relationship. The combination of these two factors played a further significant role in providing financial support for SME business transactions within the subcontracting system. Figure 6-3 below shows an estimation of the structure of external credit to the manufacturing industry in Taiwan from 1973 to 1990. The greatest amount of external credit came from the categories

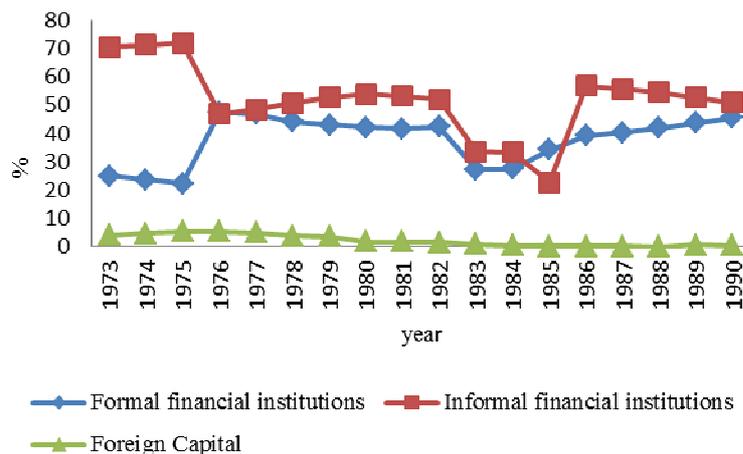
'Yige xiaobaochan de anli diaocha: jiating guanxi yu guyong guanxi de jiaohu zuoyong, *Taiwan: a Radical Quarterly in Social Studies*, vol.2, no.3,4(1989), pp.189-215.

²²⁹ Shieh, Minray, 'Taiwan jixie gongye de fazhan', in *Jixie chanye fazhan de huigu yu zhanwan*, *Kexue fazhan*, vol.457 (2011), pp.39-42, <http://old.npf.org.tw/PUBLICATION/FM/091/FM-R-091-009.htm>. (accessed 11 January 2010).

of private enterprises and families. The category of private enterprises includes loans from private enterprises and the workings of the credit system between private enterprises.

Furthermore, the statistics also demonstrate that the percentage of turn-over credit loans from the public financial institutions has increased. The banks were more willing to grant turn-over credit loans to the SMEs may be related to the fact that these loans were mainly short-term credit loans on which higher interest rates were charged. The evidence shows that the SMEs did not rely heavily on the formal institutions for turn-over credit funds. Instead, they relied on credit from private enterprises and family. The subcontracting system provides a foundation for the financial support based upon mutual economic interests and social relationships.

Figure 6-3. Estimation of the External Capital Structure of the Taiwanese Manufacturing SMEs by Financial Source (%), 1973-1990



Source: Bureau of Economic Research, Central Bank of the R.O.C. (Taiwan), Report on the Source of Capital of Public and Private Enterprises in Taiwan Area (Taipei: Central Bank of the R.O.C., 1976, pp.4-6; 1978, pp.6-8; 1980, pp.13-16; 1983, pp.12-13; 1985, 10-13; 1987, p.59, p.77; 1988, pp.60-62; 1989, pp.59-61; 1990, 1991, pp.61-63).

Note: 1. The original government data list only the source of capital in manufacturing and other different industries. The estimation is calculated based upon the statistics of the manufacturing industry times 90% for the SMEs in manufacturing industry.

2. The formal institutions include the government, the SOEs and the public financial institutions.

6-4. Conclusion

The state interest influenced the formation of the economic policy which focused on sustaining the development of the SOEs and LEs. The industrial structure was formed on this principle. According to the government statistics, most of the SOEs dominated the upstream industries which were concentrated in the textile and

chemistry industries. The industrial structure and the FDI investment industries created a market for the SMEs. This market is limited to certain industries where the Taiwanese SOEs could provide materials or intermediate goods from the upstream industries.

At the same time, the legal regulations for corporate registration facilitated the registration process for small factories in the rural areas. These lowered the entry barriers so that SMEs could set up factories and begin work. These policies and regulations did not, however, specifically focus on helping to found SMEs and their foundation should be considered an unintended consequence of economic policy. The unintended consequence of the policy and regulations also created space for social institutions to function.

The cost of borrowing from the unorganized money market was twice the cost of borrowing from the formal banking system. The government did provide cheaper credit for the private sector. However, the SMEs could not benefit from this provision. Evidence shows that the largest percentage of the sources of capital for the SMEs came from the private sector. Since the market created by the state policies lowered the entry requirements and facilitated the administration process and the downstream industries required only a small amount of financial capital to start business, SME owners were able to collect the necessary capital through family (relatives and friends). The evidence shows that most of the SME capital had this origin and the percentage of family funding has remained high over time. This is the clear evidence of the strength of social institutions which supported the founding of SMEs as businesses in the market.

The strength of the subcontracting system of the SMEs has been regarded as significant in enhancing competitiveness and reducing transaction costs for the SMEs. The structure of the subcontracting system demonstrates that the system is horizontally integrated and that no SOEs or LEs led or integrated the system vertically. The example in this chapter shows that the dynamics of the subcontracting system include the division of labour, social networks and economic incentives. This example of the function of the social institution further questions the argument that the state indirectly issued technology licenses more cheaply to the SMEs. The size of the SMEs and the skills and techniques required for SME business was unlikely to have acquired a technology license. Furthermore, the combination of economic interest and the social relations of the subcontracting system provide important turn-

over credit funding for SME business transactions. The evidence shows that the SMEs relied on private enterprises and family for their operation. Without the financial support, the SMEs would have found financially difficult to operate.

This chapter shows that the state's interest influenced the formation of the development policy and the formal institutions, based upon these policies, inadvertently created a market for the SMEs and a space for the social institutions to function. Although the cost of borrowing from the government was much less than the cost of the borrowing from the unorganized money market, the SMEs were not able to access the cheaper credit. The sources of capital for the SMEs show the strong support for them from social institutions. The structure of the subcontracting system also questions the support given them by the SOEs and LEs.

Based upon the present analysis, it is possible to argue that, without the market or the space created by the formal institutions, the social institutions would not have been able to provide significant support to the SMEs. It is worth noting that, although the government-controlled market provided cheaper credit, the SMEs did not rely on bank loans. In these circumstances, it may be argued that, without the significant support of the social institutions, the SMEs could have found it financially difficult to participate in the market and to operate business transactions. The evidence of the sources of capital for the SMEs also confirms the importance of qualifying for and being able to access government support.

Part IV. The State's Influence: the Conflict of Interest between the State and the SMEs, 1980-2000

After the late 1980s, research on Taiwan's economic development changes its focus to cross-strait economic relations. The transformation is related to two important changes. On the one hand, Taiwan's rapid economic growth brought about economic challenges to the SMEs; this implies the changing economic structure in Taiwanese society. On the other, China's economic reform in 1979 significantly influenced both political and economic relations across the strait. These two changes have attracted attention to the economic relations and political conflicts between Taiwan and China. Much has been done, for example, on Taiwanese FDI in China, comparative advantages, the economic integration of Taiwan, China and Hong Kong and the contradictions between political conflicts and economic prosperity.

However, some questions have been ignored, despite their importance in examining the role of the state in the rise and the development of the SMEs since World War II. What economic challenges influenced the SMEs' economic interests? What was the government's interest after 1990? What influenced the state's interest in drawing up the cross-strait economic policy? Did the economic interest of the SMEs conflict with the state's interest after the late 1980s? Was the state's intervention in the SMEs conditions effective?

Chapter 7. The Changing Market and the Economic Interest of the SMEs, 1980-2000

The 1970s and the 1980s were the Golden age of the Taiwanese manufacturing SMEs. However, economic prosperity brought about economic changes affected their further development. This chapter first shows the contribution of the SMEs to the Taiwanese economy; the contribution of the SMEs indicates that their prosperity depended on the export market and on the labour force. The dependence led to the economic challenges to the SMEs in the late 1980s. The second section then clarifies these challenges and their impact on the business of the Taiwanese manufacturing SMEs. The analysis of the economic challenges suggests that the government had a significant impact on the market by controlling the foreign exchange rate; this influenced the environment for the SMEs' business operations.

The third section then sees how the government dealt with the difficulties and assisted the SMEs to remedy them. The government launched two sets of policies to meet the challenges and to upgrade the economic programme further. On the one hand, it imported foreign workers from Southeast Asia; on the other, the new investment policies set up the regulations for Taiwanese outward investment in Southeast Asia and in China. These policy adjustments were considered a more open procedure, instead of providing support to the SMEs in the changing market. Moreover, the determinants of the Taiwanese FDI demonstrate the economic interest of the Taiwanese SMEs in a market which was changing in response to the state's policy changes.

7-1. Taiwan's Economic Miracle and Worries under the Prosperity

In the 1970s and the 1980s, Taiwan's GDP and rate of export growth increased. Table 7-1 below shows an estimation of the proportion of Taiwanese manufacturing SMEs in Taiwan's total GDP from 1951 to 1985. In the 1950s and 1960s, the manufacturing SMEs contributed only around 10% to 20% of Taiwan's GDP. After 1970, the manufacturing SMEs contributed more than 30% to it. Moreover, the manufacturing SMEs played a significant role in providing job opportunities in the economy. Table 7-2 below shows the estimation of the proportion of employment in SMEs in the country's total employment. It is clear that from 1970 the employment of the manufacturing SMEs occupied around 20% to 30% of the Taiwan's employment force. Therefore, in addition to the significant contribution to

GDP, the manufacturing SMEs gave work to more of the Taiwanese labour force than any other sector. The economic prosperity also implies that the SMEs, in their turn, relied heavily on the export market and the labour force.

Table 7-1. The Estimation of the SMEs' Contribution to Taiwan's GDP (%), 1951-1985

Year	GDP total(NTD) (A)	Share of manufacturing industry to Taiwan's GDP (NTD) (B)	Share of manufacturing industry to Taiwan's GDP (%) (C= (B/A x100%))	Share of SME manufacturing industry to Taiwan's GDP (%) (D=C x 90%)
1951	12259	2122	17.3	15.57
1952	17166	2679	15.06	13.55
1953	122863	3328	14.5	13.05
1954	25087	4794	19.1	17.19
1955	29838	5598	18.76	16.88
1956	34219	6799	19.86	17.87
1957	39936	8298	20.7	18.63
1958	44683	9121	20.41	18.36
1959	51525	11551	22.4	20.16
1960	62170	13500	21.71	19.53
1961	69677	15158	21.75	19.57
1962	76762	17429	22.7	20.43
1963	86823	21641	24.92	22.42
1964	101476	26318	25.93	23.33
1965	112089	29100	25.96	23.36
1966	125440	32544	25.94	23.34
1967	145162	41594	28.65	25.78
1968	169153	52501	31.03	27.92
1969	195940	65637	33.49	30.14
1970	225695	75682	33.53	30.17
1971	262247	94149	35.9	32.31
1972	314301	122853	39.08	35.17
1973	407535	172854	42.4	38.16
1974	545024	214260	39.31	35.37
1975	584494	214314	36.66	32.99
1976	701117	276844	39.48	35.53
1977	816943	327129	40.04	36.03
1978	970269	408725	42.12	37.9
1979	1164073	495832	42.59	38.33
1980	1442870	599595	41.55	37.39
1981	1703818	677130	39.74	35.76
1982	1899971	668934	35.2	31.68
1983	2100005	754729	35.93	32.33

1984	2343078	879455	37.53	33.77
1985	2473786	929142	37.55	33.79

Source: Directorate-General of Budget, Accounting and Statistics, Executive Yuan R.O.C. (Taiwan), *Quarterly National Economic Trends* (Taipei, 1984, 2001), pp.32-33, pp.38-39.

Note: According to the Taiwanese government statistics, the Taiwanese SMEs dominated around 90% of manufacturing industry. Therefore, the estimation of the proportion of the SME manufacturing industry to Taiwan's GDP is times 90%.

Table 7-2. The Estimation of the Percentage of Total Employment Provided by the SME Manufacturing Industry in Taiwan, 1951-1991

Year	% of employment share by the manufacturing industry (A)	Estimation on the % of employment provided by the SME manufacturing industry (B=A x 90%)
1951	11.99	10.79
1952	12.35	11.11
1953	12.85	11.56
1954	12.95	11.65
1955	13.22	11.89
1956	13.1	11.79
1957	13.4	12.06
1958	13.76	12.38
1959	14.39	12.95
1960	14.66	13.19
1961	14.82	13.33
1962	14.86	13.37
1963	15.6	14.04
1964	15.41	13.86
1965	16.26	14.63
1966	15.62	14.05
1967	17.42	15.67
1968	17.88	16.09
1969	18.37	16.53
1970	20.21	18.18
1971	21.28	19.15
1972	22.86	20.57
1973	26.67	24
1974	26.97	24.27
1975	27.53	24.77
1976	28.82	25.93
1977	28.45	25.6
1978	30.52	27.46
1979	32.42	29.17
1980	32.92	29.62
1981	32.4	29.16
1982	31.83	28.64

1983	37.59	33.83
1984	33.83	30.44
1985	32.02	28.81
1986	30.78	27.7
1987	29.94	26.94
1988	28.39	25.55
1989	27.79	25.01
1990	27.05	24.34
1991	27.44	24.69

Source: Directorate-General of Budget, Accounting and Statistics, Executive Yuan R.O.C. (Taiwan), *Quarterly National Economic Trends, Directorate-General of Budget, Accounting and Statistics* (Taipei, 1980, 1997), p.21, pp.24-25.

Note: According to the Taiwanese government statistics, the SMEs dominated around 90% of manufacturing industry. Therefore, the estimation on the percentage of the SME employment to the Taiwan's total employment forces was calculated on the percentage of the employment force in manufacturing industry to Taiwan's total employment force times 90%.

In the 1980s various problems emerged from the Taiwanese economy to challenge the SMEs. First, the rapid development of manufacturing industry damaged the environment. The Taiwanese government passed a series of new laws to protect the environment in the 1980s. These regulations had both a positive and negative impact on the Taiwanese economy. They brought new business for firms dealing with the environment and pollution. But for many SME factories, the regulations increased the cost of production and reduced profits.²³⁰

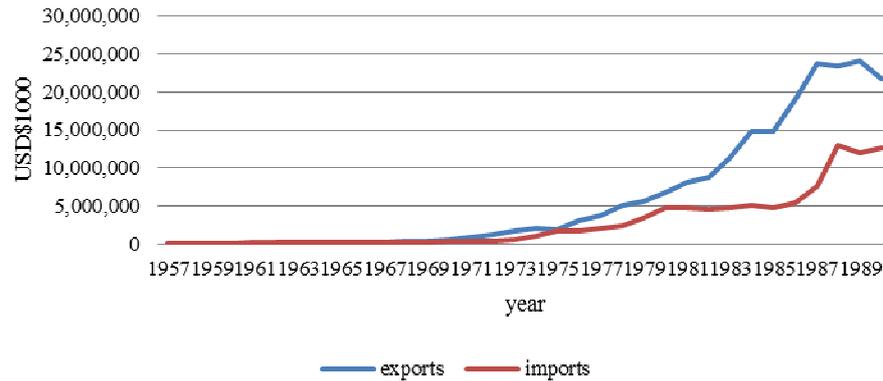
Second, the large amount of exports not only brought profits, but also led to international trade problems. The U.S. market has always been the largest market for Taiwanese exports. In the 1980s, the U.S. trade deficit with Taiwan was large (as shown in Figure 7-1 below). The U.S. government in the 1980s urged the KMT government to revalue the NTD in order to balance the U.S.-Taiwan trade.²³¹ Table 7-3 below shows the foreign exchange rate of the NTD and USD., fixed at 1 USD to 40 NTD. In 1987 the value of the NTD appreciated rapidly from 1:37 to 1:31 within a

²³⁰ For further details, see Fei, John C.H., "Ideology of Economic Development in Taiwan," in *Experiences & Lessons of Economic Development in Taiwan*, eds. Li, Kuoting & Yu, Zongxian, (Taipei, 1982), pp.83-102.

²³¹ Various debates concerning the appreciation of the NTD against the USD arose in the late 1980s. One group of scholars argues that the huge increase of foreign reserve in the mid-1980s should have led to a simultaneous appreciation of the NTD. However, government intervention slowed down the appreciation of the NTD in the late 1980s and this then led to a market bubble in the early 1990s. Another group of scholars indicates the importance of the U.S. influence on the appreciation of the NTD in the late 1980s. Under the special 301 Report of the Trade Act 1974, the KMT government was forced to relax control on the price of foreign exchange. The focus of this dissertation is on the impact of the appreciation of the NTD on the SMEs. For further debates, see Yu, Zhongxian and Wang, Kinli, *Taiwan paomo jingji* (Taipei, 1999); Liu, Shouxian, 'Taiwan paomo jingji de fazhan yu jiantao', *Jingji qanzhan*, 5 January 1996, pp.114-119.

year. From 1987 to 1997 the foreign exchange rate remained at 1:26. The appreciation of the NTD had a serious impact on Taiwanese manufacturing industry, since (1) most of the factories were export-oriented and (2) the U.S. had always been the major market. The appreciation of the foreign exchange rate largely reduced export profits and business was sacrificed.

Figure 7-1. Value of Exports and Imports with the U.S. (USD\$1000), 1957-1989



Source: Directorate-General of Budget, Accounting and Statistics, Executive Yuan R.O.C. (Taiwan) *Statistical Yearbook* (Taipei, 1997), pp. 302-309.

Table 7-3 Foreign Exchange Rate of U.S.D. against NTD, 1980-1997

1980	01:36.0
1981	01:36.8
1982	01:39.1
1983	01:40.1
1984	01:39.6
1985	01:39.9
1986	01:37.8
1987	01:31.8
1988	01:28.6
1989	01:26.4
1990	01:26.9
1991	01:26.8
1992	01:25.2
1993	01:26.4
1994	01:26.5
1995	01:26.5
1996	01:27.5
1997	01:28.7

Source: Department of Economic Research, Central Bank of the R.O.C. (Taiwan), *Foreign Exchange Rate*, <http://www.cbc.gov.tw/mp1.html>. (25 January 2011).

Third, Figure 7-2 below shows the increases in labour wages in manufacturing industry from 1980 to 1990. The calculation of these wages is converted to US dollars based upon the changing exchange rate every year. They are converted to show the sudden increase of labour costs for the SMEs during this period. Most of the SMEs are export-oriented and their largest market is in the U.S. The conversion of labour wages clearly shows the burden on the Taiwanese SMEs during this period. From 1986 to 1989, the rate of labour wages increased from 20% to 30%. In other words, the production cost for the SMEs increased from 20% to 30%.

Figure 7-2. Average Monthly Earnings of Manufacturing Industry in Taiwan (US\$), 1980-1990



Source: Directorate-General of Budget, Accounting and Statistics, Executive Yuan R.O.C. (Taiwan), *Statistical Yearbook of the R.O.C.* (Taipei, 1991), p.9.

In addition to the appreciation of the foreign exchange rate, labour shortages and the development of the labour movement in Taiwan also worsened the economic environment for the SMEs.²³² According to the official account in 1987, there were at least 200,000 unfilled vacancies in manufacturing industry, since manufacturing industry found it hard to recruit workers in view of its low wages compared with other sorts of industry, such as commerce and services.²³³ The link between the lower wage

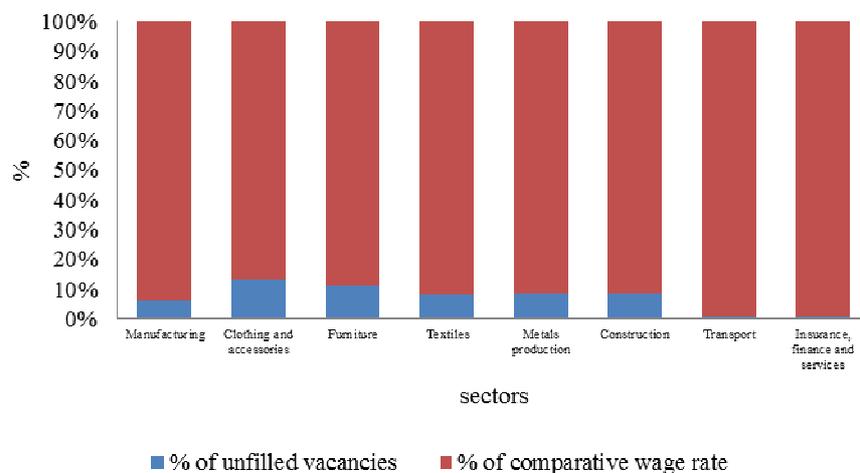
²³² For further details, see Galenson, Walter, "The Labour Force, Wages and Living Standards," in *Economic Growth and Structural Change in Taiwan: The Post-war Experience of the Republic of China*, ed. Galenson, Walter (London, 1979), pp. 384-447.

²³³ For further details, see Lin, Jiping, 'Sample Attrition and Statistical Estimation Effectiveness of Matched Cross-sections: An Analysis Based on the 1981-2000 Quasi-longitudinal Manpower Utilization Survey,' paper presented at the 5th Conference on survey research Methodology and Application (Taipei, 02 September 2004).

and the percentage of unfilled vacancies is shown in Figure 7-3 below. It demonstrates that the lower the rate of comparative wages, the higher the rate of unfilled vacancies.

Figure 7-3 clarifies the loss of competitiveness of manufacturing industry in the labour market: it is always the case that industries, such as transport or financial services, which had fewer unfilled vacancies, had comparatively higher wages. Industries such as clothing and accessories, construction and furniture which had a comparatively large number of unfilled vacancies also had comparatively lower wages. Weak competitiveness in wages caused the problem of a labour shortage in manufacturing industry (for labour-intensive industries, such as clothing and textiles in particular) in the late 1980s.

Figure 7-3 Percentage of Unfilled Vacancies and Comparative Wage Rate in Taiwan in 1988 (%)



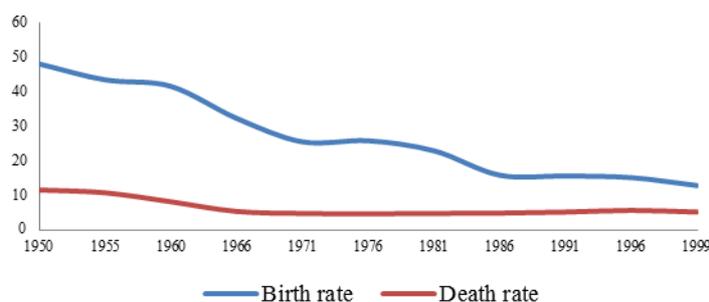
Source: Directorate of the General Budget, Accounting and Statistics, Executive Yuan R.O.C. (Taiwan), *Reports of the Labour Movement* (Taipei, 1988), pp.18-20.

The appreciation of NTD also contributed to the comparatively low wages in the manufacturing industry. The export-oriented manufacturing SMEs were in a dilemma: in order to lower the production costs and maintain competitiveness in the global market, the wage for workers had to remain low; however, since they did not rise, labour shortages resulted, from the growth of other industries in the Taiwanese market. Moreover, it is difficult for the export-oriented manufacturing SMEs to alter

labour production quickly (since this involves developing new technologies and thus abundant capital).

Demographic changes also influenced the changes of the labour market. In the early 1950s Taiwan had a high birth rate and a high death rate (as shown in Figure 7-4 below). After thirty years, the structure changed and became characterised by a low birth rate and low death rate. This change in population structure also caused the problem of a labour shortage. People who were born in the 1950s to 1960s are called the baby-boom cohort. In the 1970s, this became the main labour force for the growing manufacturing industry. During this period, the participation rate was perceptibly high.

Figure 7-4. The Changing Rate of Births and Deaths in Taiwan, (%) 1950-1999



Source: Directorate of the General Budget, Accounting and Statistics, Executive Yuan R.O.C. (Taiwan), *Statistical Yearbook of the R.O.C.* (Taipei, 2000), p.68.

The next generation after the baby-boom was born in the late 1960s to 1980s. The birth rate during this period is much lower than in the baby-boom generation. The low rate of population growth is also affected by the government policy of the 1960s. In the 1950s, in a situation of combat readiness, the government encouraged large families. However, the high growth of population caused problems in turn, such as a shortage of food. Therefore, in 1964 the government pursued a birth control policy and encouraged ‘two children in one family’. However, the low birth rate posed a challenge for manufacturing industry.²³⁴

Moreover, in the late 1980s the labour unions organised a labour movement. Labour unions were set up very soon after the KMT government came to power in China. After the move to Taiwan, they maintained their organisations. Before 1987,

²³⁴ For further details, see Lee, Joseph S., ‘Asia in the 21st Century: Challenges and Opportunities in Work and Labor’, *Japan Labor Bulletin*, vol. 40 (2)(2001), pp.13-19.

the unions rarely went on strike for workers benefits even before martial law prohibited freedom of association and the right to protest. In 1987 martial law came to an end and the protests led by the labour unions followed within in the year. Since then, the Taiwanese labour unions have become active in striking for better working conditions, salaries and benefits for their members. In times of prosperity, the workers and the unions took advantage of it. This, again, increased the burden on the SME owners and weakened Taiwan's global competitiveness.

Overall, the Taiwanese labour market in the 1980s and the 1990s was challenged by the shortage of labour and the rise of labour movements. The shortage of workers forces was increased by the changing population structure, while the rise of the labour unions and labour movement challenged the entrepreneurs' initiatives. These factors are the key to the rise in labour wages in 1980s and 1990s, a rise which became the main driver of the migration to China by the Taiwanese SMEs. The shortage of labour and the changing environment speeded up the migration of labour-intensive manufacturing. To put it another way, in the late 1980s and the early 1990s, the conditions of the labour market were not attractive enough to supply the labour needs of Taiwan's labour-intensive industries.

7-2. The Determinants of Taiwanese Outward Investment

In this situation, the Taiwanese government implemented different policies. To cope with the labour shortage, in particular for manufacturing industry, the Taiwanese government first allowed in 1985 the entry of foreign workers (from South East Asia). Importing foreign forces had both a good and a bad effect on the development of Taiwanese economy. On the one hand, by reducing labour costs, the government helped the labour-intensive industry to solve the problems of the labour shortage and of remaining competitive in the global market. On the other hand, importing foreign workers may also reduce job opportunities for certain local workers. Therefore, the government strictly controlled the number of foreign workers until 1990.²³⁵

Since the policy of importing workers could not solve the problems of understaffing, in the mid-1980s the Taiwanese government permitted the Taiwanese

²³⁵ For further details of the impact of the foreign workers on the Taiwanese workers, see Jiang, Fengfu, 'Zhonggao ling yu jiceng laogong zhi shiye qingshi ji yinying duice', *Industry of Free China*, vol.91, no.7 (2001), pp.41-81; Lan, Kezheng, "Wailao yingjin dui Taiwan laogong jiuye zhi yingxian," *Jingji fazhan han laodong shichan bianhua xueshu huiyi* (Jiayi, 2001).

SMEs to invest in other countries where sufficient low-paid workers could be found. In the late 1980s China and some countries in Southeast Asia (Indonesia, Malaysia, the Philippines and Thailand) were not too far from Taiwan and could meet the needs of the Taiwanese SMEs.²³⁶ Figure 7-5 below shows a comparison of GNP per capita in China, Indonesia, the Philippines, Thailand, Malaysia and Taiwan from 1986 to 1993.²³⁷ It is clear that China had the lowest GNP per capita in the group; the Chinese GNP per capita was only half of that in Taiwan. In other words, China was able to provide the cheapest labour force of all the Southeast Asian countries listed. Figure 7-6 shows the percentage of the factors drawing Taiwanese enterprises to invest abroad. It shows that more than 80% agree that lower labour costs were the determinant for their choice of China. Other factors, including the Chinese market and the lower cost of land, were related to the market mechanism and the reduced cost of production.

Figure 7-7 shows the average monthly earnings of the Taiwanese workers in manufacturing industry, the basic salary regulated by the Taiwanese government and the average wage of Chinese workers from 1984 to 1995. In 1984 the average monthly earnings of a Taiwanese worker were around six times higher than the average monthly earnings of a Chinese worker. The Taiwanese basic salary (generally the salary paid to foreign workers in Taiwan) was around three times higher than the average wage of the Chinese workers. The comparison implies that the SMEs were able to reduce production costs by means of the lower labour costs in China.²³⁸ In general, most research on the determinants of Taiwanese FDI in China identified that cheap labour costs, cheap raw materials and land, an export-oriented FDI strategy and

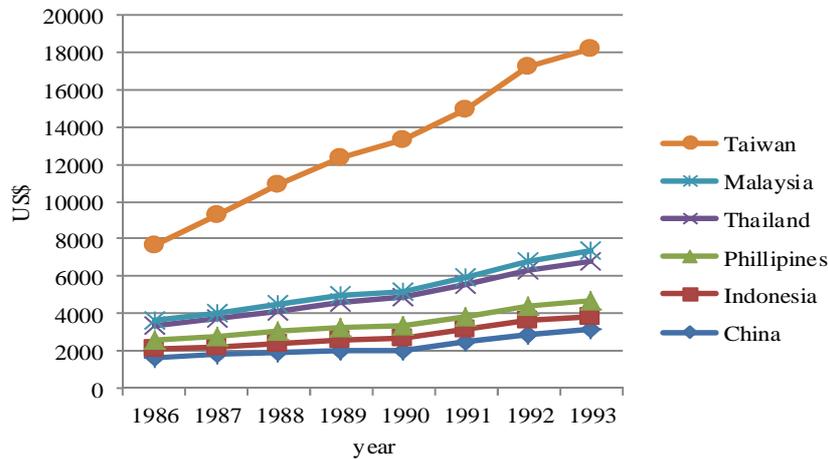
²³⁶ Since large amount of research has been done concerning the determinants of Taiwanese FDI in China from the late 1980s, this chapter categories only a few of the factors instead of clarifying any new determinants for Taiwanese FDI in China. It focuses on whether these pull factors respond to the economic challenges faced by the SMEs in Taiwan. Some comparative studies of China and Southeast Asia show that the wage differences and government policies made China a better FDI host country for Taiwanese investors than other Southeast Asian countries. For further details concerning Taiwanese FDI in China, see Huang, Yasheng *FDI in China: An Asian Perspective* (Hong Kong 1997); Wei, Yingqi and Liu, Xiaming, *Foreign Direct Investment in China: Determinants and Impact* (Cheltenham, 2001); Wu, Yanrui, *Foreign Direct Investment and Economic Growth in China* (Cheltenham, 1999); Zhang, Changuo, *Taishang dalu tozi wenti yanjiu* (Hong Kong, 2007); Fan, Joseph, P.H., *Does 'Good Government' Draw Foreign Capital? : Explaining China's Exceptional Foreign Direct Investment Inflow* (Washington, D.C., 2007); Organisation for Economic Co-operation and Development, *Foreign Direct Investment in China: Challenges and Prospects for Regional Development* (OECD publishing, 2002).

²³⁷ Vietnam is not included in the comparison of GNP since no data on the Vietnamese GNP from the Asian Development Bank are available before 1997.

²³⁸ The average monthly earnings of a Chinese worker are converted into U.S. dollars based upon the exchange rate of the RMB against the U.S.D. from 1984-1995. The conversion is needed for comparing the labour cost for the SMEs in China and in Taiwan for goods in the export market in the U.S..

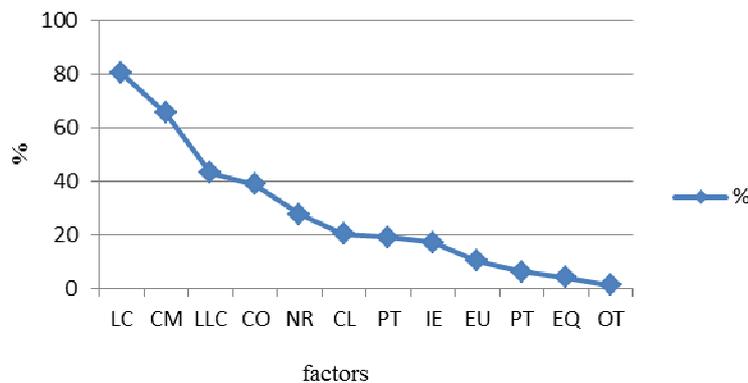
Chinese connections (including language, culture and geographical proximity) are the significant determinants for Taiwanese investment in China.²³⁹

Figure 7-5. The Comparison of GNP per Capita in China, Taiwan, Malaysia, Indonesia, the Philippines and Thailand (USD\$), 1986-1993



Source: Asian Development Bank, *Key Indicators of Developing Asia and Pacific Countries* (Manila, 1999), pp.80-88, pp.126-136, pp.182-192, pp.262-272, pp.312-322, pp.332-342, pp.376-384.

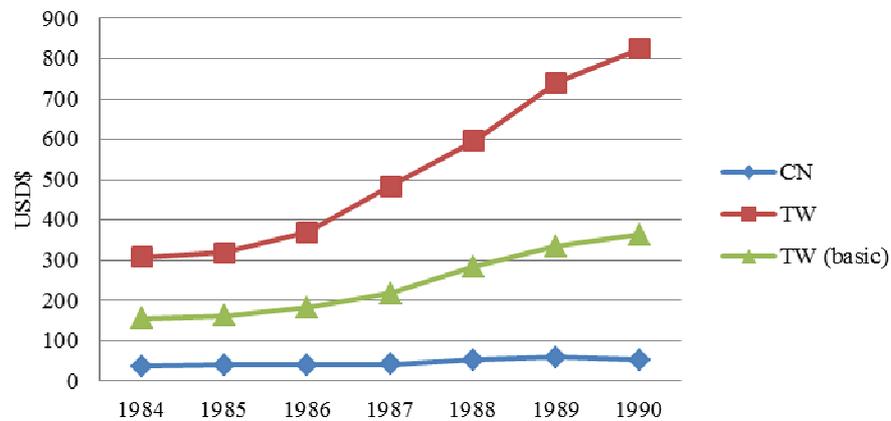
Figure 7-6. The Pull Factors in the Taiwanese Enterprises' Investment in China



Source: Ministry of Economic Affairs, *Report of Investment Commission* (Taipei, 2005), pp.11-12.
 Note: LC= Lower Labour Cost; CM=Chinese Market; LLC= Lower Land Cost; CO= Cooperation with Contractors; NR= Natural Resources; CL= Clients Requirements; PT= Preferential Tax and Levies; IE=Investment environment; EU=Effective use of capital; EQ= Export Quota; OT= Others.

²³⁹ Li, Huajie, 'Zaofu zhonghua de minzhi xuanze: lun jianli zhonghua qian de xianshi yiyi', *Ganao Jingji*, no.5 (1989), pp.21-23; Gao, Kongliang, *Trade and Investment across the Taiwan Strait: Maintaining Competitive Advantage, Pursuing Complimentary* (Taipei, 1992); Bello, Walden and Rosenfeld, Stephanie, *Dragons in Distress: Asia's Miracle Economies in Crisis* (San Francisco, 1990). Zheng, Zhu Yuan, *Haixia liangan de jingji fazhan* (Taipei, 1983).

Figure 7-7. The Comparison of the Monthly Earnings of Taiwanese Workers in Manufacturing Industry, Taiwanese Monthly Basic Salary and the Monthly Earnings of Chinese Workers



Source: Directorate of the General Budget, Accounting and Statistics, Executive Yuan R.O.C. (Taiwan), *Statistical Yearbook of the R.O.C.* (Taipei, 1991), p.9; National Bureau of Statistics of the P.R.C., *China Statistical Yearbook* (2001), p.135; Statistical database of the Council of Labour Affairs, Executive Yuan R.O.C. (Taiwan), Basic Salary of Workers, <http://statdb.cla.gov.tw/statis/stmain.jsp?sys=220&ym=6700&ytm=9900&kind=21&type=1&funid=q04011&cycle=4&outmode=0&compmode=0&outkind=11&fld0=1&rdm=weSAkBP2>. (accessed 25 April, 2011).

7-3. Conclusion

The SMEs played a significant role in Taiwan's export market and GDP in the 1970s and the 1980s. The significant contribution of the SMEs to Taiwan's economy indicates that the SMEs relied heavily on the export market and the labour force. The rapid economic growth brought economic challenges for SMEs, mainly related to the supply and the cost of wages. The significant factor in the rise of labour costs was the sudden appreciation of the NTD against the U.S.D. in the mid- and late 1980s. Since the U.S. is the largest export market for Taiwanese manufacturing products, production costs increased as the NTD appreciated. Furthermore, the factor of demographic change and the change in the industrial structure also increased labour costs and reduced the supply of labour in manufacturing industry. In this situation, the government first allowed the entry of foreign workers.

The analysis of economic challenges indicates that the state had a significant impact on the market by controlling the price of foreign exchange. The fluctuating exchange rate significantly influenced the market environment for SME business operations. The analysis of policy adjustments shows that the state did not provide further support or subsidies to the SMEs. Although the tax exemption and the export subsidies remained, most of the SMEs did not rely heavily on such support (as shown

in Chapters 5 and 6). Although the government's policy changed the market environment and this in turn influenced the SMEs' economic activity, other factors, such as demographic changes and the development of other industries in Taiwan made the market environment more difficult for the SMEs.

Instead of providing support, the policy became more open. The imported foreign workers opened the labour market but the admissions quota was still in control as regards job opportunities and benefits for Taiwanese workers; however, the control restricted the ability of the policy to solve the staffing problems. In 1986 the government permitted Taiwanese outward investment in other countries where manufacturing SMEs could employ adequate numbers of worker at a cheaper rate.

Two popular places for Taiwanese investment to turn to in the late 1980s were China and South East Asia. Evidence shows that China had the lowest GNP per capita of any country in the two groups; this implies that China could provide cheaper labour than they could. The investigation by the Taiwanese government also shows that the reducing production costs, in particular that of labour, was the key determinant for Taiwanese FDI in China. The comparison of the average monthly earnings of the Chinese workers and the Taiwanese workers from 1984 to 1995 demonstrates that the cost of labour forces was much lower in China than in Taiwan. In conclusion, this chapter clarifies that the economic interest of the Taiwanese SMEs lay in these lower labour costs which China could provide in the late 1980s.

Chapter 8. The Interests of the State and its Limits on SME Investment Behaviour

The economic interests of the SME clearly lay, then, in investing in China because of the cost of labour. What were the state's concerns in terms of SME investment in China? The economists who analysed cross-strait trade and investment tended to believe that free trade and investment would bring huge profits for the two economies based upon comparative advantage, business interests, the division of the international labour market and changes in the industrial structure. Most analysts, for example, Robert Ash and Y.Y. Kueh, Douglas Fuller and Hsu and Liu confirm that in a framework of free trade and investment economic earnings exceed costs. Fuller's analysis further shows that Taiwanese investment in China did not result in the rise of unemployment and hollowing-out of Taiwanese industries.²⁴⁰ According to Hsu and Liu, the hollowing-out effect may occur when analysing their data on individual firms. They suggest that the hollowing-out effect could have been mitigated by upgrading and developing new industries instead of controlling outward investment in China, because, as Ash and Kueh indicate, even if the Taiwanese manufacturers had not invested in China, they would have directed their capital elsewhere.²⁴¹ The academic research was sympathetic to the economic needs of the SMEs in the changing economic situation after the late 1980s.

However, Sun Yunsuan, who was Premier from 1978 to 1984, claims that China was in the process of transition and neither well-established institutions nor clear regulations would protect the rights and property of Taiwanese investors there.²⁴² In addition to the economic concerns, the biggest problem lies in political conflicts and military resistance across the strait. Hence, before 1991 there was limited transit trade between Taiwan and China via Hong Kong; and Taiwanese investment in China was prohibited. Even after 1991, trade and investment across the strait were managed and restricted. Yet in 1994 the government promoted the 'Go-South' policy. The aim of this policy was to encourage Taiwanese investment in

²⁴⁰ Fuller, Douglas B., 'The Cross-Strait Economic Relationship's Impact on Development in Taiwan and China', *Asian Survey*, vol.48, issue 2 (2008), pp.239-264.

²⁴¹ Ash, Robert and Kueh, Yi Yao, 'Economic Integration within Greater China: Trade and Investment Flows between China, Hong Kong and Taiwan', *The China Quarterly*, no.136 (1993), pp.711-745; Hsu, Chenmin and Liu Wanchun, 'The Role of Taiwanese Foreign Direct Investment in China: Economic Integration or Hollowing-Out?', *The Journal of the Korean Economy*, vol.5, no.2 (2004), pp.207-231.

²⁴² For further details regarding the institutional problems in China, see Guo, Anmin, 'Taishang zaidalu touzi manlin zhi kunjing', *Zhonggong yangjiu*, vol.26, no.8 (1992), pp.33-41; Qiu, Honghui, '1992 Nian de ahongguo jingji', *Zhonggong yanjiu*, vol.27, no.1 (1993), pp.53-67.

Southeast Asia instead of China. Most of the policies consisted of encouragement and supplies for the Taiwanese enterprises which invested in Southeast Asia.²⁴³

The academic research and the government's policies lead to the main questions of this chapter. If the benefits from free trade and a more open investment policy with China are larger than the cost, why was a beneficial policy opposed? Was this only a political issue? Were the SMEs able to influence the formation of economic policy? Did the state's interests and the policy restrictions influence the SMEs' investment behaviour in China? This chapter examines whether the state policy, based upon its interests, was able to influence SME investment behaviour after the late 1980s.

To this end, the chapter begins with a general explanation of the government's political purpose in implementing bans and restrictions on cross-strait trade. A significant political transformation occurred in the 1980s; the chapter analyse the impact of the changing political system on the formation of the cross-strait economic policy in that and the following decade, in order to examine how far political conflicts, the state's interests and policy restrictions influenced the SMEs' investment behaviour in China.

The analysis has four sections. The first section briefly shows the transformation of political conflicts across the strait from 1970 to 2000. The second section clarifies the impact of the political reform on the distribution of political power in Taiwanese society. The third section focuses on the impact of the changing political power structure on cross-strait investment relations. The fourth section then compares the new economic policies towards investment and trade in China and in Southeast Asia based upon the government's interests. Finally, the analysis explores how far the political conflicts, state's interest and policy restrictions were able to influence the SMEs' investment behaviour.

8-1. The Political Conflicts across the Strait

The conventional view of the political conflicts between the KMT and the CCP resulted from the historical hatred, ideological differences and the impact of the

²⁴³ Zhang, Shuya, *Nanjin zhengce*, Xianshan Taiwan lishi zidian, <http://tkb.nmth.gov.tw/Doth/Article.aspx?1793^%b1i%b2Q%b6%ae>. (25 April 2011); for further details, see Peng, Baixian, ed., *Nanxian Zhengce yu Taiwan jingji de weilai* (Taipei, 1995).

Cold War.²⁴⁴ These historical factors lead to the main dispute in the 1980s and the 1990s. In the late 1980s and early 1990s the dispute usually centred on the issue of ‘one China’—was it the People’s Republic of China or the Republic of China?²⁴⁵ The political resistance in the mid-1990s transformed it into the national consciousness of Taiwan vs. Chinese nationalism. The main political issue after 1990 lay in the controversy over sovereignty in Taiwan.

The political quarrel can be traced back to the Shimonoseki Treaty in the late 19th century. For the Chinese, the Shimonoseki Treaty causes historical shame, since the last Chinese empire could not defend its territory. Therefore, they believe that reunification is a historical mission and Taiwan is an inseparable part of China. However, for the Taiwanese, the Chinese, or more specifically, the Chinese Communist Party and the government of the People’s Republic of China have never had legitimate sovereignty over Taiwan.²⁴⁶

Therefore, the political issue concerning Taiwanese sovereignty has never subsided. The historical hatred regarding ‘one-China’ and the new conflicts concerning ‘one China, one Taiwan’ led to obstacles being raised against open cross-strait trade and investment.²⁴⁷ The political conflicts between Taiwan and China has continued since 1947; however, how far would these historical and political factors affect the government’s interests when it made cross-strait economic policy and sought to influence SME investment behaviour in the late 1980s and the 1990s?

²⁴⁴ Zhan, Jun, *Ending the China Civil War: Power, Commerce and Conciliation between Taipei and Beijing* (New York, 1993).

²⁴⁵ Mainland China Affairs, *Guanyu yige zhongguo de hanyi*, http://www.mac.gov.tw/ct.asp?xItem=57875&ctNode=5645&mp=1&xq_xCat=1992. (accessed 13 June 2011).

²⁴⁶ The disputes of ‘unification’ vs. ‘independence’ were intensified by the domestic political struggle of the KMT and the DPP. George Crane explains the different political standpoints of the KMT and the Democratic Progressive Party (DPP). The domestic political struggle made it more difficult for the KMT (who were in power until 1999) to relax their cross-strait policy since the DPP became more influential in the 1990s and opposed an open cross-strait policy. Crane concludes that an integrated market would be hindered by internal political struggle in Taiwan and the indirect business pattern would remain informal because of political conflicts. Crane further points out the causes (in Crane, George Crane T., ‘China and Taiwan: Not Yet ‘Greater China’, *International Affairs* (Royal Institute of *International Affairs*), vol. 69, no.4 (1993), pp.705-723.

²⁴⁷ Lin, Xiangkai, “Taizhong jingji wanlai yu guojia anquan,” *Liangan jiaoliu yu guojia anquan, quncehui lianan jiaoliu yu guojia anquan yiangtaohui lunwen ji* (Taipei, 2003), pp.213-275; Huang, Tianlin, “Santong, jingjijiaoliu yu jingji anquan,” *Liangan jiaoliu yu guojia anquan, quncehui lianan jiaoliu yu guojia anquan yiangtaohui lunwen ji* (Taipei, 2003), pp. 277-305; Wu, Zhongji, “Liangan Jiaoliu dui Taiwan jingji yu guojia anquan de yingxian,” *Liangan jiaoliu yu guojia anquan, quncehui lianan jiaoliu yu guojia anquan yiangtaohui lunwen ji* (Taipei, 2003), pp.91-211.

8-2. Chiang Ching-kuo and the KMT's Political Reform, 1970-1987

The relationship of the state and the SMEs had been distant. Although the administrative organisation consulted the SMEs through different business organisations in order to adjust policies, the SMEs could not influence the formation of policy. The remoteness and the inability of the SMEs to influence the state's policy lay in the political power structure. In the 1970s, a series of political reforms was gradually carried out. This changed the political power structure and influenced further political transformation in the 1990s.

In the 1970s several factors had led to political reform in Taiwan. These factors included external and internal political and economic factors. The first and most significant external shock came in 1971, when the government of the Republic of China in Taiwan resigned its seat in the United Nations and was replaced by the People's Republic of China. This marked a significant defeat in international relations for the KMT government. Later in 1979 the U.S. government officially broke off diplomatic relations with the Republic of China (namely, the KMT government in Taiwan). The diplomatic crisis threatened Taiwan's safety, since it meant the loss of a powerful ally. Equally, the 1973 and 1979 oil crises affected the economic development of Taiwan. Aside from the shocks to international politics and the economy, they brought instability to internal politics.²⁴⁸

From 1949 the KMT government was challenged by several local organisations which questioned the legitimacy of the KMT's sovereignty in Taiwan after World War II.²⁴⁹ In the 1970s the KMT government was severely challenged by the growing power of the Tangwai. Several local elections, such as the elections for municipal and district councilmen, were held in Taiwan in the 1970s. More and more candidates from the Tangwai won local elections. In 1979 the Kaohsiung Incident occurred when the *Formosa Magazine* and other opposition politicians held a

²⁴⁸ "Woguo lianda daibiaotuan xuanbu tuichu lianheguo," *Zhonghua minguo shishi jiyao* (Taipei, 25 October 1971), pp.214-248; "Meiguo zhengfu tongzhi woguo zhongzhi gongtong fanyu tiaoyue," *United Daily*, Taipei, 1 January 1979.

²⁴⁹ The main political issue lies in the controversy over legitimate sovereignty in Taiwan. After World War II, the United Nations agreed to Taiwan's being placed under trusteeship by the government of the Republic of China (that is, of the ROC, namely, the Kuomintang); but it was trusteeship, not reunification. As a result of this, the KMT government could not claim legitimate sovereignty in Taiwan. For further details, see The Editing Group of the Discussions on Taiwan's Sovereignty, ed., *Taiwan zhuquan lunwen ji* (Taipei, 2001); The Editing Group of the Discussions on Taiwan's Sovereignty and One China, ed., *Taiwan zhuquan yu yige zhongguo lunshu dashi ji 1943-2001* (Taipei, 2002).

demonstration in order to encourage and demand democracy in Taiwan.²⁵⁰ The KMT government then arrested the opposition politicians and convicted them of insurrection.²⁵¹ This was the first serious political challenge to the KMT government in the course of their thirty-year domination in Taiwan.

In addition to the external and internal disturbances, a further problem within the KMT gradually intensified in the 1970s. Before 1970 Chiang Kai-shek's son, Chiang Ching-kuo, was not included among the core members of the KMT. Chiang Ching-kuo's political power was gradually enhanced in the 1970s and in 1972 he became the premier of the Executive Yuan. In order to deal with external oil shocks and to stabilise the domestic challenges from the Tangwai, Chiang Ching-kuo took the initiative to put political reforms into action in accordance with the economic development policy.

His aim in the reform was to alleviate the ethnic problems in Taiwan by promoting Bensheng ren candidates to the rank of higher government officials. These new elites were technocrats who specialised in engineering, agriculture or other economic and technological fields. Chiang's economic policy was based upon Keynesian economics: expanding government spending so as to increase needs and economic growth. The promotion of these Bensheng ren elites, on the one hand, put an end to the Waisheng ren monopolisation; but, on the other hand, these technocrats took over economic power and took more and more important positions within the KMT. Meanwhile, Chiang Ching-Kuo also encouraged young people to join the KMT and promoted young politicians to play a greater role in party affairs. The inclusion of Bensheng ren technocrats and the younger generation of KMT members was another means of strengthening his political and administrative power against the conservatives within the KMT.

Although Chiang Ching-kuo had created his own power base within the KMT by the early 1970s, when Chiang Kai-shek died in 1975, some conservatives did not fully support his son's as leader of the party and the country. Several memoirs record

²⁵⁰ The *Formosa Magazine* was the political magazine founded in 1979 by opposition politicians in Taiwan. It opposed the KMT's one-party rule in Taiwan and promoted democracy.

²⁵¹ These opposition politicians were jailed for various terms (most of them to more than ten years or even life imprisonment). In the late 1980s, when martial law ended, these political prisoners were released. Most of them then became leading members of the Democratic Progressive Party. They have participated in Taiwanese elections since the 1990s. In 2000 when the DPP won the presidential election, these people became the key policy-makers in Taiwan. For further details, see Huang, Fusan, *Meili dao shi jian*, (Taipei, 2001).

the power transformation and struggles within the KMT.²⁵² From the early 1970s, Chiang Ching-kuo controlled the military and the national security bureau, trained his own people in the KMT and used new and Bensheng ren technocrats in the administrative system. Although there was opposition to him, his domination of these departments helped him to defeat his opponents and become the chairman of the party within the year.

After the political struggle within the KMT, Chiang Ching-kuo included his own people in the core power groups. According to the membership list of the Central Committee, many technocrats were members by 1976, including his successor, President Lee Teng-Hui. Comparing this membership list with the one in 1952, it is clear that more Bensheng ren technocrats and the younger generation of technocrats were included in the decision-making system.²⁵³ Moreover, some Bensheng ren entrepreneurs were also included. Such changes of membership show the changes in the political power structure within the KMT. The new power structure within the KMT had a significant impact on the further political transformation in the 1990s.²⁵⁴

Table 8-1 shows the political weights of different social-economic groups from the 1970s to 1987. The ruling elites are the KMT and the core members who, led by Chiang Ching-kuo, decided which policy to adopt. The ruling elites monopolised both government organisations and capital. What is different about the KMT ruling elites during this period was that the groups contained both Waisheng ren and Bensheng ren ruling elites. The KMT elites have a political weight of 10.

The group of government bureaucrats were technocrat members of the KMT party and therefore were responsible for implementing the party's policy. During this period more Bensheng ren technocrats and the young generation of Waisheng ren technocrats took higher-level positions in the government administrative system. Although their influence on the policy-making process was less than that of the KMT core elites, their influence lay in the implementation of the policy and the moderate ethnic conflicts in Taiwanese society. This group has a political weight of 7.

²⁵² Some indicated that several people were thinking to run for KMT chairman. Under the party-state institution, becoming the chairman of KMT was more crucial than becoming the President of Republic of China. These people include General He Ying Qing and Madam Soong. For further details concerning the internal political struggle, see Yang Wen and Pei, Xiaomin, eds., *Bailishi hulue de lishi*, (Henan, 2008); Zhang, Zige, *Working at the side of Mayling Soong* (Beijing, 2003); Xiong, Zhongren, *He Ying Qing Zhuan* (Taiyuan, 1993).

²⁵³ For details of membership list in 1952, see Appendix 5-2.

²⁵⁴ Appendix 8-1.

The group of urban politicians was not influential in the policy-making process. Compared with the previous period, few Tangwai politicians participated in local politics. The Tangwai movement from time to time demonstrated or published newspapers or magazines criticising the KMT government. Nevertheless, their influence was limited since most elections were restricted to the local level and the military and police systems were strictly controlled by the KMT. Despite this, the Tangwai undermined the stability of the KMT's regime and therefore have a political weight of 4. During the period of the 1970s and 1980s, when Chiang Ching-kuo was in power, he severely limited the influence of those capitalists who had good connections with the government's development policy. Although the influence was restricted, with the onset of parliamentary elections, the urban capitalists, including the SMEs, had limited influence on certain policies through the business organisations in particular during the years when legislators were standing for election. Therefore, during this period, they have a political weight of 3.

The unionisation of workers was also not allowed before the end of martial law. During this period, the urban workers had no right to establish labour unions without government permission for this political activity.²⁵⁵ Students, poor people and farmers had very limited influence on government policy. The urban students were not influential, since under martial law they could not participate in politics and demonstrations. The urban poor and rural farmers were not allowed to take part in politics or to form into groups. Like the workers, these groups had limited influence on government policy; they only participated in the local and parliamentary elections. Therefore, these groups have a political weight of 1.

Overall, compared with the political power structure in the previous period under Chiang Kai-shek (see Chapter 5), the changing political power structure during Chiang Ching-Kuo period lay in the increasing strength of the Tangwai movement

²⁵⁵ The KMT government established some labour unions in China which continued in Taiwan. However, they were controlled by the KMT and did not function as modern labour unions do (for example, to organise protests for better welfare for their members). Li, Yunjie, *Taiwan gonghui de zhengzhi jingji fenxi* (Taipei, 1992); Wang, Zhenghuan and Fang, Xiaoding, 'Guojia jiqi, laogong zhengce yu laogong yundong', *Taiwan: A Radical Quarterly in Social Studies*, vol.13 (1992); He, Xueying, *Taiwan zizhu gonghui yundongshi* (Taipei, 1992).

and the rise of Bensheng ren power within the KMT. Some local and parliamentary elections opened opportunities, but, due to the limited scope of the elections, other social groups were not able to influence government policy significantly. Apart from these, the KMT elites mainly held the political power. The political power structure explains why the relation of the state and the SMEs was distant: under the political system, the SMEs could have only limited influence on the government's policy-making.

Table 8-1. Political Weight of Different Social Groups in Taiwan 1970-1987

Social groups	Political weights
KMT ruling elites (Waisheng ren and Bensheng ren)	10
Government bureaucrats (Bensheng ren and young generation of Waisheng ren)	7
Urban politicians	4
Entrepreneurs	3
Urban workers	2
Urban students	1
The poor	1
Farmers	1

8-3. Lee Teng-hui and Taiwan's Democratisation, 1988-2000

Chiang Ching-kuo died in 1988 and was succeeded as president by Lee Teng-hui. As discussed above, Taiwan's politics had been dominated by the Waisheng ren; Lee was one of the Bensheng ren elites who had been promoted by Chiang in the 1970s. At first, Lee did not gain the full support of the KMT party. There were many

senior members and conservatives who opposed his political reforms in the 1970s and 1980s. The conservatives tried to delay the election of him as KMT chairman.²⁵⁶ Standing for a minority in the KMT party, Lee tried to cooperate with the younger generation of the KMT, local party members and the Democratic Progressive Party (DPP). This attempt succeeded and Lee was finally elected. In order to strengthen his power, Lee carried democratic policies yet further.²⁵⁷

Further democratic development proceeded in Taiwan in the 1990s. A series of disagreements on democracy erupted within the KMT. The conservatives were opposed to having direct elections at every level. By contrast, the reformers proposed making elections direct, presidential elections in particular.²⁵⁸ Direct elections could easily constrain the power of the KMT conservatives over Lee. In 1990, he was the last president to be elected by the National Assembly of the Republic of China in Taiwan, as the 8th president. On 1 May 1991 the National Assembly decided to repeal the Temporary Provision Effective during the Period of Communist Rebellion. This move had a significant impact on the development of democracy in Taiwan. The Temporary Provision suspended general elections in Taiwan, which stabilised the KMT's authoritarianism over Taiwanese society. The restoration of elections changed the political power structure in Taiwan.

Table 8-2 shows the changes in the political weights of different social groups after the changes in the election system. The new ruling elites were now the ruling elites of the KMT. Although this was a new group, the KMT was still the political force dominating Taiwan. They thus still have 10 points of political weight in the model. The urban political bureaucrats were still responsible for implementing policies. There is no increase or decrease in their political weight, which remains at 7 points. The urban politicians in this period were the newly-established political party—the Democratic Progressive Party (DPP) – and the New Party which split off

²⁵⁶ Lee, Teng-hui, *Jianzheng Taiwan: Chiang Ching-kuo yu wo* (Taipei, 2004).

²⁵⁷ For example, Mr. Soong Chu-Yu strongly supported Lee during this period. Mr. Soong is now the Chairman of the People First Party (Qinmintang). He was the most popular politician in the 1990s, holding many significant positions in the KMT and was elected governor in 1995. Mr. Soong failed in 2000 to be nominated by the KMT as a presidential candidate. Therefore, he soon resigned from the KMT and campaigned in the election as an independent candidate.

²⁵⁸ He, Xuchu, "Minjintang yaoqiu xaingai, zhuzhang zhongtong zhixuan," *United Daily*, Taipei, 05 January 1993; Hu, Fo, "Zhuzhang zhongtong zhixuan binwu biyao," *United Daily*, Taipei, 29 August 1993; Jiang, Zhongming, "Zhongtong zhixuan tiqian, duoren zancheng," *United Daily*, Taipei, 07 September 1993.

from the KMT. The DPP was founded by the Tangwai politicians in 1986.²⁵⁹ The members of the New Party are the younger generation of the KMT who disagreed with President Lee's reforms within the KMT in the early 1990s.²⁶⁰ The DPP has been increasing its power through local elections since 1987. The New Party has some supporters, but its power is weaker than that of the DPP. Their influence was gradually increased by the open voting in the general and presidential elections and they began to oppose the KMT's sovereignty. Their political weights in the model thus increase to 8 points.

The entrepreneurs during this period also increased their political weight because of elections.²⁶¹ The increasing influence of the entrepreneurs can be seen from the KMT central membership lists. The central members used to include only KMT officials, military leaders and bureaucrats. After 1987, several significant entrepreneurs became members of the KMT central decision-making system.²⁶² The political weight of the urban capitalists therefore increased to 7 points. It was possible for them to influence government policy by voting.

The political weights of the urban workers increased more during this period since labour unions had become active in fighting for labour benefits. Their political weights increased to 6. The political weights of students, the poor and the farmers increased to 5 points. The political transformation re-distributed political power in society. In these circumstances, the SMEs gained more power to influence the formation of government's policy through elections. In other words, the relation of the state and the SMEs was not as distant as it had been in the previous decade. The question then is whether the state interest complied with the economic interests of the SMEs in terms of cross-strait trade and investment.

²⁵⁹ For the history of the DPP, see Democratic Progressive Party, <http://www.dpp.org.tw/index.php>. (accessed 20 July 2011).

²⁶⁰ Li, Xinhong, "Xinliangxian qinxian shisiquan qan xuanbu zuxintang," *United Daily*, Taipei, 29 July 1993; Sun, Kuangrong, "Yike meishi de rouxin mingzhu zhengtang," *United Daily*, Taipei, 30 July, 1993; Jiang, Zhongming, "Xin guonintang liangxian chengli xintang," *United Daily*, Taipei, 10 August, 1993; The New Party, <http://www.np.org.tw/>. (accessed 20 July 2011).

²⁶¹ Many elections took place in the 1990s, including elections for legislators, councillors, mayors and presidents. All the campaigns required money and people to support the candidates. Therefore, the donation of entrepreneurs to these politicians became significant sources of funding. The status of capitalists was thus raised and it became possible for them to affect government policy through donations for campaigns. For further details, see Chen, Guolin, *Heijin: Taiwan zhenzhi yu jingji shikuang jiemi* (Taipei, 2004).

²⁶² Appendix 8-2.

Table 8-2. Political Weight of Different Social Groups in Taiwan 1988-2000

Social groups	Political weights
KMT ruling elites	10
Government bureaucrats	7
Urban politicians	8
Entrepreneurs	7
Urban workers	6
Urban students	5
The poor	5
Farmers	5

8-4. The Impact of the Changing Political Power Structure on the Formation of the New Investment Policies

From 1949 to the 1960s, cross-strait relations were hostile; several small-scale battles continued between Taiwan and China. In the 1970s fighting was suspended but the bombing of the Taiwan Strait continued. The military resistance continued until 1978, when the Chinese government launched its significant economic reform and open policy in order to solve various problems in the economy.²⁶³ In 1979 Deng announced ‘An official notice for Taiwanese fellow countrymen’ which tried to reconcile his administration with that of the KMT government. This declaration can be considered the turning point for modern cross-strait relations. It had several implications in both the political and economic spheres. Politically, it points out that the PRC government is opposed to any form of independence for Taiwan. The clear line for negotiation is no independence; but as long as the KMT government complies

²⁶³ Nolan, Peter, *State and Market in the Chinese Economy: Essays on Controversial Issues* (Basingstoke, 1993); Nolan, Peter, *China's Rise, Russia's Fall: Politics, Economics and Planning in the Transition from Stalinism* (Basingstoke, 1995); Nolan, Peter, *China at the Crossroads* (Cambridge, 204); Howe, Chris, Kueh, Yi Yao and Ash, Robert, eds., *A survey of the Chinese Economic Reform* (London, 2003); Ash, Robert, ‘The Long-term Outlook for Economic Reform in China’, *Asia-Europe Journal*, vol.4, no.2 (2006), pp.177-196. Lin, Yifu, *Zhongguo jingji gaige yu fazhan*, (Taipei, 2000); Lin, Yifu, *There's No Textbook Paradigm for Interpreting the Chinese Economy* (Beijing, 2007).

with the ‘one China’ policy, anything and everything (whether it is PRC or ROC) can be negotiated. This line significantly influenced the next 30 years of cross-strait relations. Meanwhile, the declaration also announced that the People’s Liberation Army (PLA) would stop firing artillery shells at the islands of Jingmen and Mazu.²⁶⁴

The political principle and the military policy had great influence on further communications across the strait. Economically, China required financial capital and new technology to solve its difficulties regarding labour and light industry. In addition to the economic requirements, investment from overseas Chinese was preferred by the Communist government.²⁶⁵ With this in mind, the Chinese launched a series of encouragement and welcome policies for Hong Kong and Taiwanese investment and trade (more details of these policies are discussed in the next chapter).

8-5. Chiang Ching-kuo and the Cross-strait Policy, 1978-1986

Although China modified its cross-strait policy, Taiwan was in an unstable political situation in particular in the late 1970s; both external shocks and internal disturbances challenged KMT sovereignty. In these circumstances, Chiang Ching-Kuo responded to Deng by the ‘Three-no policy’. The ‘Three-no’ stood for no contacts, no compromises and no negotiations.²⁶⁶ Although the KMT government practised the ‘three no policy’ politically in 1979, there was a small amount of transit trade then (via Hong Kong) between Taiwan and China. In 1985 the Taiwanese administration announced the ‘three no policy’ concerning transit trade across the Taiwan Strait. This declared that the policy of the Taiwanese government towards transit trade with China (via Hong Kong) was ‘no contacts, no encouragement and no

²⁶⁴ Jingmen and Mazu are the two small islands located closest to China (Amoy and Fujian Province). Attacks from China did not completely cease until the announcement issued in 1979. The Taiwanese and Chinese armies fired artillery shells between Jingmen and Mazu and Amoy and Fujian at each other on the odd-numbered days every month. Officially, the war was ended in 1979 when the announcement stipulated the end of the ‘odd-day fire’. Deng Xiaoping, *Zhonghua renmin gongheguo quanguo renda chanweihui gao taiwan tongbaoshu*, Beijing, 1 January 1979, <http://tw.people.com.cn/GB/26741/139936/139938/8427598.html>. (accessed 15 July 2011).

²⁶⁵ For discussions on China’s economic problems in the late 1970s and the early 1980s, see Singh, Ajit ‘The Plan, the Market and Evolutionary Economic Reform in China,’ UNCTAD Discussion Paper, UN Conference on Trade and Development, no. 76 (1993); Lin, Bin, ‘1979 Nian de zhonggong jingji’, *Zhonggong yanjiu*, vol.14, no.1 (1980), pp.51-62; Zhu Liang, ‘Renmin zhanzheng yu xinjingji zhengce’, *Zhonggong yanjiu*, vol.14, no.10 (1980), pp.57-64; Xiao, Yehui, ‘Liangnian lai zhonggong jingji de tiaozheng jiqi danqian cunzai de wenti’, *Zhonggong yanjiu*, vol.15, no.4 (1981), pp.41-52; Lin, Bin, ‘1980 Nian de zhonggong jingji’, *Zhonggong yanjiu*, vol.15, no.1 (1981), pp.55-69; Lin Bin, ‘1981 Nian de zhonggong jingji’, *Zhonggong yanjiu*, vol.16, no.1 (1981), pp.48-6.

²⁶⁶ “Zhongguo Guomintang zhuxi Chiang Chingkuo chongshen buyu zhonggong hetan,” *United Daily*, Taipei, 4 April 1979.

interference'.²⁶⁷ The political and economic 'three-nos' were the principle for the first period of cross-strait policy, until 1987.

Table 8-3 shows the social groups' reaction to the open policy towards China from 1978 to 1987. The ruling elites were opposed to the open policy towards China, because their political longevity under the external and internal shocks was threatened by the Chinese Communists. The KMT elites were then strongly opposed an open policy towards China. The government did not worry as much about economic profits as about political challenges since the economy had grown and prospered in this period. The political power of the KMT ruling elites weighed 10 points in opposing the open policy in order to secure their sovereignty. During this period, the urban political bureaucrats were a part of the KMT party. Hence, the KMT's interests coincided with theirs. In the context of the urban political bureaucrats, 7 points were given to opposing the open policy towards China.

In terms of the reaction of other social groups at the time, their influence on the government's cross-strait policy was very low. On the one hand, establishing new political parties was still prohibited; on the other, the limited local elections could not influence the government in power. In these circumstances, the reaction of the group of urban politicians, the urban workers, the urban students, the poor and the farmers were not considered since they could not influence policy by voting at elections.

The results in Table 8-3 clarify the factors affecting the restrictions on the open policy towards China and explain the tough policies towards China during this period. Since the local elections did not help the urban capitalists and other social-economic groups to influence government cross-strait policy, the bans on cross-strait relations resulted instead from the political interests of the KMT elites and the political bureaucrats.

Table 8-3. Political Weight of Different Social Groups and Their Reaction to the Open Policy towards China 1978-1987

Social groups	Political weights	Group reaction to the open policy (Political power points)		
		Favour	Oppose	Uncertain

²⁶⁷ Three Principles for Transit Trade with Hong Kong and Macau was issued in 1985 by the Ministry of Economic Affairs.

KMT ruling elites	10	0	10	
Government bureaucrats	7	0	7	
Urban politicians	4	n/a	n/a	
Urban capitalists	3	n/a	n/a	
Urban workers	2	n/a	n/a	n/a
Urban students	1	n/a	n/a	n/a
The poor	1	n/a	n/a	n/a
Farmers	1	n/a	n/a	n/a
Total	29	0	17	n/a

8-6. *The Changing Cross-strait Policy, 1987-1994*

In July 1987 Chiang Ching-kuo announced the ending of martial law. There were debates regarding his policy decision.²⁶⁸ Apart from the factors of Chiang's changing policy, the ending of martial law had a significant impact on cross-strait relations. In early 1987 some young legislators (the new elites who had been promoted by Chiang's political reforms within the KMT party) interrogated the administration during a parliamentary session regarding the bans on cross-strait communication. They urged the government to lift the bans, in particular those on travelling to China.²⁶⁹ Newspapers and public opinion also supported these young

²⁶⁸For further details, see Wang, Yeyang, 'Chiang, Ching-kuo yu guomintang de minzhu zhuanxin, *Yianhuang Chenqiu*, no.5 (2006), <http://www.usors.cn/blog/wension/MyEssayDetail.asp?id=4558>. (accessed 05 May 2011); Zhao, Yongmao, 'Taiwan difan paixi de fazhan yu zhengzhi minzhu hua de guanxi', *Zhengzhi kexue luncong*, no.7(1996), pp.1-26; Wu, Naide and Chen, Mingtong, "Zhenquan Zhuanyi han jinying liudong: Taiwan difan zhengzhi jinying de lishi xingsheng," in *Taiwan guangfu chuqi shi*, ed. Lai, Zehen (Taipei, 1993), pp. 303-334; Rigger, Shelley, *Politics in Taiwan: voting for democracy* (London, 1999); Mao, Jiaqi, *Chiang Ching Kuo de yisheng han tade sixian yanbian* (Taipei, 2003).

²⁶⁹ These young legislators are usually are the second generation of Waisheng ren. The first generation (who came with the KMT government in 1949) were getting old in the late 1980s; most of them were in their late 60s or 70s. They were worried that they might not able to go back China to see their family before passing away. Therefore, the young legislators urged the government to adjust its cross-strait policy for compassionate reasons. Legislative Yuan, R.O.C. Taiwan, *The Record of Conventions and Interrogation*, 3 March 1987; "Wan zhongguo tanqin xungen jiejie, liwei cu zhengyuan fankuan xianzhi," *United Daily*, Taipei, 07 October 1987.

legislators.²⁷⁰ Even the political opposition, the DPP, supported the more open policy towards China.²⁷¹ Without the lifting of martial law, these legislators or politicians who supported this could have been imprisoned or executed for treason. The ending of martial law brought increasing freedom of speech and democracy in Taiwan. These factors are significant for the policy.²⁷² Under pressure from the public, guidelines on ‘How Taiwanese People Could Visit Chinese Relatives’ were issued in November 1987.²⁷³

When Lee Teng-hui came to power in 1988, his government re-framed the cross-strait policy. It set up a government organisation and formal regulations for further cross-strait communication. On 23 February 1991 the KMT government established the Mainland Affairs Council to deal with cross-strait affairs. Later in the same year, the KMT government announced the Guidelines for National Unification.²⁷⁴ In the same year, the KMT government officially permitted Taiwanese investment in China. In addition to the passing of laws, in 1992 the negotiations between the Strait Exchange Foundation and Association for Relations across the Taiwan Straits began. The political issues could not be settled, but there was an urgent need for economic cooperation, in particular in the 1990s. These non-governmental

²⁷⁰ Opinion polls investigated by the *Zili Evening Paper* show that 64% supported to relax the restrictions on visiting relatives in China and 24% agreed that it was time to relax the restrictions (*Zhili Evening Paper*, Taipei, 3 August 1987). “Shunying minqing zhiding dalu tanqin zhengce,” *United Daily*, Taipei, 17 September 1987.

²⁷¹ The movement to return home was advocated by the DDP in the late 1980s. The movement seems to have been out of tune with the DPP’s orthodox principle—establishing the Republic of Taiwan. In the late 1990s and early 2000s, the DPP was anti-China (while contrariwise, the KMT became more China-friendly). However, the DPP politicians who strongly opposed the CCP government joined the returning-home movement in the late 1980s and visited their ancestral home towns in China in the 1990s. “Dui kaifan minzhong qianwan tanqin, minjintang cu zhongyuan fankuan xianzhi,” *United Daily*, Taipei, 26 August 1987.

²⁷² According to some unofficial information in the mid 1980s, many Waisheng ren, especially old soldiers (who had come with the KMT in 1949) had gone back to China (via Hong Kong) to visit their Chinese relatives before 1987, when the KMT government gave its official permission. “Laobin laojia tanqin,” *United Daily*, Taipei, 15 October 1987.

²⁷³ The document ‘How Taiwanese people could Visit Chinese relatives’ was issued by the Ministry of Domestic Affairs since there was no special department for dealing with Mainland affairs. Some of the articles of the methods were then merged into the new cross-strait regulations issued in 1992. Before 1992 many cross-strait rules were scattered and not well-organised.

²⁷⁴ Guidelines for National Unification was issued on 23 February 1991 and abolished on 1 March 2006. Mainland Affairs Council, Guidelines for National Unification, <http://www.mac.gov.tw/ct.asp?xItem=68276&CtNode=5836&mp=4>. (11 June 2011). For further discussions on the guidelines, see Huang, Kunhui, ‘Guojia tonyi gangling yu dalu zhengce’, *Zhonggong yanjiu*, vol.26, no.10 (1992) pp.16-39.

organisations achieved several significant economic agreements which facilitated trade relations between Taiwan and China.²⁷⁵

Although the formal organisations and the negotiation mechanisms were established, the objective of the cross-strait economic policy was to control and manage trade and investment. Based upon principles of control and management, the regulations which largely concern cross-strait economic activity lie in the setting-up of an indirect model of trade, investment and transportation. Therefore, in the early period of the 'open' policy, it was actually open no more than indirectly.²⁷⁶

Table 8-4 shows the social groups' reaction to the open policy towards China from 1987 to 1994. The ruling elites during this period both favoured and opposed to the open policy. On the one hand, military threats and political conflicts still threatened their political longevity. On the other, economic needs and public opinion forced them to adjust the cross-strait policies. In these circumstances, 6 points were given to favouring an open policy and 4 points were given to opposing the open policy of the KMT ruling elites. In terms of the political bureaucrats, they were still under the control of KMT. Therefore, 4.5 points were given to them if they favoured the open policy and 2.5 points were if they opposed it. The interests of the KMT ruling elites and the political bureaucrats in this case coincided.

The urban politicians, as the evidence above shows, were the group which advocated the relaxed restriction of Taiwan's bans. Therefore, 4 points were given to favouring the open policy of the urban politicians. The urban capitalists still favoured the open policy because of the appreciation of the NTD in the late 1980s. With more elections at the local level, the urban capitalists gradually increased their influence in this period by supporting politicians in elections. However, most politicians who participated in elections also had limited influence on the government's policy. It was possible to issue and pass bills in parliament; however, the parliament did not have a mechanism to enforce them on the government. The influence of the capitalists was indirect and not strong enough to enforce changes in government policy. Similar comments apply to the reaction of other social groups. On the one hand, there were no

²⁷⁵ Straits Exchange Foundation, <http://www.sef.org.tw/mp.asp?mp=300>. (20 January 2011); Association for Relations across the Taiwan Straits, <http://big5.arats.com.cn/>. (20 January 2011).

²⁷⁶ The attitudes of the Taiwanese government towards economic policy in China can be found from several speeches of the Premier, Hau, Peitsun. Mainland Affairs Council, ed., *Xinzhengyuan yuanzhang Hau Pei Tsun Daluzhengce yanlun xuanji* (Taipei, 1992); Mainland Affairs Council, *Dalu shiwu fagui bianhui* (Taipei, 2001). More details regarding the indirect model are examined and discussed in Chapter 9.

opinion polls concerning the issue; but, on the other, their influence through voting and elections were still limited. The evidence provided by the newspapers indicates only that public opinion and some of the legislators were urging the government to lift the prohibitions. Therefore, the influence of the urban politicians can be calculated. The influence of the political power weights from other groups on the issue, however, is not clear due to the lack of direct evidence and the political system.

Table 8-4. Political Weight of Different Social Groups and Their Reaction to the Open Policy towards China 1987-1994

Social groups	Political weights	Group reaction to the open policy (Political power points)	
		Favour	Oppose
KMT ruling elites	10	6	4
Government bureaucrats	7	4.5	2.5
Urban politicians	4	4	0
Entrepreneurs	3	n/a	n/a
Urban workers	2	n/a	n/a
Urban students	1	n/a	n/a
The poor	1	n/a	n/a
Farmers	1	n/a	n/a
Total	29	14.5	6.5

Comparing Table 8-3 with Table 8-4, it is clear that although the KMT was still the dominating political power in Taiwanese society, with the abolition of the Temporary provisions and the restoration of elections, the political influence of the urban politicians had increased. The increase in the political power of the urban politicians affected KMT's adjustments in cross-strait policy. Of course, other factors, such as the foreign forces and economic needs were also among the KMT's concerns. Nevertheless, during these two periods, under China's changing policy, the KMT government was uncertain about the impact of the open policy on its political

longevity. The concerns of the safety of their political interests limited the relaxation of the cross-strait policy in the early period. It is also worth noting that, although the SMEs were able to influence the legislators through elections and push them to relax the restrictions on cross-strait policy, the legislators were not strong enough to take on the government. Therefore, the cross-strait policy was made on the basis of the KMT's political and economic interest. In other words, the political conditions made the Taiwanese government give up the prospect of economic efficiency in order to consolidate national defence and political power.

8-7. Elections and the Changing Cross-strait Policy, 1994-2000

It is clear that the changing interest of the Taiwanese government in 1987 improved and facilitated investment and trade across the strait. The government institutionalised cross-strait relations and adjusted the development policy in Taiwan. However, the peaceful political situation from 1987 did not last long. Political relations went downhill in 1995. In 1995 the U.S. parliament approved Lee's visit at Cornell University. This political movement resulted in the Third Missile Crisis across the strait. The missile crisis continued in 1996 before the first direct presidential election in Taiwan. Political conflicts and a military crisis interrupted the formal economic negotiations between Taiwan and China.²⁷⁷ With the rise of political conflicts in 1996, Lee in 1996 announced the 'no hurry, be patient' policy concerning cross-strait investment. The policy pointed out that under the military threats and the lack of formal institutions to protect Taiwanese private investment in China, it was not enough to open direct transportation and communication. This implied that the government did not favour closer economic cooperation with China and would be strict over investment in China.²⁷⁸

²⁷⁷ Liu Qiyun, "Li zongtong fanmeian, meizhongyuan biaojuetongguo," *United Daily*, Taipei, 03 May 1995; Lin Meiling, "Li fanmei, duian fanying qianglie," *United Daily*, Taipei, 16 June 1995. "Dalujunfan yingpai qianglie fantan shiya," *United Daily*, Taipei, 16 June 1995; Lu, Deyun, "Guofanbu zhengshi, zhonggong liangtian fashe simei feidan," *United Daily*, Taipei, 23 July 1995; "Zhonggong jinchen fashe liangmei feidan," *United Daily*, Taipei, 08 March 1996; "Zhonggong zuoshe sanmei feidan, minzhong mubiaoqu," *United Daily*, Taipei, 09 March 1996; "Zhonggong disanpo yanxi, shouri wu haikong huodong," *United Daily*, Taipei, 19 March 1996; Gu, Zhi, '2000 Nian de liangan guanzi', *Zhonggong yanjiu*, vol.35, no.2 (2001), pp.96-106.

²⁷⁸ The policy was first mentioned by President Lee on the Third National Conference for Operators. The members of the conferences were mainly the entrepreneurs. Concerning the details of the policy, see further Mainland Affairs Council, *Jieji yongren zhengce shuoming*, Taipei, 03 January 1999, http://www.mac.gov.tw/ct.asp?xItem=57944&ctNode=5645&mp=1&xq_xCat=1999. (accessed 11 June 2011).

During Lee's period, the economic policy across the strait fluctuated. He gradually opened up investment in China in 1991; however, his government enforced several restrictions on investment and prohibited some large Taiwanese investments in China. It is worth noting that, with the restoration of elections, in particular the direct presidential election in 1996, these restrictions on investment and trade policy across the strait required the support of most Taiwanese voters. The opinion polls from 1995 to 2000 show people's opinions on cross-strait policy in different fields in different years.

8-8. Analysis of Public Opinion Polls, 1995-2000

This section separates the public opinion polls from 1996 to 2000 into three categories. The first category shows public opinion towards political issues across the strait. The political issue includes the issue of independence and unification, military threats and national security. The second category is of public opinions concerning Taiwanese investment in China. The third category concerns direct transportation across the strait.

According to the government documents, from 1995 to 1999, the majority agreed that the Chinese government was hostile towards the Taiwanese government/people. The highest vote was 88% in September 1995 when the missile crisis occurred. The lowest percentage was 28.2% in June 1998. The average percentage concerning this issue remained 50%. Concerning the issue of independence or unification, the majority agreed on retaining the status quo and deciding later between unification and independence. This opinion exceeded the average by 30%-40% from 1994 to 1999, implying that most people had no conclusive answer on unification or independence. Concerning the issue of military threats, the opinion polls investigated in early 1995 (before August) showed that most respondents did not think China would attack Taiwan. Later in 1995 (after August) people agreed that China would mount a military attack on Taiwan if Taiwan officially announced independence. However, by 1996 the majority had ceased to think so. Furthermore, concerning the issue of 'one country, two systems', from 1991 to 1998 a very high percentage (generally over 60%) did not agree with the policy. In 1999 when Lee defended the 'Special Relations between Two Countries' policy, the opinion polls showed that on average 50% agreed with his view of cross-strait relations. On political issues, the majority did not favour the Chinese government.

However, in terms of unification or independence, most people were hesitant. Some opinion polls showed strong support for independence. But some opinion polls showed that most people still considered themselves both Taiwanese and Chinese.²⁷⁹

The second category concerns Taiwanese investment in China, from several points of view. The first section presents public opinion on the restrictions on Taiwanese investment in China. From 1996 to 1999, most people agreed that the Taiwanese government should control and manage investment and capital flows to China. Some opinion polls even showed that over 50% agreed that the government should restrict Taiwanese investment in China even further. Interestingly, when considering the policy of ‘no hurry, be patient’, most believed that the policy needed to be adjusted. More specifically, opinion polls among Taiwanese industrialists and entrepreneurs, highly opposed the ‘no hurry, be patient’ policy and were in favour of a more open investment policy. It is worth noting that there were different opinions from the capitalist group and from ordinary people. However, there was still a majority agreeing that the government should control and restrict investment in China.²⁸⁰

The third category is regarding direct transport links across the strait. It shows that the majority were in favour of opening direct transport links in particular circumstances. Moreover, some opinion polls showed that if the issue of direct trade affected national security, opinion was equally divided. It is also worth noting that the opinion polls from the entrepreneurs showed that direct transport links would increase their willingness to remain in Taiwan. Overall, concerning the general pace of cross-strait communication (including political, economic and transportation), from 1993 to 1999 the majority considered the pace of opening up was adequate.²⁸¹

Comparing the public opinion polls in these three categories, it can be seen that the political issue was confusing. Some opinion polls tried to demonstrate that, without military threats, most would agree to independence immediately. However, the military threats existed and should be considered among the political factors. In terms of investment issue, it is clear that from ordinary people had a different opinion from the entrepreneurs. Regarding the issue of direct transport links, people generally approved of them in certain circumstances. However, the opinion polls did not specify

²⁷⁹ Appendices 8-4, 8-5, 8-6, 8-7, 8-8.

²⁸⁰ Appendices 8-9 and 8-10.

²⁸¹ Appendix 8-11.

what these circumstances might be. This raised the question how far political conflicts and military resistance affected economic activity and voting behaviour.

Some opinion polls combined several issues at once. In 1996 the Ministry of Chinese Affairs in Taiwan investigated whether China's military threats would affect election behaviour. Over 80% of the people questioned said that their voting decisions were not affected by the military threats. Another investigation integrated military threats with the investment plans of private enterprises and found that more than 70% of the Taiwanese entrepreneur respondents considered that their business was not affected by the military threats. These opinions showed that there were no strong or definite connections between politics and investment.²⁸²

Based upon the opinion polls, the analysis in Table 8-5 looks at different social groups' reactions to the open policy towards China from 1994 to 2000. The ruling elites were still the KMT elites. Economic issues became more challenging for the KMT government after the appreciation of the NTD affected foreign orders and Taiwanese exports. Politically, more and more opposition parties competed with the KMT elites in elections. Under the pressure of the economic and political changes, the KMT government had little choice but to adjust its policy towards China. Its political life might or might not be threatened since different social groups supported or opposed the policy. Their preference would affect the KMT's tenure through elections. It was also uncertain for the ruling elites whether China's policy of 'economic integration leading to political integration' would threaten their political control. A more open policy would increase the support from the capitalists and raise political funds for elections. However, the same policy might also lose the support of other social groups and thus lose elections. Therefore, while the rents from capitalists would increase, other rents from other groups might decline. In these circumstances, the KMT government weighed 5 points on each side.

For the group of political bureaucrats, the new economic development policy, including the establishment of Asia-Pacific Regional Operation Centre, needed a further open investment policy with China; however, national security was another concern for these bureaucrats. Certainly, an open policy would increase the benefits

²⁸² Appendix 8-12.

for the new economic development project.²⁸³ Having similar concerns to the ruling elites, the political bureaucrats weighed 3.5 points on each side.

The group of urban politicians, including the DPP and the New Party, competed with the KMT party in elections. Support for and resistance to the open policy varied with the nature of the political parties. The major supporters of the DPP during this period were workers, farmers and young students. For the benefit of their major supporters, the DPP opposed complete openness to China because it reduced their political longevity and thus the rents from their supporters to support it.²⁸⁴ The New Party fully supported an open policy towards China and suggested that the KMT government should negotiate with the Communist government immediately. Since this group shows differing political attitudes, 4 political power points should go to opposing the open policy and 4 points to favouring it.²⁸⁵

It is clear from the opinion polls that the urban capitalists favoured the open policy towards China because of the profits and orders they had lost by the appreciation of NTD. They would increase their profits and value added in manufacturing if the KMT government permitted investing in China. Therefore, the political power points of the urban capitalists gave 8 points to favouring the open policy.

The other four groups, workers, students, the poor and the farmers, represent the ordinary people in the opinion polls. It is clear that most of them agreed that the government should control and restrict large investments in China, a view to be explained by the uncertainty of these groups. Students were uncertain whether an open policy would increase their job opportunities in the future. On the one hand, when numerous factories migrated and only head offices remained in Taiwan, job opportunities would be diminished. On the other, an open policy might attract investment from China and other foreign countries; however, they were uncertain whether the job opportunities thus created would be open to them. In these uncertain

²⁸³ For further details of the development history and plans of the Asia-Pacific Regional Operations Centre, see http://park.org/Taiwan/Government/Theme/Asia_Pacific_Rigional/apc02.htm. (accessed 11 November 2010); Mainland China Affairs, *Liangan guanxi yu dalu jingmao zhengce*, http://www.mac.gov.tw/ct.asp?xItem=57893&ctNode=5645&mp=1&xq_xCat=1997. (accessed 7 February 2011); Council for Economic Planning and Development, Executive Yuan R.O.C. (Taiwan), *Yatai jingyun zhongxin jihua zhi jixiao yu zhanwang* (Taipei, 2000).

²⁸⁴ Qiu, Guochang, "Women dui danqian zhongguo zhengce de jidian kanfa", conference paper of Mingjindan zhongguo zhengce yantao hui (Taipei, 1998) pp.1-7.

²⁸⁵ The allocation of points was based upon election results from 1991 to 2000.

circumstances, keeping the status quo was probably their choices. The workers would lose their jobs if the urban capitalists invested in China and closed their businesses in Taiwan in order to spend less on wages. The concerns of workers were different from the concerns of students. The students were more uncertain about future jobs; the workers, however, would lose jobs immediately if more enterprises invested in China. Again, it was possible that the Chinese or foreign enterprises might create other opportunities. However, they were not sure about the transaction cost for a transition from one industry to another. Given this uncertainty and not knowing whether an open policy would be better or worse for them, they probably chose to keep the status quo for the sake of their jobs.

The poor, for their part, had even less capacity to find a job than the students and the workers. Therefore, their concerns may have been similar to the other groups. They were not sure whether the new open policy would increase their benefits. But they did know that it would reduce their job opportunities. The farmers, however, may have been concerned whether the open investment policy would be accompanied by an open trade policy. The open investment policy might have only a limited impact on their career. But, with more entrepreneurs investing in China and more Taiwanese white-collar workers transferring to China with them, consumer consumption would be affected, with possibly a bad effect on their profits. Moreover, if the open investment policy were in accordance with a more open trade policy, Chinese agricultural products would in the Taiwanese market compete with their products. And it was highly likely that the Chinese produce would be cheaper, since production costs in China were lower. The groups of students, workers, the poor and farmers thus had different concerns over the open investment policy and could not decide whether it would leave them better or worse off. This, based upon the Rodrik model, made them highly likely to oppose it.

The results of Table 8-5 help to explain that the political conflicts across the strait after 1995 were no longer politically -oriented because the government power needed public support. Of course, different factors, including political ideology, ethnic recognitions and economic factors would affect voters' behaviour. The argument that politics was the basis for the policy restrictions on cross-strait investment policy was too general. The political transformation and the redistribution of political power in society complicated cross-strait relations. In order to remain in power, the government needed an electoral majority. The analysis here demonstrates

that the government interest did not comply with the economic interests of the SMEs. Did the conflicting interests between the state and the SMEs affect SME investment behaviour?

Table 8-5. Political Weight of Different Social Groups and Their Reaction to the Open Policy towards China 1994-2000

Social groups	Political weights	Group reaction to the open policy (Political power points)		
		Favour	Oppose	Uncertain
KMT ruling elites	10	5	5	
Government bureaucrats	7	3.5	3.5	
Urban politicians	8	4	4	
Urban capitalists	7	7	0	
Urban workers	6	0	0	6
Urban students	5	0	0	5
The poor	5	0	0	5
Farmers	5	0	0	5
Total	65	22.5	11.5	21

8-9. The Limits of the State: the Pattern of Taiwanese Outward Investment, 1986-2000

Since the government had its own interests and concerns for its economic needs, many bans and restrictions on investment in China were enacted but also more encouragement to invest in Southeast Asian countries. For example, the Taiwanese government negotiated with some Southeast Asian governments (mainly Thailand, Malaysia, Indonesia, the Philippines, Singapore, Vietnam and Brunei) in order to set up and sign investment, trade and transportation agreements. These agreements would facilitate and protect Taiwanese investment in these countries. Furthermore, the

government also issued special loans and insurance for enterprises which invested in these Southeast Asian countries.²⁸⁶

In contrast, not until 1996 did Taiwan and China make preliminary economic agreements on investment protection and a dispute mechanism, which were signed by the two civil organisations (on behalf of the two governments). In other words, under the formal institutional framework, Taiwanese investment in some Southeast Asia countries was freer and better protected. However, the statistics of Taiwanese outward investment question the influence of government's policy on SME investment behaviour.

A closer examination of the average number of investments in China and in Southeast Asia clarifies the types of enterprise which did not follow the government's guidance. Figure 8-1 shows a comparison of the average amount of money of investment cases in China and in Southeast Asia. The average amount of FDI per investment in Southeast Asia exceeds the average amount of FDI per investment case in China. The comparison implies that the type of enterprise that invested in China was mainly small or medium-sized.

Figure 8-2 below shows Taiwanese investment in China and in these Southeast Asia countries from 1987 to 2000. Before 1991 there was no official record (from the KMT government) of Taiwanese investment in China because the KMT government had prohibited such investment. It is clear that the Taiwanese investment in Southeast Asia countries rose quickly from 1988 to 1990 when there was a huge appreciation of NTD against USD. However, after 1991, when the Taiwanese government opened up investment in China, Taiwanese investment in the SEA countries declined sharply. After 1992, the Taiwanese investment in China was much higher than in the SEA countries. The pattern of Taiwanese investment shows that, regardless of government restrictions or encouragement, most Taiwanese investment still went to China and not elsewhere.

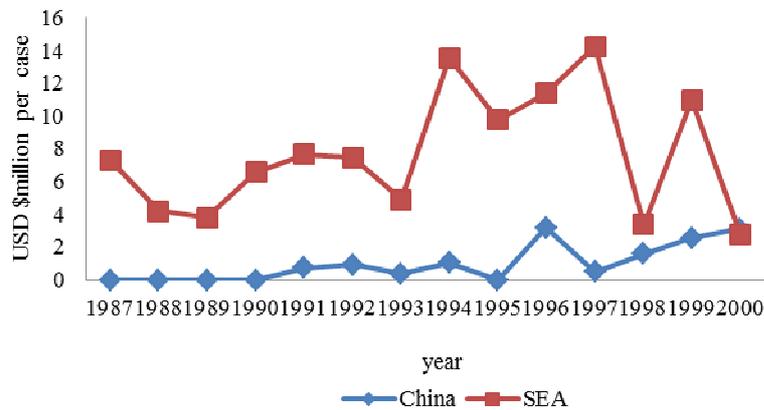
The investment pattern also shows an increase of investment from 1995 to 1998. The increase of Taiwanese investment in China during this period was indifferent to the severe political and military tensions across the strait. In 1995 President Lee Teng-hui's visit to Cornell University in the United States resulted in the Third Taiwan Strait crisis. The People's Liberation Army conducted missile

²⁸⁶ Bureau of Economic Research, the Central Bank of the R.O.C., *Taishang dui dongnanya guojia touzhi zhi yannxi* (Taipei, 1997).

tests in an area only sixty kilometres north of Pengjia Islet in August 1995 and March 1996. Clearly, however, the missile crisis did not disturb Taiwanese investment in China. The reduction of Taiwanese investment in China in 1998 and 1999 was affected by the Asian Financial Crisis. But, while the political conflicts and military tests did not suspend investment and trade, further improvements concerning economic cooperation were postponed.²⁸⁷

Based upon the evidence of Figure 8-1 and Figure 8-2, it can be assumed that the government had limited influence on the investment behaviour of SMEs. Despite the government restrictions and political conflicts and crisis, the SMEs followed the market wherever the lowest labour costs could be found. Relatively speaking, the large enterprises were influenced by the government policy and invested in Southeast Asia.

Figure 8-1. The Average Amount of Taiwan's Investment Cases in China and in Southeast Asia (USD\$ million), 1987-2000

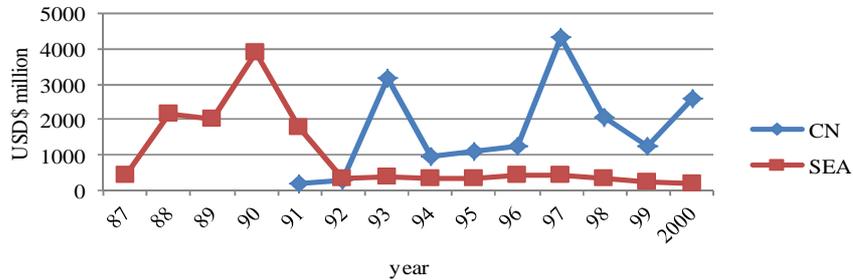


Source: Investment Commission, Ministry of Economic Affairs, Executive Yuan R.O.C. (Taiwan), *Statistical Yearbook of Investment Commission* (Taipei, 2001), pp.77-79. National Bureau of Statistics of China, *China Statistical Yearbook* (Beijing, 2001), p.602.

Note: (1) 'Southeast Asia' stands for four countries: Malaysia, Thailand, the Philippines and Indonesia. (2) The FDI statistics of Taiwanese investment in China from 1987 to 1990 are based upon the *China Statistical Year Book*.

²⁸⁷ "Laingan lianghui xieshang guandao quanmian zhongduan," *United Daily*, Taipei, 02 July, 1995.

Figure 8-2. Taiwanese FDI in China and in Southeast Asia (USD\$ million), 1987-2000



Sources: Investment Commission, Ministry of Economic Affairs, Executive Yuan R.O.C (Taiwan), *Statistical Yearbook of Investment Commission*, (Taipei, 2001), pp.77-79.

8-10. Conclusion

This chapter explains the government's interest in making cross-strait economic policy and how far the state's interest and the policy influenced the SME investment behaviour. Although the economists generally agree that free trade and investment with China would bring larger earnings than cost to the Taiwanese economy, in the late 1980s the government banned and afterwards restricted investment in China. At the same time, the government encouraged Taiwanese investment in Southeast Asia with the incentive of preferential terms. The contradiction between economic profits and government policies is usually explained by the single factor of political conflict across the strait. Such political conflict did influence free trade and cross-border investment; however, the political transformation complicated the government's interest and the formation of the new trade and investment policy. What is more important is whether it was the political conflicts, the state's interests or the policy restrictions that influenced SME investment behaviour.

The analysis of the political transformation from 1970 to 2000 shows that when a new dictator came to power, he needed to create different power groups in his support because he had no power of his own. This can be found from Chiang Ching-Kuo's political reform and Lee Teng-Hui's democratisation. The impact of political transformation led to the re-distribution of political power in the power structure. The re-distribution of political power structure also affected the most recent cross-strait economic policy. In 1979 China's economic reform and the announcement of Deng

Xiaoping significantly changed the cross-strait relations after the Cold War. The offer of political compromises and an open market policy forced the KMT government to adjust its cross-strait policy.

In the first period, from 1979 to 1986, Chiang-Ching-Kuo did not compromise with Deng but announced the 'three nos' policy. During this period, it is possible to argue that political conflicts and the political interest of the KMT were the cause of policy restrictions across the strait. This argument needs more explanation. Politics hindered open cross-strait policy because the political power structure was still dominated by the KMT's ruling elites and its political bureaucrats. Facing both internal and external challenges, the KMT chose to retain the status quo without huge adjustments of cross-strait policy. Since the decision-making system was still dominated by the party and the SMEs and other socio-economic groups were unable to influence the decision-making system, the making of policies was based upon the interests of the party and the ruling groups.

In the second period from 1987 to 1994, Chiang Ching-Kuo finally permitted travelling to China and lifted martial law. Chiang Ching-Kuo's political reform in the 1970s and the gradual opening of parliamentary elections in the 1980s produced a developed younger generation of KMT members. The re-distribution of political power gave the opposition political party and the young KMT members more influence on the decision-making system. Nevertheless, it is worth noting that although the urban politicians and the younger generation KMT members had increased political power weights, it was still difficult for them to dominate the government because the electoral system for the president was still indirect and dominated by the National Assembly. In other words, the influence of other social groups on the issue was limited through voting and elections.

In the third period from 1994 to 2000, the impact of political conflicts on economic activity became obvious. The government policy disrupted trade and investment; nevertheless, with the changing political power structure, the government needed public support to remain in power and to enforce these restrictions on cross-strait investment and trade. The analysis of public opinion polls showed that in the 1990s there was no clear-cut split on an ethnic or national basis. Yet public opinion polls concerning investment and trade issue show clear differences before 1996 and after 1996 and different opinions from the people and from entrepreneurs about investment and trade policies.

Before 1996 and the policy of 'no hurry, be patient', the separation between those who favoured and opposed open trade and investment policy and why they did so was not very clear. The policy in the early 1990s, on the one hand, slowly improved investment and trade institutions across the strait. For the entrepreneurs, a policy which gradually opened up opportunities was what they were looking for. They also preferred well-established institutions for their business between Taiwan and China which would reduce transaction cost. On the other hand, the early policy was indeed gradual and under the control of the government. For other socio-economic groups, these policies were accepted, since the restrictions and control remained. In other words, Lee Teng-Hui's cross-strait policy before 1996 was moderate and was accepted by most Taiwanese voters.

With the changing policy on trade and investment after 1996, public opinions polls showed a clear split between the entrepreneurs and the people. Different socio-economic groups had different interests; and these interests made them favour, oppose or question more open trade and investment policy in the future. The diversified interests of different social groups resulted in a relaxation of investment and trade under the government restrictions across the strait. The relaxation and restrictions were in response to the government's interest in retaining power by complying with the diverse interests of the social groups. In this period, with the changing political power structure and the start of presidential elections, the interests of different social groups were able to influence the government's cross-strait policy.

By analysing the political transformations and changes in power structure, it becomes clear that the politically-oriented policy allowing cross-strait economic activity was produced by several factors. The aim in setting up the restrictions was related to the desire to stabilise political power and to remain in power. When the main interest was the survival of the political party, the government did not support the investment of SMEs in China, even though China was the best environment for it. This implies that the government did not support the best interests of the SMEs.

Although the government set up the restrictions on cross-strait investment to serve its own political and economic interests, a comparison of Taiwanese FDI in China and in Southeast Asia shows that the government had limited influence on the SMEs' investment behaviour. Neither the government restrictions nor the military crisis disturbed the continuing inflow of Taiwanese investment in China. Further comparison of the size per Taiwanese investment case in China and in Southeast Asia

confirms that the government had only limited influence on SME behaviour. The evidence shows the limits of the government in influencing this investment behaviour.

To conclude, the consequences of political transformation significantly affected people's power to influence the decision-making system. Although political conflicts across the strait did influence economic policy, with the changing political system, government policy required voters' support. A beneficial economic policy could not be implemented because the changing of the political power structure in Taiwanese society created different socio-economic groups with divergent economic interests regarding investment and trade across the strait and these changed the government's concern to form a cross-strait policy with both relaxation and restrictions. The analysis also shows that even though the SME group gained more political power to influence the government's policy through elections, the state's interest did not comply with their needs. Nevertheless, SME investment behaviour was not affected by the government's restrictions nor the political conflicts. Evidence shows that the Taiwanese government had limited influence on SME investment behaviour; SME investment continued to flow into China without government support and the SMEs followed the market mechanism.

Based upon the findings of this chapter, it may be argued that the SME investment behaviour in China was not influenced by the political conflicts, the state's interest nor the policy restrictions. This significantly questions the support of the state to the SMEs from the 1960s to the 1980s. If the state had provided substantial support (both direct and indirect) to the SMEs in the post-war period, presumably the SMEs would have relied on it and the state could have influenced the SMEs' investment behaviour in the form of the state-influenced investment by the Taiwanese large enterprises in Southeast Asia. The evidence presented in this chapter shows the opposite.

Part V. The State's Constraints? Why the State Had Only Limited Influence on SME Investment Behaviour, Trade and Business Transactions across the Strait

In view of the conflicting interests between the state and the SMEs, the state set up restrictions in order to maintain national and economic security. The restrictions involved several different areas: transportation, trade and the scrutiny of the type and amount of investment from Taiwan to China. Nevertheless, the continuing and increasing flow of Taiwanese FDI in China demonstrates that these restrictions and control were ineffective. The prosperity of cross-strait trade and the high level of Taiwanese FDI in China raised two questions: first, why did the state have such a limited influence on the SMEs' investment behaviour and their business transactions across the strait? Were the restrictions ineffective? Why did these restrictions fail to control and manage trade and investment in China? And second, What supported SME investment and business operation across the strait notwithstanding the government's restrictions?

Chapter 9. The Constraints on SME Trade and Business across the Strait, 1980-2000

The conflicting interests between the Taiwanese government and the SMEs resulted in controls and restrictions on cross-strait trade and investment. Despite these constraints, large amounts of Taiwanese FDI continued to flow to China, instead of Southeast Asia. On the one hand, the increasing FDI in China indicates that the government had limited influence on the SMEs' investment behaviour. On the other, this raises the question of how much impact the restrictions and controls had on cross-strait trade and investment. The intention of the Taiwanese government was to manage and control trade and investment across the strait by establishing an indirect model. The indirect model banned direct contacts between Taiwan and China including trade, investment and communication. All activity from Taiwan to China was to reach it via a third place. This chapter seeks to explain the limited control of the indirect model on SME trade, investment and business operation across the strait by analysing the grey areas which this model created and the dynamics of the social institutions which supported the SMEs across the strait from the late 1980s to 2000.

The chapter begins by analysing the policy framework in which the indirect model was created. The second section, by showing the distribution of Taiwanese FDI in China, indicates the over-generalised nature and ignorance in the common explanations of the part played by the culture and social networks in facilitating this investment, despite the constraints of the indirect model. The third section then tries to explore explanations by analysing the economic cost incurred with by the indirect model, the management and control on trade, capital flows and financial sources. Finally, the chapter compares four instances of investment in China by Taiwanese LEs and SMEs, in order to demonstrate the significance of the social institutions which facilitated SME business operations across the strait.

This chapter demonstrates that the formal institutional framework, including the restrictions of the Taiwanese government and the regulations of the Chinese government, created certain grey area which eased the progress of trade, investment and SME business operations across the strait. The dynamics of the Taiwanese social institution continued to provide support for this purpose within the grey areas all through the 1990s.

9-1. The Cross-strait Indirect Model under the Formal Policy Framework

Since the mid-1980s the Taiwanese government had adjusted several trade and investment policies in order to deal with the increasing indirect trade with China. In 1984 the Taiwanese government relaxed its restrictions on the categories of imported Chinese products. A year later, the Taiwanese administration announced the ‘three no policy’ concerning transit trade across the Taiwan Strait. This ‘three no policy’ declared that the Taiwanese government wanted ‘no contacts, no encouragement and no interference’ in the transit trade with China (via Hong Kong). From 1987 to 1989, however, the Taiwanese government permitted more agricultural and industrial materials to be imported from China to Taiwan.²⁸⁸ Although the regulations indicate that the Taiwanese government would not interfere in this transit trade, they reaffirmed the ‘no contacts’ policy to strictly prohibit direct contacts between Taiwanese businessmen and Chinese businessmen or any official departments.

In 1990 the Taiwanese government issued ‘Regulations Governing Indirect Investment and Technology Cooperation in Mainland China’. These regulations derived from three principles: first, investment is only permitted when the types of industry do not threaten national security or affect Taiwan’s economic development; second, the operations of all investment in China shall take place through a third country; and third, the total investment amount per case does not exceed 1 million USD.²⁸⁹ In accordance with the relaxation on investment in China, in 1991, the Taiwanese government regulated how capital could flow between Taiwan and China. The pattern of the mode focuses specifically on managing the remittance routes between the two.

These early adjustments of trade and investment policies were legislated under the ‘Act Governing Relations between the People of the Taiwan Area and the Mainland Area’ in 1992. The regulations cover all aspects of cross-strait communications, particularly investment, transport, trade and economic cooperation.

²⁸⁸ In 1987 the Ministry of Economics permitted twenty-seven categories of Chinese agricultural and industrial raw materials to be sent to Taiwan; at the end of 1987 the number increased to thirty categories. Laws and Regulations Database of the Republic of China, Regulations Governing Products of Mainland China, <http://law.moj.gov.tw/LawClass/LawContent.aspx?PCODE=Q0040008>. (accessed 07 May 2011); Laws and Regulations Database of the Republic of China, Regulations Governing Indirect Export Products to Mainland China, <http://law.moj.gov.tw/LawClass/LawContent.aspx?PCODE=Q0040009>. (accessed 07 May 2011).

²⁸⁹ Laws and Regulations Database of the Republic of China, Regulations Governing Indirect Investment or Technological Cooperation in Mainland China, <http://law.moj.gov.tw/LawClass/LawContent.aspx?PCODE=Q0040010>. (accessed 07 May 2011).

Article 35 in Chapter 5 specifies indirect trade across the strait. According to the regulations, transportation, including flights (both cargo and civil) and cargo ships are required to transfer or transit through a third place if their final destination is either China or Taiwan.²⁹⁰ Under the indirect transportation principle of Article 35, the Bureau of Foreign Trade of the R.O.C. launched the 'Regulations Governing Permission of Trade between Taiwan Area and Mainland Area' in 1993, concerning the types of export and import commodity permitted across the strait.²⁹¹

Based upon Article 35 and the regulations on trade, investment and finance across the strait, the triangle trade system was formalised and Hong Kong became the significant buffer zone for Taiwan-China trade. Although the regulations do not specify that the third place should be Hong Kong, trade via Hong Kong was related to its geographical location, since Hong Kong lies mid-way between Taiwan and China. In addition to its geographical location, Hong Kong is a free port without customs duties and controls for transshipment. The bans on direct trade and transportation across the strait made Hong Kong the best buffer zone for transshipping trade commodities between Taiwan and China.

Another part of Article 35 also specifies the methods for investing in China and the process of applying for these investments. The Investment Commission of Ministry of Economic Affairs in 1993 enforced the 'Regulations for Verification of Investment or Technological Cooperation in Mainland China', based upon the principle of Article 35. The KMT government specified three types of investment: permitted (labour-intensive traditional manufacturing industry); prohibited (high-tech manufacturing industry, government investment, finance, insurance and service industries) and special-case-examination. The penalties for breaking these rules and regulations were fines of 30 million NTD to 120 million NTD and the suspension of the right to invest in China.²⁹²

²⁹⁰ Mainland Affairs Council, Act Governing Relations between the People of the Taiwan Area and the Mainland Area, 31 July 1992, <http://www.mac.gov.tw/ct.asp?xItem=87948&CtNode=5659&mp=1>. (accessed 07 May 2011).

²⁹¹ Laws and Regulations Database of the Republic of China, Regulations Governing Permission of Trade between Taiwan Area and Mainland Area, <http://law.moj.gov.tw/LawClass/LawContent.aspx?PCODE=Q0040002>. (accessed 07 May 2011).

²⁹² Laws and Regulations Database of the Republic of China, Regulations for Verification of Investment or Technological Cooperation in Mainland China, <http://law.moj.gov.tw/LawClass/LawContent.aspx?pcode=Q0040001>. (accessed 07 May 2011).

Categories of investment amounts and percentages are included in the regulations and were adjusted in 1997. In 1993 the regulation had stipulated that different types of firm could invest only up to a specified total. In 1997, under the impact of the 'no hurry, be patient' policy, the regulation was adjusted to a percentage based upon the enterprise scale. The penalties were also changed. In addition to raising the fines, the government would also suspend the imports and exports of an offending company for two months or up to two years or would revoke its import-export registration.²⁹³ Although the 'Regulations for Verification of Investment or Technological Cooperation in Mainland China' show that the government allowed labour-intensive SMEs to go to China, other related regulations and restrictions caused inconvenience to these investors.

With these investment and trade regulations, the Ministry of Finance in Taiwan also legitimated the remittance rules for cross-strait trade and investment. According to the 'Regulations for Permission on Financial Transaction between Taiwan Area and Mainland China' issued by the Ministry of Finance in 1993, remittance transactions (both inward and outward) between Taiwan and China had to be made through a financial institution in a third place.²⁹⁴ The transit-through-a-third-

²⁹³ In 1993, the 'Regulations for Verification of Investment or Technological Cooperation in Mainland China' indicated that personal investment or investment by SMEs, whose net capital was below two million U.S. dollars, could have a total investment amount below 1 million USD. Moreover, for investment below 1 million, it was not necessary to set up a firm in a third place. However, if small investment accumulated over 1 million within two years, the investors or the enterprises had to set up a firm in a third place. However, larger corporations with a net capital above 2 million U.S. dollars had their investment amount in China restricted to 40% of the net value of the corporations. These larger corporations were asked to set up a firm in a third place to deal with the transfer of financial capital. Furthermore, if the corporation was in a special category of the industrial classifications, it required verification from other government ministries. In 1997 the regulation was adjusted. For investments by SMEs and individuals, the total amount was limited to 60 million NTD or 40% less than the authorised capital (or the net value). Large Corporations and listed companies were limited to 20%, 30% or 40% less than the authorised capital (or the net value). The amendments to the 'Regulations for Verification of Investment or Technological Cooperation in Mainland China' were issued by the Ministry of Economic Affairs on 15 July, 1997.

²⁹⁴ Laws and Regulations Database of the Republic of China, Regulations for Permission on Financial Transaction between Taiwan Area and Mainland China, <http://law.moj.gov.tw/LawClass/LawContent.aspx?pcode=Q0040004>. (accessed 07 May 2011); Laws and Regulations Database of the Republic of China, Statute for Civil Remittance and Settlement of Exchange, <http://law.moj.gov.tw/LawClass/LawContent.aspx?PCODE=G0450006> (accessed 07 May 2011); Laws and Regulations Database of the Republic of China, Guidelines for Financial Organisations in Taiwan Area to Process Money Remittance in Mainland Area, <http://law.moj.gov.tw/LawClass/LawContent.aspx?PCODE=G0380056> (accessed 07 May 2011); Laws and Regulations Database of the Republic of China, Guidelines for Banks in Taiwan Area to Process Foreign Exchange for Import and Export in Mainland Area, <http://law.moj.gov.tw/LawClass/LawContent.aspx?PCODE=G0380068> (accessed 07 May 2011); The 'financial institution in a third place' indicates banks in a third place excluding any overseas branches of Taiwanese banks and Chinese banks. Therefore, based upon the regulation, Hong Kong, the British

place regulation also applied to travellers between Taiwan and China. The indirect model was established on the principle of the Act and different regulations on trade, investment, remittance and immigration. This indirect model had its own rules. First, all the economic activities had to proceed via a third place. Second, most cross-strait communication and activity were one-way only. The KMT government strictly controlled Chinese investment in Taiwan and Chinese people travelling to Taiwan. Third, the setting-up of the formal institution was aimed at managing and controlling cross-strait economic activity rather than facilitating it.²⁹⁵

9-2. What Facilitated Taiwanese FDI in China?

Since the indirect model constrained trade and investment across the strait, what facilitated trade and investment in its place? Kotkin defines the meaning of 'global tribes' as "cultural groups whose members are geographically dispersed, maintain worldwide business and cultural networks and share a strong sense of a common origin as well as important values on the primacy of science and knowledge in general"²⁹⁶. The idea of global tribes highlights a notion of fading political ideology and the emergence of economic cooperation via ethnic origins.²⁹⁷ Much has been written on the culture and the kinship relations shared between Taiwan and China (via Hong Kong) which mediated the political conflicts and facilitated the investment which eluded the formal institutional arrangements.²⁹⁸

For example, Chang implemented the increasing volume of trade and investment statistics showing a gradually integrating market and argued that, despite government barriers, a Greater China Zone was gradually emerging between the three main entities.²⁹⁹ Chang's research highlights the role of economic interests and social networks in the linked route of Taiwan-Hong Kong-Guangdong-Fujian even without

Virgin Islands (BVI) and the Cayman Islands are the most popular 'third-places' for the Taiwanese enterprises.

²⁹⁵ Mainland Affairs Council, *Liangan santong zhengce shuoming*, http://www.mac.gov.tw/ct.asp?xItem=57934&ctNode=5645&mp=1&xq_xCat=1999. (accessed 11 April 2010).

²⁹⁶ Kotkin, Joel, *Tribes: How Race, Religion and Identity Determine Success in the New Global Economy* (New York, 1993), p.19-93; Meng, Qing Shun, *Gangauo yu haixia liangan guanxi* (Sichuan, 1999).

²⁹⁷ Chang, Maria, H., 'Greater China and the Chinese Global Tribe' *Asian Survey*, vol.35, no.10 (1995), pp.955-967.

²⁹⁸ For further discussions on Hong Kong as a political buffer zone, see Shao, Zhonghai, 'Xiankang zai zhonggong jingji kuozhan yu liangan guanxi fazhan zhong banyan de jiaose', *Zhonggong yanjiu*, vol.32, no.3 (1997), pp.64-74; Yang, Kaihuang, 'Xiankang zai liangan zhijian suo banyan de jiaose', *Zhonggong yangjiu*, vol.31, no.1 (1997), pp.114-122.

²⁹⁹ Chang, M., *op.cit.*, p.965.

the support of formal institutions. The key point is that these overseas investors could ‘understand, utilise and exploit connections or networks’³⁰⁰ and this has always been ‘the predominant mode of getting anything done in mainland China’³⁰¹. A similar argument can be found in Harding. Harding contends that economic integration between Taiwan, Hong Kong and China can be regarded as “the realization of economic complementarities, in turn, is facilitated by the cultural ties among Chinese societies”³⁰². Harding and Chang believe that this triangular economic cooperation cannot be separated from Chinese culture. The role of the social institution is indeed to lubricate business transactions and reduce transaction costs.³⁰³

Approaching the distribution of FDI and the trade volume from the research discussed above, when we take a closer look at the FDI distribution in the four provinces in China (as shown in Figure 9-1 below), it is clear that the largest volume of Taiwanese FDI from 1991 to 2000 went to Guangdong and Jiangsu. This distribution indeed questions the influence of kinship relations on investment behaviour. According to Taiwanese population data, Hoklo people occupy 75% of the total population and Hakka people 15% of it. The people who came with the KMT government after 1949 form only 13% of the total population. Furthermore, several researchers on social class indicate that most Hoklo and Hakka people were engaged in agriculture, commerce and small-scale manufacturing industries.³⁰⁴ In contrast, the

³⁰⁰ Chang, M., *op.cit.*, p.965. For similar argument regarding Taiwanese investment in Fujian, see Chi, Peter, S.K., Kao Charng and Hsin, Ping Lung, ‘Hong Kong and Taiwan Enterprises in Mainland China: Accelerators of Economic Transformation and Development?’, in *The East, the West and China’s Growth: Challenge and Response*, eds., Cassel, Dieter and Herrmann-Pillath, Carsten (Baden, 1995), p.181.

³⁰¹ Chang, M., *op.cit.*, p.965.

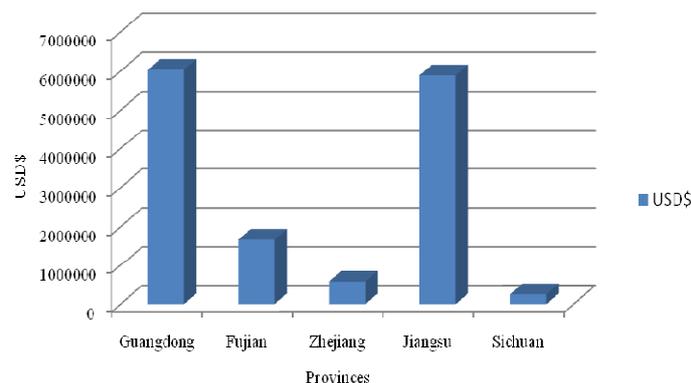
³⁰² Harding, Harry, “The Concept of ‘Greater China’: Themes, Variations and Reservations’,” in *Greater China: The Next Superpower?*, ed. Shambaugh, David (Oxford, 1993), pp.8-30.

³⁰³ Sung, Yunwin, ‘Non-institutional Economic Integration via Cultural Affinity: The Case of Mainland China, Taiwan and Hong Kong’, *Occasional Paper of Hong Kong Institute of Asia-Pacific Studies*, no.13(1992), pp.1-43; Standifird, Stephen S. and Marshall, Scott R., ‘The Transaction Cost Advantage of Guanxi Based Business Practice’, *Journal of World Business*, vol.35, no.1(2000), pp.21-42.

³⁰⁴ For more details, see Cai, Shuling and Qu, Haiyuan, ‘Bijiao Taiwan gezuqun zhi jiaoyu qude’, *Journal of Social Sciences and Philosophy*, vol.2, no.2 (1993), pp.188-202; Huang, Yizhi, ‘Taiwan diqu jiaoyu jihui bu pingdengxin zhi bianqian’, *Chinese Journal of Sociology*, vol. 18 (1995), pp. 243-73; Wu, Naide, ‘Binliang han tuoxie, xizhuang han pixie: Taiwan jieji liudong de zuqun chayi ji yuanyin’, *Taiwan: a Radical Quarterly in Social Studies*, vol.1 (1997), pp.137-167; Chen, Kuanjeng, Yeh, Hsiujen Jennifer, ‘Social Structure at Work: The Effects of Educational Development on Educational Mobility in Taiwan’. Paper presented at *Conference on Social Stratification and Mobility: Newly Industrializing Economies Compared* (Taipei, 1998), pp. 123-150; Cai, Shuling, ‘Social Change and Status Attainment in Taiwan: Comparisons of Ethnic Groups’. *International Perspectives on Education and Society*, vol. 2(1992), pp. 225-256. Cai, Shuling and Chiu, Heiyuan, “Changes in Educational Stratification in Taiwan,” in *Persistent Inequality--Changing Educational Attainment in Thirteen Countries*, eds. Shavit, Yossi, and Blossfeld, Hans-Peter, (Oxford, 1993), pp. 193-227.

Waisheng ren served mainly in the military or in government organisations. In terms of kinship relations, Waisheng ren have closer relations with their Chinese family members, whereas Bensheng ren have produced several generations in Taiwan had distant relations with their original families in China. Yet this latter group of Bensheng ren were the ones mainly engaged in the SMEs. A few existing writers have noted the ethnic differences in their careers and over-generalised the function of kinship relations. If the kinship relations had still been functioning, the largest amount of Taiwanese FDI should have gone into Fujian province, because most of the people who were engaged in SMEs were Hoklo (or Hakka) people. A closer examination of FDI distribution questions how far kinship relations and culture across the strait facilitated Taiwanese investment in China in the 1990s.

Figure 9-1. Statistics on Approved Indirect Mainland Investment by Year and Area (US\$ 1,000), 1991-2000



Source: Investment Commission, Ministry of Economic Affairs, Executive Yuan R.O.C. (Taiwan), *Statistics on Approved Indirect Mainland Investment by Area and Industry, 1991-1995*, (Taipei, 1995)pp.88-92. Investment Commission, Ministry of Economic Affairs, Executive Yuan R.O.C. (Taiwan), *Statistics on Approved Indirect Mainland Investment by Area and Industry, 1991-2001*, (Taipei, 2001), pp.66-70.

9-3. How the SMEs Overcame the Restrictions of the Indirect Model

The explanations provided in this chapter are analysed from three standpoints. The first considers the cost incurred by the indirect model: would this cost have been reduced if the government had allowed direct transport links across the strait? The second aspect is to ask whether trade was stifled or affected at all by the indirect model; did this model manage and control trade across the strait? The third aspect

focuses on the capital flows across the strait; did the indirect model manage and control capital across the strait?

9-3.1. The Economic Cost of the Indirect Trade and Investment Model

The restrictions of the indirect model on transportation, trade, investment, money remittance and civil flights suggest that certain costs may affect it. The possible cost for SME investment and business operation in China can be analysed from three perspectives. The first is related to the cost of travelling time and the price of flight tickets using civil aviation. This inconveniences caused by the indirect model caused the main complaint by the Taiwanese investors. The second is related to the shipping cost. According to the government statistics, 99% of the cross-strait trade relies on shipping and only 1% of cross-strait trade is treated as air cargo. The cost of shipping greatly affected the cost and profits to the Taiwanese manufacturing enterprises, in both China and Taiwan. The third is related to the remittance of money across the strait via a third place.

The government report in 2003 evaluated the benefits of the direct model on cross-strait trade and investment. The government report calculated that direct shipping would reduce the shipping cost from 12 billion to 8 billion NTD per year and save shipping time from 16-27 hours per trip. In terms of air cargo, the cost would reduce by around 8.1 billion. In terms of civil aviation, travellers will reduce their travelling costs by around 132 billion NTD. The reduction of transportation costs with the move to direct trading would help the individual enterprises to pay 15% to 30% less in transportation costs. The benefits of the direct trade on transportation lie in this economic efficiency. By reducing transportation time and cost, delivery becomes more effective and increases the amount being transported from ports and airports.³⁰⁵

However, government's report in 2003 does not quite match what happened after the government adjusted the policy for direct trade and investment in 2010. The investigation of Industrial Bureau of the R.O.C. shows that the Taiwanese enterprises expected that the cost of staff travelling can reduce 26.45% compared with the indirect model.³⁰⁶ However, according to the annual report of the Civil Aeronautics

³⁰⁵ Chen, Liying, Wang, Siyue, Kuo, Naifeng and Yang, Haoyan 'Liangan santong dui Taiwan chanye zhi yingxiang: zongti jingji xiaoguo zhi pinggu', *Dalu jingji fazhan yantaohui lunwen ji*, (Taipei, 2002), pp.6-13.

³⁰⁶ Chung Hua Institution for Economic Research, *Dalu gongye fazhan xiankuang yu zhizaoye fu dalu touzi dui woguo chanye jingzhengli zhi yingxian yingjiao: kaifan santong dui Taiwan chanye fazhan de yingxian* (Taipei, 2002), pp.91-92; Ling, Zujia, Tan, Jinyu, Ling Meixuan and Chen, Jinlong 'Liangan

Administration, Ministry of Transportation and Communications, the price of the direct flight ticket was higher than it was expected.³⁰⁷ The Fair Trade Commission and the newspapers also criticised the issue of higher price of the direct flight ticket.³⁰⁸

The phenomenon can be explained by the restrictions on direct flights, affected by the national security concerns. The government report on the impact of direct trade and transportation on national defence indicates that some controls on direct transportation are necessary. The impact of direct trade and investment on national security can be separated into two parts. The first part is related to security defence, the second to military strategy. From the standpoint of national defence, it would be more difficult to prevent unexpected attacks on Taiwan if military action were impeded by civil flights, air cargoes or shipping. From the standpoint of military strategy, in order to open direct flights and shipping, the military strategy would need to be adjusted. The Department of National Defence highlighted the significance of ‘the central line of the Taiwanese Strait’ which maintains Taiwan’s national security. An alternative way would be to implement ‘fixed locations, fixed lines and fixed time’ for direct flights and shipping. Under the ‘three fixes’, it would be the easier for the national defence to detect irregular flights or ships to Taiwan.

However, under ‘the three fixes’, direct flights are limited to certain routes, airlines and times. This implies that the demands for direct flights are likely to exceed the supply. In addition, only certain Taiwanese and Chinese airlines are permitted in the direct flight market. In other words, the direct flight market lacks competition

kaifang zhihang dui woguo jingji yu chanye yingxiang zhi fenxi’, National Policy Foundation. (Taipei, 2003); Tan, Jinyu, ‘Kaifang santong hou hangyun chengben zhi xiaoyi pinggu’, National Policy Foundation (Taipei, 2002). Lin, Zhu Jia and Zhu Yun Pong, ‘Liangang zhiheng de zhengzhi jingji fenxi’ National Policy Foundation, (Taipei, 2006), pp.1-13.

³⁰⁷ “Liangang Kongyun piaoqia zhi jiantao yu shuoming: yi Taipei yu Shanghai hangxian weili,” *Report of Civil Aeronautics Administration*, Taipei, 23 September 2010, pp.2-6.

³⁰⁸ “Gongping hui zhudong lian diaocha liangan zhihang piaoqia yezhe longduan qingshi,” *the press release of Fair Trade Commission, Executive Yuan*, Taipei, 22 June 2010; Cha, Wenye and Yan Kui, “Taiwan kejie huyu rang liangan zhihang hangban piaoqia gong heli,” *Xinhuanet*, Beijing, 13 May 2011, http://big5.xinhuanet.com/gate/big5/news.xinhuanet.com/fortune/2011-05/13/c_121414348.htm. (accessed 18 June 2011); “Liangang zhihang piaoqia guogao, huahang changrong aifa,” *Hong Kong China News Agency*, Hong Kong, 10 March 2011, <http://www.hkcnr.com/content/2011/0310/90979.shtml>. (accessed 08 May 2011); Qiu, Qiongweng, “Liangang Zhihang nizeng hongyan hangban, jiangqia zaiwang,” *United Evening News*, Taipei, 16 May 2011.

from other airlines. The lack of market competition and the fixed locations, routes and times meant that both direct flights and indirect flights cost travellers the same.³⁰⁹

The cost of shipping was another concern for the Taiwanese enterprises across the strait. According to the investigations of the Industrial Bureau of the R.O.C., most manufacturing industries expected that direct trade would reduce 14.56% of the shipping cost.³¹⁰ However, the Taiwanese shipping companies did not expect a huge reduction of shipping cost from the direct trade model. The investigation from these shipping companies also shows that the shipping companies assumed that direct trade would reduce the shipping cost by only 3%-4%.³¹¹ These expectations are markedly different. The gap can be explained by the import-export structure and the types of industries across the strait.

The cost of shipping is closely related here to the nature of the goods shipped across the strait, which are related to the types of industry in Taiwan and in China. The major export goods from Taiwan to China included electronic and electricity products, industrial materials and machine equipment; all goods which are suitable for shipping. In terms of the structure of imported Chinese goods to Taiwan, the major imported Chinese goods were raw materials from agriculture and mining, coal in particular, such as are suitable for bulk cargo vessels.³¹² Due to the differences of ships and bulk cargo vessels, directly shipping exported goods or imported raw materials is usually one-way because Taiwan has no suitable products for exporting in bulk to China and China has few suitable products for importing to Taiwan. In other words, the returning ships are usually empty. This does not necessarily reduce shipping cost unless the ships can transit at Hong Kong to exploit other business opportunities.

When the shipping companies transported materials for processing factories in South China, the final products were directly exported from China (or Hong Kong) to the U.S. or the European market. Therefore, it was more beneficial for the Taiwanese shipping companies to transit at Hong Kong. While taking Taiwanese export goods to China, they were able to ship Taiwanese export goods due for export to the U.S. and

³⁰⁹ “Liangnan Zhihang zhi yingxiang pinggu,” *Report of Executive Yuan*, Taipei, 15 August 2003; Civil Aeronautics Administration, *op.cit.*, pp.6-9.

³¹⁰ Ling, Z. J., Tan, J.Y., Ling, M. X. and Chen, J.L., *op.cit.*, p.8.

³¹¹ Chung Hua Institution for Economic Research, *op.cit.*, 2002, pp.202-206.

³¹² For details of trade structure across the strait, see Gao, Chan and Sun, Anrong, *Liangnan sandi jianjie maoyi de shizheng fenxi* (Taipei, 1995), pp.73-142; Zhang, Shuping, ‘Haixia liangan jingmao guanxi yu zhanwang’, *Zhonggong yanjiu*, vol.26, no.7 (1992), pp.25-29.

the European markets. On the return journey, they were able to ship goods imported from the U.S. and the European market to Taiwan. Therefore, the shipping companies found that the indirect trade model did not necessarily increase their costs and at the same time it increased their business opportunities.³¹³

According to the government's evaluation and research, most respondents felt positively about the direct trade and investment model and blamed the indirect trade and investment model for increasing production costs for Taiwanese enterprises. The analysis in this section shows that while the indirect trade and investment model did increase the costs of time and transportation, the direct model did not necessarily reduce this considerable extra cost. The key lies in the demand and supply of the market and the industrial structure for cross-strait trade.

9-3.2. Management and Control on Trade

Although the Taiwanese government launched several regulations in order to manage the transit trade between the three, it could not completely control the flow of goods. The reason was the grey areas in the indirect trade mode. In terms of imported Chinese products, although the government prohibited the import of Chinese products to Taiwan, with a little extra work in Hong Kong, they were no longer 'Chinese'. For example, when these Chinese products were first exported from China to Hong Kong, their packaging was changed (in particular, the simplified Chinese printed on the packaging was replaced by traditional Chinese) and the goods were then re-exported from Hong Kong to Taiwan.³¹⁴ In these circumstances, it was difficult for the government to prohibit all Chinese products from Hong Kong unless it prohibited Hong Kong products as well.

In terms of export products to China, the indirect trade was sometimes in fact a semi-direct trade in reality. For example, the Taiwanese exporters claimed that the final destination for the export goods as they left Taiwan was Hong Kong. In the middle of the trip, they might substitute fresh export documents where the destination appears as China. There is no technical or legal problem in switching documents, since re-routing a voyage is allowed. When the goods arrived in Hong Kong, the Hong Kong customs would have no right to levy tax on them since they were

³¹³ Chung Hua Institution for Economic Research, *op.cit.*, 2002, pp.206-209.

³¹⁴ During the 1980s the Chinese simplified characters were not allowed in Taiwan. The change of packaging, on the one hand, made the products more 'Hong Kong' than 'Chinese'. But on the other hand, under martial law and its provisions, the simplified Chinese characters were illegal.

consigned to Chinese buyers. By doing this, the Taiwanese exporters could save the tax imposed by the Hong Kong customs. These forms of trade occurred in the triangle model very often.³¹⁵

The grey areas which formed the semi-direct triangle trade occurred only in sea transport. For airfreight and civil flights, it was obligatory to transfer at a third place. The trading behaviour among the three entities shows that the government policy could not prohibit economic activity. Either before or after the enactment of legislation, the flow of goods continued according to its own patterns.

9-3.3. Management and Control of Financial Capital

The management and control of financial capital across the strait can be separated into two aspects: the policy framework which regulated capital flows and the sources of the capital formed by the SMEs. The regulations on capital flows included regulations by both the Taiwanese and the Chinese government because capital transfer for or by the SMEs in business in China could be influenced by both governments. In addition to the capital transfer, the source of the capital played an important part. The second aspect examines whether the Taiwanese government was able to control and manage the sources of financial capital of the SMEs.

The capital flows of SME investment in China included not only capital outward from Taiwan, but also capital circulating across the strait. When the SME entered the Chinese market, their capital transfer across the strait was regulated and affected by the policies of both governments. The Taiwanese government managed and controlled Taiwanese capital transfer by setting up the indirect remittance model. On the one hand, the indirect remittance model required capital to go through the banks in a third place. On the other, the regulation limited the direct remittance of NTD or Renminbe (RMB) outward and inward between Taiwan and China, even through a third place. The first round of the Taiwanese investment flowed to China usually following the regulations on the indirect model and under government management and verification.

However, the remittance from China to Taiwan, based upon the regulations, seems to have been easier than the other way around. The order issued by the State

³¹⁵ Based upon the information of the investigation by the Chung Hua Institute for Economic Research (the research project was sponsored by Ministry of Economic Affairs, R.O.C.). Gao, C. and Sun, A. R., *op.cit.*, pp.169-174.

Council, 'Regulations on encouraging Taiwanese investment', indicates that the Taiwanese enterprises were permitted to remit legal profits and legal incomes or to liquidate money capital overseas through normal channels. The regulation was simple and clear; however, it was not as efficient as it looked when making a remittance.³¹⁶

According to the regulations on foreign exchange by the Chinese government, there are several formal and legal ways to remit money: (1) Payment for goods: according to the regulations on 'payment for trade and imported goods by outward remittance', the enterprises need permission from the Bureau of Foreign Trade for the operation and have to register for export/import rights in the industrial and commercial bureau. After acquiring the permission and the rights, the enterprises are qualified to apply for outward remittance in the Bureau of Foreign Exchange. When remitting, the banks require the enterprises to supply them with many different documents; after remitting, the banks are asked to submit the verification reports to the Bureau of Foreign Exchange.³¹⁷

(2) Foreign reimbursement: the Bureau of Foreign Exchange of the P.R.C. is responsible for registering the foreign reimbursement of the foreign enterprises. Foreign investors are asked to register the foreign reimbursement and supply the Bureau with loan contracts, investment contracts, a report of capital examination, application for foreign reimbursement, registry certification and other documents. When the foreign reimbursement is remitted in China, it requires another process to inform the Bureau of Foreign Exchange. As soon as payment falls due, all the documents used in applying for the inward foreign reimbursement and for outward reimbursement must be submitted to the Bureau again.³¹⁸

(3) According to the regulation, it is possible after tax to remit business profits from China to Taiwan. Before this can be done, the enterprises need to pay tax and fines, make up deficits and pay the social warfare fund. After all this is done, the profits are finally eligible for remission overseas. Meanwhile, based upon the

³¹⁶ The Office of Taiwan Affairs People's Government of Fujian Province, Regulations on encouraging Taiwanese investment by the State Council of the People's Republic of China, Article 10, <http://www.fjstb.gov.cn/html/20070522/582681.html>. (accessed 08 December 2010).

³¹⁷ Department of Treaty and Law, Ministry of Foreign Trade and Economic Cooperation, *P.R.C. Zhonghua Renmin Gongheguo Duiwai Jingji Fagui Huibian* (Beijing, 2000), pp.53-33, p.65, p.72, p.102, p.121, p.135. Guangzhou Foreign Economic Relations and Trade Commission, ed., *The PRC Rules and Laws in Foreign Investment and Import and Export Commodity Management* (Guangzhou, 1994), p.139-166.

³¹⁸ Department of Treaty and Law, Ministry of Foreign Trade and Economic Cooperation, *P.R.C., op.cit.*, pp.526-621.

regulation on ‘liquidation for foreign investment enterprises’, it is possible for foreign enterprises to withdraw their investment from China. Again, before the withdrawal can be made, the enterprise is required to liquidate capital for paying salaries and employees’ insurance, tax and other debts. After liquidation and payments, it can then apply for outward remittance from the Bureau of Foreign Exchange.³¹⁹

Although the formal channels allow the Taiwanese enterprises to remit business profits back to Taiwan, the process of remittance was time-consuming and the standards of verification strict. Hence, three illegal or semi-legal means of remittance were commonly used by the Taiwanese enterprises. First, the enterprises would purchase other foreign currency, such as U.S. dollars and HK dollars, through the black market. After changing RMB into foreign currency, it is easier to bring foreign currency in cash out of China and deposit it in another overseas bank account.³²⁰

Second, some enterprises lend in China and repay in Taiwan. The enterprises, which had come to China earlier, lend to the enterprises which came to China later and require financial capital for investment and turnover funds. The second group of enterprises then repays the debts to the first group in Taiwan. The use of this loan-repayment mode was not limited to the Taiwanese enterprises in China; sometimes they lend money to tourists and expeditions in China, which repay them when they go back to Taiwan. Through this loan-repayment mode, the enterprises are able to indirectly ‘remit’ their profits back to Taiwan.³²¹

The third method of semi-legal money remittance occurs when the enterprises manipulate the price of imported and exported goods. When the enterprises export goods from China, the price which they declare is lower than the real price of the exported goods. When they import goods, conversely, the price is declared to be higher than the real price. By manipulating the price of imported and exported goods, it is possible to reduce the profits they make in China and retain the profits in overseas paper companies for further investment.³²²

³¹⁹ Department of Treaty and Law, Ministry of Foreign Trade and Economic Cooperation, *P.R.C., op.cit.*, p.526, p.327. Mainland Affairs Council, ed., *Dalu dequ fushui fagui bianhui* (Taipei, 1992).

³²⁰ “Liangan dixia jingrong fanjian jiaoliu yijiu,” *China Times*, Taipei, 07 July 1998; Chen, Junyi, “Liangan dixia jingrong huodong riyi chanjue,” *Commercial Times*, Taipei, 03 March, 1995; Lo, Liangsha, “Dixia huikuan zuikuai shifenzhong,” *Economic Daily News*, Taipei, 13 May 2008.

³²¹ “Liangan huikuan quankao xinyong,” *United Daily*, Taipei, 10 August 1997.

³²² Gao, Xijun, Lin, Zujia., Lin, Wenlin and Xu, Caixue, *Taishan jingyen: Tauzi dalu shikuang baodao* (Taipei, 1995).

The first method of remittance is clearly illegal and risks are high for the enterprises which exchange foreign currency in the black market and bring the cash out of China. The second and third methods of remittance are considered semi-legal, since they are making a detour through the grey area. However, due to the complicated process of legal remittance, most Taiwanese enterprises used semi-legal ways to remit their profits from abroad. The maintenance of profits then facilitated re-investment in their Chinese business or they used it as turn-over credit for business transactions. This behaviour was, on the one hand, influenced by the Chinese regulations on the control of foreign currency; it was also, on the other hand, affected by the way in which money could be sent out from Taiwan. The policy framework established by both governments created some grey areas which facilitated SME capital transfer across the strait.

9-4. Dynamics of the Taiwanese Social Institution

The grey area created by the formal institutional framework facilitated capital transfer across the strait and the avoidance of government supervision and regulations. Although the channels for capital transfer could avoid government restrictions, what about the source of the financial capital? Figure 9-2 below shows the estimation on the sources of capital formation of the manufacturing SMEs. It is clear that the major source of the SME capital formation came from the family category and remained at around 80% for the whole period. Other sources for the SME capital formation remained low. The estimation of the capital formation suggests that, since the SMEs still relied heavily on the private sector for capital formation, the Taiwanese government controlled only the channel for its transfer.

Figure 9-3 and Figure 9-4 below show a comparison of the sources of turnover credit funds in China by different foreign corporations. Comparing the loans from Chinese banks to the foreign corporations, such as the U.S., Japanese or other Western corporative firms with loans from Chinese banks to the Taiwanese enterprises, it is plain that the Chinese banks preferred the former to the latter. This may be explained by the types of enterprise from Taiwan and the difficulties of the planned market economy.

When banks extend credit to their clients, they do so at some risk. In order to minimize the likely default, banks usually carefully evaluate loan applications, and monitor and manage the loans. The banks usually first appraise the ability of the

clients to service their debt, gather credit information about their clients and rate them on different levels. Second, the banks evaluate the security of the borrowing enterprises. A security means an asset a creditor can liquidate in order to recoup a loan which a borrower cannot pay.³²³ Banks most often accept four kinds of security: hypothecated time deposits, a letter of guarantee from a government or other financial institution, a lien on real estate and secured movable property. The priority for the banks is those clients with unsecured financing, even the most creditworthy. Next in line are loans secured by hypothecated time deposits and guarantee from other banks. Banks are usually less interested in clients who provide real estate and movable property as security.

Based upon the standards for approval loans, from the market's perspective it was difficult for the Taiwanese enterprises to be granted loans by Chinese banks. The Taiwanese enterprises were mainly small/medium-sized ones. These SMEs are in themselves difficult to supply with valuable enough security for loans. In particular, the Taiwanese SMEs usually had problems over the use for security purposes of factory land or buildings as the lien on real estate. Since China is a Communist country, the Chinese Constitution indicates that 'organisations or individuals are not allowed to invade or occupy, purchase or sell, or transfer the right of land use by any illegal means',³²⁴.

The Constitution sees land as in public ownership. Hence, although the reform began in 1978, not until 1990 was the use of land revised. In 1990 China's State Council issued an order concerning 'the regulation of land use and land transformation'; it aimed to reform the system of land use for further economic development.³²⁵ The significant issue is that the regulation separates ownership from the right to use. Under this principle, land can be used for selling, transferring the right to use right, renting and mortgaging. These changes of land use are expected to pull in more foreign investment to China. However, the process of acquiring the certification of land use for free trade is complicated and time-consuming. Therefore, it is unusual for Taiwanese SMEs to offer factory land as security for loans.

³²³ Yu, Zongxian and Gao, Chan, *Liangan jingmao guanxi zi tanso* (Taipei, 1991).

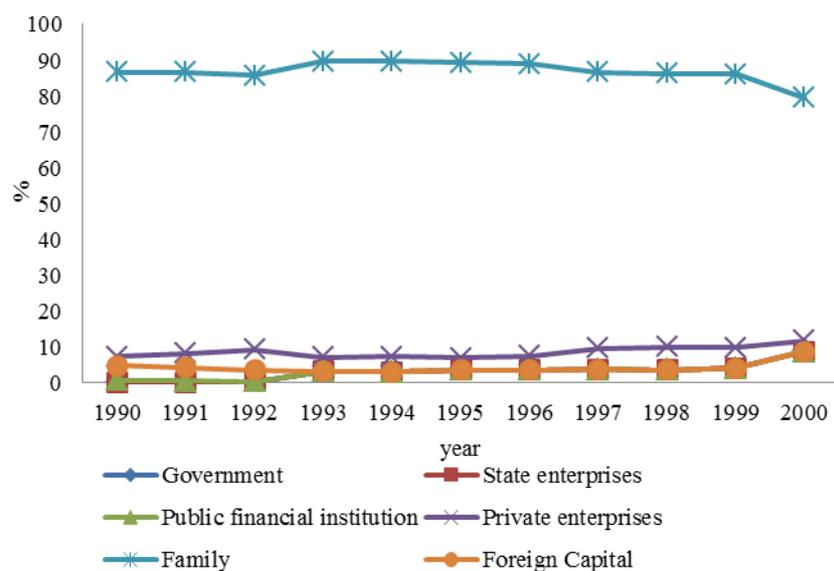
³²⁴ Constitution of the People's Republic of China, Article 10, Number 4, http://www.gov.cn/gongbao/content/2004/content_62714.htm. (accessed 06 June 2011).

³²⁵ Guangzhou Foreign Economic Relations and Trade Commission, ed., *op.cit.*, p.231-286.

Moreover, the factory building or machinery is hard to accept as security because their value is hard to realise.³²⁶

In addition, the Chinese commercial banks were challenged by the problem of lacking information about these Taiwanese SMEs, since this was the first time that they had negotiated business loans with them. The financial system between Taiwan and China did not create a credit reference agency; this made it more difficult for the Chinese banks learn about the credit-worthiness of the Taiwanese SMEs. Moreover, as mentioned above, the Taiwanese SMEs sometimes manipulated flows of capital and credit, while the Chinese banks are very careful with their financial statements. Unless the Taiwanese enterprises were large corporations or the parent company in Taiwan guaranteed them (the parent company is usually large and famous), the Chinese banks lent money to the Taiwanese enterprises very reluctantly.

Figure 9-2. Estimation of the Internal Capital Structure of the Taiwanese Manufacturing SMEs by Financial Source (%), 1990-2000

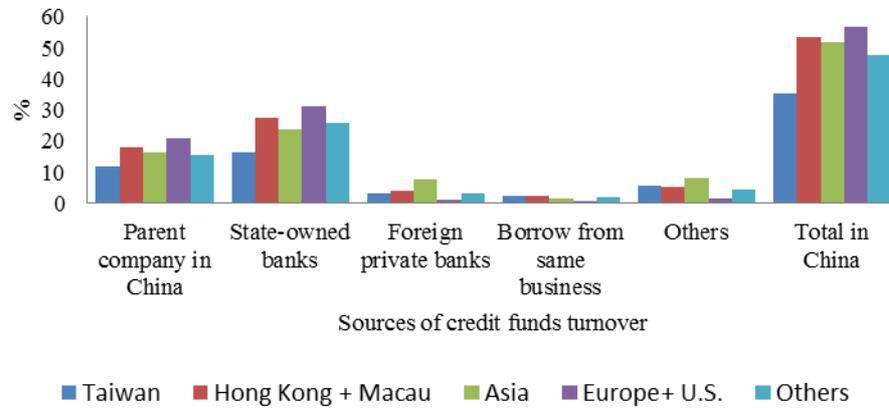


Source: Bureau of Economic Research, Central Bank of the R.O.C., Report on the Source of Capital of Public and Private Enterprises in Taiwan Area (Taipei: Central Bank of the R.O.C., 1992, p.59-61; 1993, pp.60-61; 1994, pp.58; 1995, pp.52-53, pp.56-57; 1996, pp.54-55; 1997, p.47-51; 1998, pp.47-53; 1999, pp.40-41, pp.46-47, p.38-39; 2000, pp.51-53; 2001, pp.61-64).

Note: 1. From 1993 the categories in the statistics of the Reports combine 'government', 'state enterprises' and 'public financial institution' together into 'government and public financial institutions). 2. The original government data list only the source of capital in manufacturing and other different industries. The estimation is calculated on the basis of the statistics for manufacturing industry times 90% for the SMEs in manufacturing industry.

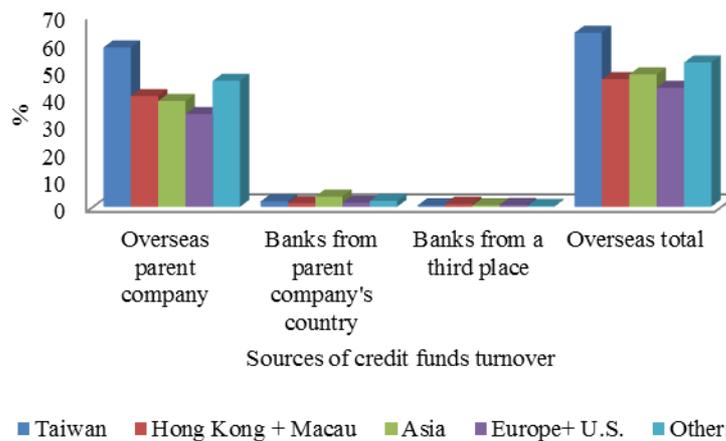
³²⁶ Ministry of Economic Affairs, ed., "Dalu jingji," in *1982 Nian dalu jingji qinshi pinggu*, (Taipei, 1983), pp.441-481.

Figure 9-3. A Comparison of Sources of Credit Funds Turnover of the Foreign Companies in China by Countries and Regions (%)



Source: Investment Commission, Ministry of Economic Affairs, Executive Yuan R.O.C. (Taiwan) and Chun Hua Institute for Economic Research, *Dalu jingying huanjing bianqian dui taishang touzi yingxian zhi yanjiu* (Taipei, 1996), pp. 148-149.

Figure 9-4. A Comparison of Overseas Sources of Credit Funds Turnover of the Foreign Companies in China by Countries and Regions (%)

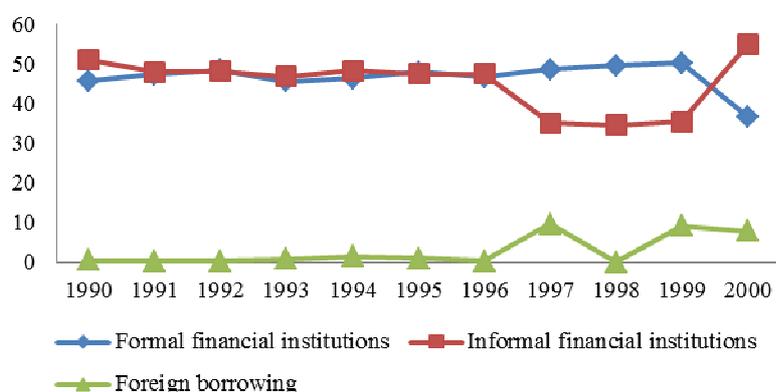


Source: Investment Commission, Ministry of Economic Affairs, Executive Yuan R.O.C. (Taiwan) and Chun Hua Institute for Economic Research, *Dalu jingying huanjing bianqian dui taishang touzi yingxian zhi yanjiu* (Taipei, 1996), pp. 148-149.

The evidence shown above suggests that the Taiwanese SMEs did not rely on the support of the Chinese government for their turn-over credit in China. The major support of the turn-over credit or the SMEs can be found from the statistics on its sources. Figure 9-5 below shows the credit turn-over fund of the Taiwanese manufacturing enterprises in the 1990s. It is clear that the major sources of credit turn-over funds relied heavily on business credit and private borrowing. The major

financial sources of the SMEs in China relied on Taiwanese parent companies for credit turn-over funds; and the financial sources of the Taiwanese parent companies came from the family category (as shown in Figure 9-2), business credit and private borrowings. The financial support structure clearly identifies that the Taiwanese social institutions continued provided significant financial support for the SMEs in China.

Figure 9-5. Estimation of the External Capital Structure of the Taiwanese Manufacturing SMEs by Financial Source (%), 1990-2000



Source: Bureau of Economic Research, Central Bank of the R.O.C. (Taiwan), Report on the Source of Capital of Public and Private Enterprises in Taiwan Area (Taipei: Central Bank of the R.O.C., 1992, p.59-61; 1993, pp.60-61;1994, pp.58; 1995, pp.52-53, pp.56-57; 1996, pp.54-55; 1997, p.47-51; 1998,pp.47-53; 1999,pp.40-41, pp.46-47, p.38-39; 2000, pp.51-53; 2001, pp.61-64).

Note: From 1980 the categories in the statistics of the reports adjusted.

2. The original government data list only the source of capital in manufacturing and other different industries. The estimation is calculated on the basis of the statistics for manufacturing industry times 90% for the SMEs in manufacturing industry.

9-5. Comparison of Four Instances of Investment Cases: the Formosa Plastic Group, Pou Chen Group, Uni-president Enterprises Corporation and Tinghsing

Formosa Plastic Group is one of the largest enterprises in Taiwan, mainly producing petro-chemistry-related products. The founder, Mr. Wang Yung-Ching, planned to invest in China in 1989. The Chinese government, in particular Deng, welcomed Formosa’s investment and strongly supported Formosa’s projects in China. The project is called the ‘Hai Cang Project’ (Hai Cang is a small town in Fujian Province) which aimed to build up another petro-chemistry kingdom in China. The project finally failed because the Taiwanese government interfered. According to the reports of the newspapers at the time, the prohibition of Formosa’s investment was highly political. The Taiwanese government used several methods to prohibit Formosa’s investment: (1) suspending the Formosa Group and its branch companies

on the stock exchange; (2) freezing Formosa's capital and loans in the banks; (3) forbidding Formosa's high-level managers to go abroad. Therefore, in 1992 it was announced that the project was suspended. The case of the Formosa Group implies that the Taiwanese government could supervise capital flows, and particular could influence the investment behaviour of the large corporations by controlling the sources of finance.³²⁷

The Formosa Group is an upstream industry and has been supported by the government in terms of technology, preferential terms and capital. Unlike the Formosa Group, Pou Chen was an SME in the downstream manufacturing industry. The Pou Chen Corporation is a footwear manufacturing company which was founded in 1969 in Taiwan. Initially it produced canvas and rubber footwear. In 1978 it gradually transferred as an original equipment manufacturer (OEM) for the international branded sport company 'Adidas'. Since then it has focused on manufacturing athletic and casual footwear for other international branded companies, including Nike, asics, Reebok, PUMA, NewBalance, Merrell, Timberland and Converse. In 1981, Pou Chen began investing in other countries where cheaper labour forces and materials for shoe-manufacturing could be found. In 1988 Pou Chen transferred investment to Yue Yuen Industrial (holdings) Ltd. in Hong Kong. Yue Yuen is the holding company which directs Pou Chen's investment in Vietnam, China and Indonesia. In 2005 the press estimated that Pou Chen dominated around 17% of the global athletic and casual footwear market.

Pou Chen is a typical Taiwanese labour-intensive manufacturing SME. The initial financial capital was 500,000 NTD in 1969; it was a downstream footwear manufacturer which relied on the export market and the raw materials (rubber and canvas) which were supplied by the SOEs and LEs. Since it was a traditional labour-intensive manufacturing SME and was not constrained by the restrictions on the amount of total investment and technology in China, it was easier to transfer investment to Hong Kong and then to invest in new factories in China. However, it is worth noting that it invested in China in 1988, which was earlier than the Taiwanese government officially permitted this practice. Comparing the story of Pou Chen with the investment case of Formosa Plastic, it is clear that business of Pou Chen has

³²⁷ Formosa Plastic Group, <http://www.fpg.com.tw/> (accessed 01 November 2010); Wei, Hua, 'Dui dangqian liangan jingmao qingshi zhi tantao', *Zhonggong yanjiu*, vol26, no.7 (1992), pp.42-45; Xiao, Hongliu, 'Taisuo liangan jianchang shijian yiye zhiqiu', *Zhonghua shangzhong*, vol13, no.7 (1980), pp.8-17.

continued to prosper in China. This demonstrates that Pou Chen did not rely heavily on government support for its capital formation and the indirect support of cheaper raw materials or intermediate goods were not as significant as Wade and Amsdem describe. If Pou Chen had relied on government credit support and the supply of materials and intermediate goods for production, it is highly unlikely that it could have invested in China earlier than the government officially permitted.³²⁸

Like the Formosa Plastic Group, the UPEC food producing company is the largest of its kind in Taiwan. Tinghsing Co. Ltd. is now the largest instant noodle producer of all Taiwanese enterprises in China and its instant noodles (Master Kong) dominate 40% of the instant noodle market in China. In comparison, the UPEC dominated less than 15% of this market. Many researchers have analysed its business strategy in China. Although market strategies play a significant role, few have noticed constraints for the UPEC on its investment and business operation in China.

UPEC was founded in 1967 by the Tainan business group ('Tainan Bang'). The initial business of the Tainan business group includes Tainan Spinning Co. Ltd. (1954) and Universal Cement Corporation (1960). Tainan Spinning Co. Ltd. and Universal Cement Corporation are the large enterprises that the Taiwanese government supported in order to develop the domestic industries in the early post-war period. The initial financial capital of the UPEC was 32 million NTD in 1967; it is the largest food company in Taiwan. In 1991 the UPEC began investing in China.³²⁹ In contrast, Tinghsing Co. Ltd. was founded in 1958 in Taiwan as a small-medium sized factory which initially produced castor oil. In 1990 Tinghsing began a food business in China and gradually focused on producing instant noodles.³³⁰

UPEC was founded by the Tainan business group, which is one of the influential business groups in local Taiwanese society. The Tainan business dominated the upstream industries and participated in politics. The president of UPEC is a board member of the KMT Central Committee. Political and business connections facilitated their business in Taiwan in the post-war era. In the 1970s and 1980s the average profits of Universal Cement and Tainan Spinning were 11 billion NTD and 20 billion NTD respectively. However, these political and business connections also hindered their investment in China. The president of the UPEC criticised the

³²⁸ Pou Chen Group, <http://www.pouchen.com/>. (accessed 16 March 2011).

³²⁹ UPEC, <http://www.uni-president.com.tw/>. (accessed 16 March 2011)

³³⁰ Ting Hsin Taiwan, <http://www.tinghsin.com.tw/>. (accessed 16 March 2011).

government policy which restricted the amount of investment in China. He indicated that government restrictions and controls weakened firms' competitiveness in the global and Chinese market. At the same time, after 2000 the average profits of the Universal Cermet and Tainan Spinning was less than 300 million.³³¹ Comparing these with the rapid growth of Tinghsing in the Chinese market, an SME had beaten LEs in the Chinese market in a matter of less than twenty years.³³²

The above comparison of the four cases of LEs and SMEs from manufacturing industries questions the argument of Wade and Amsden. The LEs, both the Formosa groups and the UPEC, were supported by the government in the post-war development era. They enjoyed tax exemptions, protection in the domestic market and found it easier to obtain loans from the banks. Nevertheless, after 1990 their investment plans in China were restricted by the government. The government influenced the investment project of the Formosa Plastic Group mainly by freezing its sources of capital. Moreover, the UPEC was constrained by the use of financial capital for its investment in China.

On the contrary, Pou Chen and Tinghsing began their investment in China earlier than formal permission was obtainable. It is also worth noting that they both transferred investment to China via Hong Kong. The comparison demonstrates that the SMEs did not rely on government support; in particular, the SMEs had more freedom to use their financial capital. If the SMEs had relied on the government's support, for example in credit and technology and the indirect support of the LEs to provide cheaper raw materials and intermediated goods, it would not have been easy for the SMEs to have gone to China under the government restrictions. What is more important is that in these two cases the SMEs prospered and grew larger in China. However, the LEs were not only hindered in their development by the government's policy, but had their profits reduced when the Taiwanese SMEs went to China.

³³¹ Shieh, Jinhe, 'Gongshang jutou fenfen shiang jieji yongren shuanzhan', *Business Today*, vol.50 (26 June 2005), pp.1-3; "Tongyi xijin bianzhao, xingzheng yuan yaocha," *China News*, Taipei, 5 May 2006, http://www.hamber.net/ChinaNews_Detail.php?SN=1181 (accessed 16 March 2011).

³³² "Cong Taiwan dao naidi, kang shi fu vs. tongyi: qiankun da nuoyi," *Huaxia jinwei wang* China, 26 September 2007, <http://big5.huaxia.com/sw/qycf/2007/00689948.html>. (accessed 16 March 2011).; Chang, Suchao, Lee, Chicheng, Shie Ping, 'A study on the strategic planning and organisational operations of Taiwanese group enterprise in Mainland China: case study on Uni-president and Ting Hsin international group', *Commerce and Management Quarterly*, vol.4, no.1(2003), pp.91-123; "Taimei: touzi dalu shangxian weichu kuang jiasu taishang fugan guapai," *Huaxia jinwei wang*, China, 04 August 2006, <http://big5.huaxia.com/sw/tzdl/2006/00491992.html>. (accessed 16 March 2011).

9-6. Conclusion

In the mid-1980s the Taiwanese government began to adjust its cross-strait policy, but in a passive way. Not until the 1990s were the regulations for cross-strait relations institutionalised. Analysis of government regulations and verification standards on investment in China shows that the KMT government allowed labour-intensive SMEs to invest in China. But although their enterprise was allowed, the institutions set up by the KMT government for cross-strait economic activity did not facilitate it. The principle of the cross-strait policy of the KMT government was 'indirect': trade, investment and transport links had to go through a third place. The institutionalised indirect model aimed at both normalising economic activity and protecting economic and national security. With this model, the KMT government sought to manage and control trade and investment.

Under the constraints of this model, some research indicates the role of culture and kinship relations in facilitating business among Taiwan, Hong Kong and China. However, a closer examination of FDI distribution shows that the largest amount of Taiwanese FDI went to Shenzhen (Guangdong province) rather than Xiamen (Fujian province). The existing literature over-generalised social factors which cannot be applied when analysing the ethnic structure of Taiwanese SMEs. Most SME owners are Haklo and Hakka people. On the one hand, most of their ancestors immigrated to Taiwan in the 19th century; it is then difficult to identify which part of the kinship relationships facilitated or attracted Taiwanese FDI to present-day China. On the other hand, they are not familiar with Guangdong and Jiangsu; however, the two largest amounts of Taiwanese FDI went to these two provinces, where the historical and kinship relations with Haklo and Hakka people were weaker. The evidence suggests that culture or kinship relations between Taiwan and China were relatively insignificant to SME investment behaviour.

This chapter then provides an explanation of the functioning of the social institutions in support of SME business across the strait from 1990 to 2000. It first examines the cost generated by the indirect model. Although the economic cost of the indirect model was particularly criticised by the Taiwanese entrepreneurs, the analysis in this chapter shows that the indirect model increased the cost of travelling time but did not reduce the cost by much. In terms of the price of flight tickets, it is clear that the prices for transferring via a third place and for direct flight were much the same. This was affected by the concerns of national security and the openness of the market

for direct flights. Moreover, the shipping costs would not be reduced to the degree expected by the Taiwanese entrepreneurs. The shipping routes are affected by the industrial structure across the strait. In other words, the demand and supply of both markets determined the shipping cost. Under the demand and supply and industrial structures, Hong Kong still plays a significant role and is more than a mere political buffer zone.

In terms of the institutional framework for capital flows, the restrictions of the Taiwanese government and the regulations of the Chinese government created a grey area which facilitated SME capital transfers and business operations across the strait to avoid management and control. The 'via-a-third-place' principle was meant to supervise the capital flows and avoid deep economic integration with the Chinese market. The regulations of the Chinese government on remitting money were meant to control the inflow and outflow of foreign currency in China. The SMEs manipulated the remittance regulations and used the third place to avoid control and management from both governments. The policies of both governments created the grey areas in which the Taiwanese enterprises could avoid government restrictions and controls. The analysis of grey areas within the formal institution was significant. It shows that economic activity did not exactly follow the formal institutions; instead business operated in the grey area created by the formal institutions in order to reduce government intervention and transaction cost.

Within the grey area, the social institutions provided significant financial support to SME investment in China and business operation across the strait. Evidence shows that the major source of capital formation came from the family category from 1990 to 2000. This indicates that the SMEs did not rely on the formal banking system for their business. The continuing support of social institutions for the Taiwanese SMEs business operation in China was also influenced by the Chinese formal institutional framework. Since the Chinese financial institutions and the foreign banks did not play a significant role in granting loans or in providing credit funds as turn-over for Taiwanese SMEs, the Taiwanese SMEs, having invested in China, still relied heavily on financial support from Taiwan. The reliance was on the Taiwanese parent companies and the Taiwanese parent companies relied on the financial sources supported by the social institutions.

The significant role of the financial support from the social institutions to facilitated SME investment operation in China can be found from the comparison of

the four chosen cases. This comparison demonstrates that the government was able to control and affect the investment projects of the LEs in China. Both the Formosa Plastic Group and the UPEC were financially constrained by the government. In contrast, although the government allowed the labour-intensive manufacturing SMEs to go to China, both Pou Chen and Tinghsing began their investment before they had the government's formal permission. The SMEs prospered in China; yet the profits of the traditional LEs withered. The government had limited influence on SME investment projects in China because the SMEs did not rely on government support for their finance credit and technology and they did not rely significantly on the business credit, cheaper materials and intermediate goods from the LEs, either.

To conclude, this chapter shows the indirect model did not necessarily cause inconvenience or generated cost for the SMEs. This implies that the government's formal institutions had limited control on economic activity across the strait. Moreover, the evidence also demonstrates how the Taiwanese social institution provided support to the SMEs in China. It was not the culture and kinship relations that facilitated trade and business operation across the strait. It was the grey area that two governments themselves created by their formal institutions that facilitated trade and business transactions. The social institutions continued to provide significant financial support within the grey area to facilitate SME business operations across the strait.

The comparison of the four cases also demonstrates the significance of the source of capital formation. On the one hand, the government was able to control the LE investment in China by restricting their sources of finance. On the other, since the SMEs relied more on the social institutions for credit, the government had little influence on their business operations. The SME investment and prosperity in China also questioned the role of the government in the rise and development of the SMEs in the post-war era. Significant support tends to lead to reliance on the support and the restrictions of the government were much more effective in the cases of the LE investment projects.

Part VI. Conclusion

Chapter 10. Conclusions

The neo-classical economists argue that the success of Taiwan's post-war economic development was the result of establishing a free market economy. This was what induced the rise of the SMEs, created the market mechanism and facilitated business operations. Some of the neo-classical economists agree that the government created a suitable environment, such as a free market, for the functioning of the economy and business. They do not agree that the government intervened deeply in the process of the development.

However, Wade and Amsden believe that the Taiwanese government played a significant role in Taiwan's economic miracle. The government successfully implemented development policies to plan, direct and guide the economy; in other words, the government did more than the neo-classical economists had argued. In addition to creating a suitable environment, they claim, some of the policies induced industrial development. The success of the SMEs was part of the successful story of the state-led model. Moreover, the state-led model usually highlighted the significance of the authoritarian political power which helped to implement the development policies. Both strands of thinking focus on the suitable market environment and the policies facilitated the rise and development of the SMEs in post-war Taiwan.

This chapter summarises the findings of the present research project. The first section clarifies how the social institutions work according to the historical pattern. The second section addresses the question how far the government supported the rise of the SMEs in the post-war development era. The third section provides evidence that the state had only a limited influence on SME investment behaviour in China after the late 1980s and explains why this was so. Finally, the chapter concludes by looking to historical similarities and continuity (notwithstanding the differences and discontinuity) to clarify the relations of the state, the market and the social institutions.

10-1. The Historical Pattern

Gold and Booth argue that one of the key factors in Taiwan's post-war economic success lay in its authoritarian system of government. They assume that Taiwanese society found it easy to accept authoritarian power and that local

Taiwanese society lacked a well-established financial and industrial class in. Wade further indicates that the relations of the state and the SMEs (or the private business sector in general) were distant. The state was then able to avoid disturbing interest groups in the provision of its development policies. This concept of a distant relationship resembles that of Gold, implying that after the War Taiwanese society was a passive receiver and the private business sector in Taiwanese society had not yet developed. However, they ignore the impact of the historical legacy on the development of society in the time before the KMT came to Taiwan.

Analysis of the historical pattern produces some significant findings. The open or close of the market was significant for business activity. During the early post-war period, the market was monopolised by the KMT government. That is, the market was not open to everyone. The limited access to the market may lead to the general argument that the Taiwanese society is a passive receiver.

The historical pattern shows that a more open policy benefited Taiwan's trade and economic prosperity. No matter whether the institutions were undeveloped or well-established, business and trade prospered as long as the governments did not block the market. The historical pattern also identifies that, in a different institutional framework, the social institutions had continuously provided business networks and sources of capital to facilitate trade and business operations in Taiwan.

It is also worth noting the changes to the social institutions in the late Qing period and in the early Japanese colonial period. Before 1895, the major financial capital and business remained in China (particularly Fujian province); however, in the early 20th century, Taiwanese society had built up its own social institutions, which were able to provide sufficient financial capital to support their business demands. This significant transformation was not mainly affected by the policy of the Japanese colonial government to reduce the amount of Chinese capital in Taiwan; the result rests on the accumulation of financial capital by the Taiwanese business groups in the Qing period. The ability to providing a source of capital for investment and trade also implies that trade and business in Taiwan since the mid-Qing dynasty prospered as the businessmen accumulated capital in Taiwan.

The historical pattern shows that trade in Taiwan had relied heavily on the private business groups rather than on the formal institutions which had been set up by different political powers. The dynamics of the private business groups was founded on the social institutions which provided support for private/illegal trade

under different political systems. As long as the market and trade in Taiwan remained open, the social institutions adapted to the changing environment in order to support private business. Therefore, Taiwanese society was not a passive receiver; but at the same time the historical legacy developed a dynamics in the social institutions which was adapted and transformed in line with the changing market environment, but did not challenge the political powers in their operations. The development of the social institutions gradually accumulated capital and established business networks in the society around them.

10-2. Where Did the Support Come From? The Role of the State in the Rise and the Development of the SMEs, 1949-1980

Wade agrees with Gold and Booth that the authoritarian system facilitated development policies in Taiwan because it was safe from the influence of local interest groups. The authoritarian system created the basis for successful economic development in the 1980s. In terms of development policies, Wade and Amsden suggest that the Taiwanese government intervened in the economy to guide, plan and direct the development of the SMEs by launching the policies of encouragement: tax exemptions, tax refunds for exporting SMEs, getting the relative price wrong, supporting technology and business credit for the SMEs in particular. Unlike Wade and Amsden, Rodric stresses that government increased its investment with the export growth after 1970. He then argues that the rise of export growth was supported by government investment in the subsidies for export.

The argument around the authoritarian system ignores the state's interest in forging the development policy. Party-state capitalism explains the government's support for the SOEs and certain LEs. The ISI policy severely controlled the allocation of resources for industrial production. The KMT government controlled both political and economic power and this enhanced its domination of Taiwanese society. Encouraging the development of the private enterprises and FDI in Taiwan required several restrictions to be relaxed and this relaxation would have reduced the government control on the economy.

This state's interest influenced the effectiveness of further development policies. The FDI policy in the early 1950s failed and the evidence implies that the failure of the policy resulted mainly from the control of the foreign exchange system and the restrictions on imported materials. In 1959 the KMT government adjusted the

development policy to EOI; however, the adjusted foreign exchange system and relaxation of controls on the quotas of imported materials had little liberalising effect. The evidence demonstrates that in the 1960s the control on exports and the quota for imported materials were still tight. Meanwhile, the tax exemptions did not apply to the industries which contributed to export growth. This also raises a doubt whether the state chose the right exporting industries to support. The evidence challenges Rodric's argument that most of the encouragement policies for export were implemented in the 1950s.

The state's interest further affects the impact of the policies on the SMEs. Evidence shows that the major problem for the SMEs lay in the financial support for business operations. However, the market which the government established did not provide the SMEs with significant financial support. Under the development policy, the banks mainly granted loans to the SOEs and LEs so that they could develop Taiwan's own industry. Furthermore, the evidence shows that the price of certain key materials or intermediate goods produced by the SOEs and the LEs was not necessarily lower than the price in Korea. This suggests that the state's interest led it to support mainly the SOEs and LEs. It also questions whether the government did get the relative price wrong when it came to supporting SME production.

The other factor in determining whether the SMEs benefited from the state's support lies in the problem of their qualifications. Evidence indicates that most of the SMEs did not directly benefit from governmental encouragement. The qualifications required for tax exemptions, the time-consuming administrative process and the requirement of deposits for the export tax exemption policies effectively excluded the SMEs from direct state support. The other significant evidence can be found from the indirect financial support through business credit. The SMEs could enjoy the business credit system only if they had certain qualifications. The qualification problem questions how far most of the SMEs were able to benefit from the direct and indirect support from the government.

The evidence of the debates and discussions on government's encouragement policies suggests that the series of 'encouragement' policies, such as the encouragement to export, were indeed 'open' policies. The open policies merely allowed more participants into the governed market; the SMEs, due to the qualification problem, were not eligible to receive the government's benefits. Examining the development policies and the government's support raises the

question: since the government governed the market and the encouragement and relaxation of its controls allowed only certain qualified participants in the market, how did the SMEs develop before they could qualify to enter the market and access the government's support?

The evidence of this research shows how the SMEs were able to support themselves before obtaining state support (both direct and indirect). The KMT government focused on the development of and certain LEs and SOEs (which mainly dominated transactions upstream). It was the private enterprises that dominated downstream. However, during this period, it was difficult to estimate the size of the individual enterprises in this category. The statistical data in the 1950s do not split up private enterprises according to size. This was also related to the regulations of companies and factory registration. The registration regulations helped SMEs to start up in the suburban and rural areas because the enterprises were so small that they needed only to obtain a production permit from the local council and need not apply for permission from the central government. The industrial structure and the registration regulations created a space for the functioning of social institutions.

When business opportunities arose in downstream industry, requiring small amounts of financial capital and lower labour skills, the social institutions were able to contribute the first round of money to start business. Evidence shows that a substantially high percentage of the SME's financial capital came from the category of family and the percentage remained high from the 1970s to the 1990s. Financial sources from other categories, such as banks, contributed little to the SMEs' financial capital.

Moreover, the evidence also shows that the credit turn-over fund for the SMEs came mainly from the categories of private enterprises, family, business credit and private borrowings. This dependence was related to the SME subcontracting system. Since the SMEs are usually small-scale and specialised only in certain skills, they had to cooperate with other SMEs. The structure of the subcontracting system also questions the role of the state in supporting the SMEs. Apart from purchasing raw materials and intermediated goods from the SOEs and LEs, the SOEs and the LEs did not integrate with or lead the SME subcontracting system. The examples presented of the way in which the SMEs got the work done and won orders from foreign companies could not trace any leading or guiding role for the state in the SMEs' business operations.

Evidence of the sources for capital formation and turn-over credit funding indicates the significance of the social institutions for the development of the SMEs. Although the social institutions were essential, their function was coordinated with that of the formal institution. It was found that the functions of the social institutions are slightly different from the model of social institutional theory. The social institutions are not independent of the formal institutions. Without the space left by the formal institutions, the social institutions cannot play any significant role in supporting the SMEs. Moreover, the reliance of the SMEs on the social institutions as a source of capital also demonstrates that even the government got the relative price wrong for the interest rate on bank loans, for the main source of capital was the private sector. This, again, goes back to the problem of being qualified to access the support and encouragement of the government.

The analysis and the evidence in this section question the argument of Wade, Amsden and Rodric regarding the role of the state in the rise and development of the SMEs. The state's interest mainly focused on developing the SOEs and certain LEs and this influenced the formation of its development policies. The sound development policies and the direct and indirect support looked effective; however, the main problem was how few SMEs were qualified to access the support and encouragement. The arguments about 'getting the relative price wrong' and 'government investment to lead export growth' also ignore how few SMEs actually benefited from these policies.

However, the neoclassical economists are right about the market environment that was opened by the KMT government. A more open market policy allowed more SMEs to participate in the market. Yet this newly-opened market did not provide a source of capital for the SMEs hoping to start up and to operate. The source of significant capital was the social institutions. It was the policies which focused on the development of SOEs and LEs that created the space for the social institutions to function. It is possible to argue that, as long as the state opens the market, the social institutions adapt to the environment so as to provide support for the SMEs.

10-3. Effective State Intervention? The Conflicting Interests of the State and the SMEs

The research by Wade and Amsden on Taiwan's economic development usually shifts the focus after 1980 to the rise of high-tech manufacturing industry. Their analysis of the high-tech manufacturing industry fits the state-led model once

more. However, their research ignores the further development of the traditional manufacturing SMEs after 1980. The Taiwanese SMEs dominated a large part of the export market and the employment total. The contribution of the SMEs to the Taiwanese economy indicates that the SMEs relied on the export market and the local labour force. The main challenge in the mid- and late 1980s was the rising labour costs. Several different factors were at work among the workers in Taiwan. The key factor in the survival of the SMEs occurred in the mid-1980s when the exchange rate of the NTD against the USD suddenly appreciated. The conversion of the workers' wages from the NTD to the USD brought a significant increase in production costs for the SMEs.

The impact of the rising exchange rate on the labour cost shows that the government by controlling the price had a significant impact on the market. When the government adjusted the foreign exchange rate, it did not provide complementary subsidies for the export enterprises. Instead, the state launched a more open investment and trade policy. The comparison of China and the four selected countries in Southeast Asia indicates that China was able to provide the cheapest labour costs for the Taiwanese SMEs. There were several determinants for SME outward investment in China; but the lower labour cost was the key factor, which both pushed and pulled SME investment. The economic interest of the SMEs clearly lay in the need to cut labour costs. Although China was a relatively suitable place for the SMEs to invest in, the government had a different view of the matter. The questions then are, what was the state interest which influenced the formation of the cross-strait policy? And did this policy based upon the government's interest influence SME investment behaviour in the late 1980s and the 1990s?

Economic research indicated that more open trade and investment would be beneficial for both Taiwan and China. The economic demands of the Taiwanese government were unlikely to be met. However, a comparison of the government's policies clarifies that in China its interest was in conflict with the SMEs' economic interest. The analysis of the KMT power structure explains the changes in the state's interest from the 1970s to the 1990s. Such an analysis shows, it might be argued, that it was the political conflicts between the KMT and the CCP that frustrated a beneficial economic policy with China in the 1980s. However, in the 1990s when the political power structure changed, the historical hatred between these two political parties was not the main concern. For the KMT, in order to remain in power, it had to consider

voters' opinions on the cross-strait economic policy. The evidence shows that most of the voters did not have a clear-cut political status in the 1990s; however, regarding the issue of Taiwanese investment in China, a high percentage of them agreed that the government should manage investment and trade carefully. This was not only related to national security; their concern was also affected by economic issues. If more investment was made in China, the voters were not sure whether they would keep their jobs. Although new policies might bring new opportunities, voters were uncertain about the transaction cost. In these circumstances, they wanted the status quo to remain.

After the late 1980s, the state's interest influenced the formation of Taiwanese outward investment policies. The government by offering preferential banking loans encouraged Taiwanese investment in the Southeast Asian countries. At the same time, it set restrictions on investment in China. However, the pattern of Taiwanese outward investment shows that the restrictions and the indirect model did not influence the investment behaviour of Taiwanese entrepreneurs. Comparing the size of each investment case in China and in Southeast Asia clarifies that the investment in China was mainly by small-scale and labour-intensive industries, while the size of each investment case in Southeast Asia was large. This contrast supports the view that the government was able to influence the investment behaviour of the larger private enterprises. But the influence of the government on the investment behaviour of the SMEs was limited. The SMEs clearly followed the market where the lowest labour costs could be found. This also implies that the government's preferential banking loans or other benefits were not as significant as the lower labour costs.

The analysis and evidence in this section indicate the significance of the further development of the SMEs after 1980, which questions the argument of Wade and Amsden. Although the government was able to influence the foreign exchange rate for exports, this affected only the market environment. The SME investment behaviour from the late 1980s challenges Wade and Amsden's argument concerning the role of the government in the development of the SMEs. If, as they contend, the SMEs relied on the support and encouragement of the state, including credit and technological help, the SMEs should have followed the government policy and gone to Southeast Asia as the LEs did in the 1990s. The amount of Taiwanese FDI in China contradicts the conclusion that the Taiwanese SMEs relied on the support of the state.

10-4. Why the State Had Limited Influence on SME Investment in China

The state's interest influenced the principle underlying the cross-strait economic policy, which sought to discourage Taiwanese FDI to China. The general explanation runs that culture and kinship relations facilitated investment and trade across the strait despite the restrictions raised by the political conflicts. However, it is worth noting that Taiwanese investment did not go to Fujian, the province which had the strongest kinship relations and similar dialects. On the contrary, the largest amount of Taiwanese FDI went to Guangdong and Jiangsu. The distribution of Taiwanese FDI in these two places questions the over-generalisation of factors which facilitated Taiwanese SME business operations across the strait in the face of political conflict and government restrictions. The social institution facilitated SME business operations across the strait, but in a different way from the conventional generalisation of socio-cultural factors.

The explanation can be separated into two areas. The first examines the cost and inconveniences that were generated from the imposed indirect model. Most of the cost, such as the transport links and money transfers via a third place, increased time rather than substantially increasing cost. At the same time, the shipping cost, which was crucial for most of the enterprises, would not be reduced by any direct model to the degree expected by the Taiwanese entrepreneurs. The shipping routes were affected by the industrial structure across the strait. In other words, the demand and supply of both markets determined the shipping cost. Under demand and supply and the industrial structures, Hong Kong still plays a significant role as more than a mere political buffer zone.

The second aspect was related to the grey areas created by the formal institutions. These grey areas resulted from the policy of exporting 'via a third place'. Unexpectedly, due to the 'via a third place' policy, these grey areas facilitated trade and investment across the strait and made it hard for the Taiwanese government to manage the outflow of investment capital to China. The analysis of the grey areas within the formal institution significantly explains how the investment and trade functioned and continued under the formal restrictions.

Third, the significant social dynamics which supported the SMEs in China can be found from the financial support for the Taiwanese SMEs in the 1990s. The continuing support in China from the social institutions to the Taiwanese SMEs was also influenced by the Chinese formal institutional framework. The banking system in

China and the financial market created space for the social institution. Since the Chinese financial institutions and the foreign banks did not play a significant role in granting loans or in providing turn-over credit funding for the Taiwanese SMEs, the latter after they invested in China still relied heavily on financial support from the parent companies in Taiwan. The Taiwanese parent companies in turn relied on the financial sources supported by the social institutions. This continuing financial support from the social institutions is significant.

The comparison of the four selected cases indicates what the significance was of the source of capital and demonstrates the impact of government support on the investment behaviour. Both the Formosa Plastic Group and the UPEC were among the largest enterprises to have been supported and protected by the government in the post-war development period. The analysis shows that the government was able to influence their investment behaviour by controlling their financial sources. In contrast, Pou Chen and Tinghsing were not constrained by the state because before they invested in China, in Taiwan, they were SMEs. Although the state allowed the type of industries represented by Pou Chen and Tinghsing to invest in China, it is worth noting that they both entered China (via Hong Kong) before the government officially permitted it. The evidence shows that the Taiwanese government had limited influence on SME investment behaviour because the SMEs had more freedom in making the best of their private capital without government constraints.

The analysis and explanation in this section clarify why the government had limited control over SME investment in China and business operations across the strait. The restrictions of the Taiwanese government and the regulations of the Chinese government created the grey area which turned out to foster SME investment, trade and business operations across the strait. After the late 1980s, the restrictions and regulations had limited power to manage and control SME development cross the strait. The grey area also provided space for the social institutions to support and facilitate SME business in China. This demonstrates that the social institutions were able to adapt to the changing formal institutional frameworks and this reduced government intervention in SME business operations.

Although the Taiwanese government set up restrictions and tried to control the SMEs, in the event, it clearly was not able to do so. This goes back to the main argument of the dissertation. The direct or indirect support of the state to the SMEs in the post-war period was not as important as Wade and Amsden have argued. The

further development of the SMEs and their investment in China shows that after the late 1980s the state's control and restrictions did not constrain SME investment behaviour and business operations across the strait.

10-5. Historical Similarity and Continuity

The first historical similarity is that the state policy had an important impact on the market environment; and the consequences of the influence on the market environment varied. The rise of Taiwan in Chinese economic history resulted from the changing policies of the Ming imperial court. Trade in Taiwan prospered under the sea bans of the Ming and early Qing periods. Trade in Taiwan was also open because there was no integrated political power to regulate it. The Qing and the Japanese colonial government opened the market for business; and from then on trade prospered across the strait and brought Taiwan back into the regional/international trade system. The KMT government opened the international market and induced the rise of the SMEs in the 1970s and the 1980s.

However, state policies sometimes blocked the market and affected trade and business. For example, when the Qing imperial court prohibited Chinese migrants to Taiwan in the early period, trade stagnated. Moreover, in the 1950s when the KMT government monopolised the market and controlled the foreign exchange system, the private enterprises and the SMEs were constrained. After 1990 the government restricted the Chinese market but opened up the market in Southeast Asia. The consequence was that cross-strait trade prospered despite the government's restrictions on the cross-strait market. The different consequences were related to the participants in the market, namely, the business groups and to their relationship with the state. Based upon the first similarity, it is possible to argue that the governments played significant role in opening or closing the market. As long as the market is open for trade, other supports or restrictions of the government were not necessarily effective to influence or control private business operation.

The second historical similarity is that the state gave limited support to the business groups (or sometimes banned private business altogether) and therefore their influence on the business groups was limited. The Ming imperial court prohibited private sea trade, but it could not ban the pirates' illegal sea trade. In the late Ming period, the imperial court even institutionalised these pirate leaders and their business groups. The Qing imperial court did not have clear economic policies to support or

prohibit trade and business in the mid- and late Qing period. Trade and business prospered under the control of the Taiwanese Jiao Shang. The Japanese colonial government had better economic policies, although they did not focus on supporting the development of local Taiwanese business groups. The cross-strait trade was still dominated by the Taiwanese businessmen and large amounts of Taiwanese investment occurred in Fujian Province. The policies of the KMT government in the development period did not directly or indirectly provide the necessary support for the SMEs. In the late 1980s, the government tried to help the SMEs to solve the problem of the rising labour cost; nevertheless, the encouragement policy to invest in Southeast Asia did not correspond to the best profits of the SMEs. Large amounts of SME investment went to China and the government had limited influence on investment behaviour.

The limitations of the government policies were related to the interest of the government. Given their different interests, the government offered limited support to the development of the business groups. Hence the business groups relied little on the governments and this weakened the impact of the government policies on the business groups. It also explains why the economic policies regarding the market had different consequences. The market which was sometimes restricted by the government was the market that the business groups were interested in. Conversely, the market which the government sometimes opened did not suit the profits of the business groups. From the historical pattern, an open market and free trade policy generally benefited the business groups, whether or not the government did little to support their business transaction. Since the business groups did not rely on the support of the state, how did they make profits from the market they were interested in? The historical continuity explains the dynamics which supported and fostered their business operations.

The historical continuity can be found from the support of the social institution to the business groups. The historical pattern shows that, no matter whether they were ill-established or well-established, the social institutions adapted to the changing environment and provided financial support and business connection to facilitate trade and business. The social institutions continuously provided sources of financial capital and business networks (the subcontracting system) in China for the SMEs in the post-war period and after 1990.

It is worth noting that the support of the social institution had its own prerequisites, starting with the presence of demand and supply. The research shows

that as long as there is demand and supply in the market (regardless of whether the market is opened by the state or constrained), the social institutions can provide support. Another prerequisite was the attitudes of the government. Although the state was sometimes positive but sometimes negative towards trade and business, as long as the state did not entirely block the market, the social institutions were able to function.

There is also a significant difference and discontinuity in history. Before the Japanese colonial period the social support for trade and business came from social institutions in China and Taiwan. However, the changing policy of the colonial government cut the connections. Yet, it is too general to argue that the Japanese colonial policy changed the connections and enhanced the development of the local Taiwanese society. The development of Taiwanese society for trade and business was gradually established in the Qing period. Jiao Shang built up the structure for business and society and the financial capital gradually accumulated over time. The policy of the colonial government to cut Chinese capital demonstrates that the social institutions supporting the Taiwanese local business groups were mature. Evidence can also be found from the structure of the SMEs and the continuing financial support from the social institutions when the SMEs invested in China before 1980 and after the 1980s. The social institutions in Taiwan, rather than those in China, continuously supported trade and business across the strait.

10-6. Some Significant Findings from This Research

The argument of Wade and Amsden concerning the role of the state in the rise and development of the Taiwanese SMEs overestimates the state's influence on the SMEs and underestimates the dynamics of social institutions in providing support for the SMEs.

The state's interest in the formation of development policies is, in their analysis, ignored. The legislation and the structure of the KMT facilitated its control and allocation of resources for economic development. Its party-state capitalism required firm domination over both politics and economics. These influenced the state's interest in the formation of the development policies which focused on the support to the SOEs and LEs. Evidence shows that these development policies hardly met the needs of the SMEs.

Evidence also shows that the significant influence of the state lay in the market environment; it was able to block or open the market by controlling the foreign exchange rate. The changing market environment influenced the SMEs' economic activity. This part fits the framework of the neoclassical economists. However, the market which was opened and established by the government did not provide significant financial capital for the SME business operation. In other words, the market established by the government was not strong enough to allow the SMEs to develop.

Evidence shows that the state provided only limited direct and indirect support to the SMEs. These policies include getting the relative price wrong, increasing government investment, tax exemptions, tax refunds, providing business credit, cheaper raw materials and intermediated goods. Nevertheless, the analysis indicates that the focus should not be on how much support the SMEs had from the policies; the question is how many of the SMEs were qualified to access this support and encouragement from the state. Before the SMEs were able to access to the support, they needed to sustain themselves in some other way while they qualified.

North argues that the formal and the informal institutions are interlocked and delaminated to shape economic activity; in the absence of effective government, a limited number of goods and trade, the informal rules stabilise transactions. The market which the government established did not provide a source of capital and the SMEs had difficulty in accessing state support. In these circumstances, the evidence demonstrates that the informal financial market provided the necessary capital and turn-over funding for the SMEs.

The social economists and social institutional theory extend the informal institutions and North argues that the informal institutions are socially constructed. Orru, Biggart and Hamilton maintain that the dynamics of social networks which were embedded in the society played a significant role in Taiwan's economic success. The evidence demonstrates that the main source of capital from the informal financial market came from the categories of friends, relatives and private borrowings. The informal market is thus founded on the social institutions and the SMEs relied heavily on the significant financial capital from them.

The evidence that the state had limited influence on SME investment behaviour after the late 1980s questions how far the SMEs relied on state support for their business operation. The political transformation complicated the state's interest

in the formation of the cross-strait economic policy and this led to further restrictions and management on cross-strait trade and investment. However, when the state's interests were in conflict with the SMEs', the SMEs followed the market.

The SME investment in China also demonstrates that the propitious market environment established by the KMT government could have been replaced by the Chinese government. This also implies that the key feature of a suitable market environment was its openness and some relaxation on the control of international trade. Evidence shows that the financial support to the SMEs' business operations still came from Taiwan. The control of the source of capital facilitated SME investment and avoided any constraints from the state on their economic activity.

The historical pattern identifies an open market for trade and the support of the social institutions was essential. The social institutions continuously supported the Taiwanese SMEs in China with significant financial capital. The social institutions could function because the government restrictions (namely, the conditions of the indirect model) created grey areas which encouraged the flow of financial capital. It is also worth noting that the dynamics of the social institutions derived from Taiwanese society. The differences and discontinuity of the support of the social institutions from Chinese society had occurred in the Japanese colonial period. The analysis of the historical pattern and the social institution shows that Taiwanese society was not a passive receiver. The social institutions, as Jones argues, adapted to the changing market environment to provide support for business activity.

By tracing the history from the 16th century and tracing the development of the SMEs after 1990 in China, the research project has re-examined the role of the state in Taiwan's post-war economic development. The arguments of Wade, Amsden, Rodric and other state-led development theorists cannot fully apply to the case of the SMEs. The theory of neoclassical economics on the market environment is, however, partially correct. It was not the state, but the environment established by the state that created unintended space for the dynamics of the social institutions to provide support for the development of the SMEs.

Appendixes

Appendix 5-1. The Government Administrative Structure of the Republic of China (Taiwan)

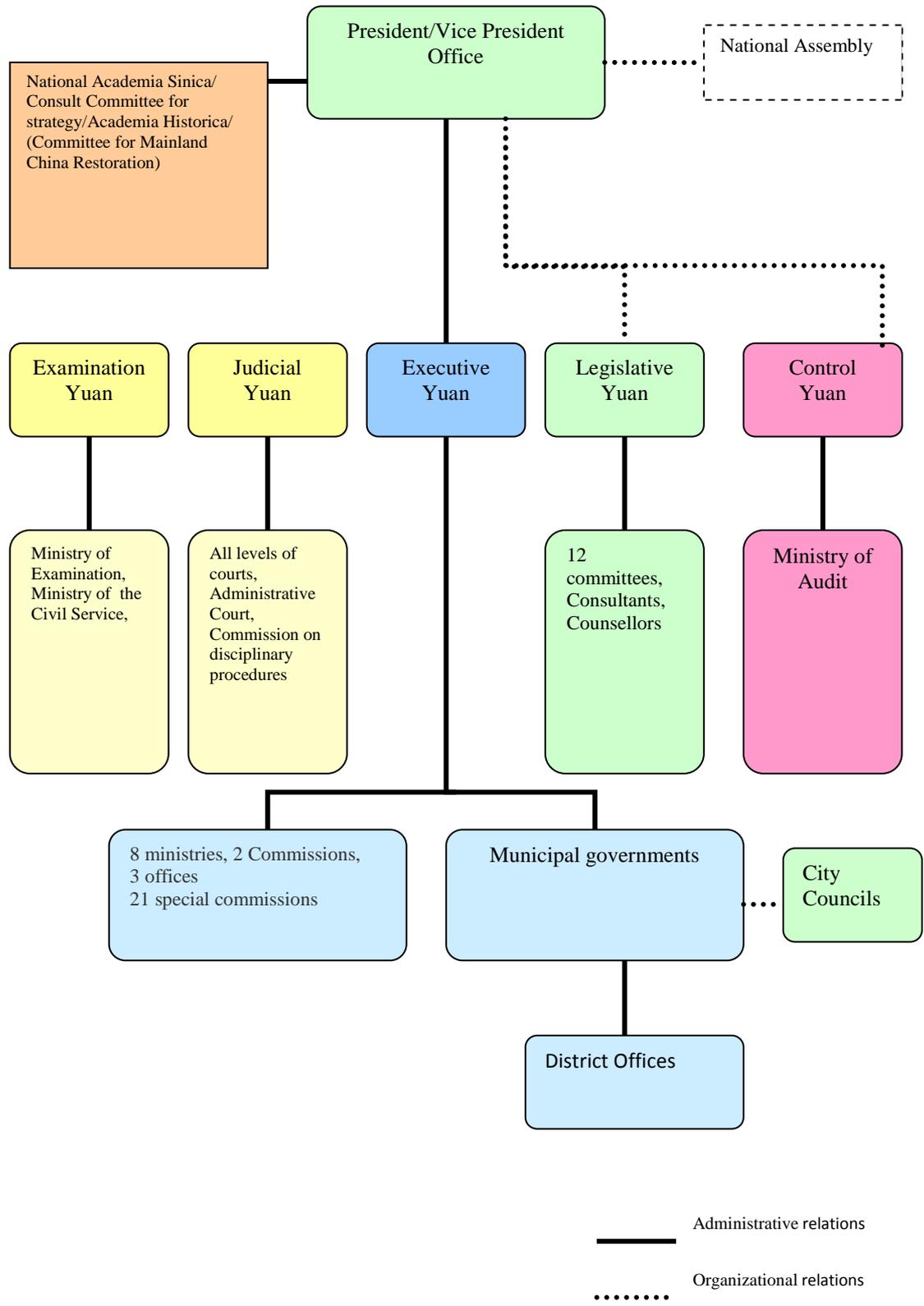
The government structure in Taiwan was almost the same as the Nationalist government in Nanking. Both government structures are based upon the People's Three Doctrines. The power of governance is divided into five branches, namely, three branches from Montesquieuan thought (The Legislative Yuan, the Executive Yuan and the Judicial Yuan) and two branches from Chinese tradition (the Control Yuan and the Examination Yuan). Figure A5-1 presents the central structure of the political administration of the Republic of China, Taiwan. The head of the ROC is the President (vice president) who is elected by the National Assembly every six years.³³³ The Executive Yuan is the state chief administration; the premier is nominated by the president and approved by the Legislative Yuan.

The Legislative Yuan is the highest agency of legislation and the will of the citizenry and is usually referred to as the Taiwanese parliament. The Judicial Yuan is the highest judicial agency in Taiwan; the Examination Yuan is the chief agency responsible for national examinations and merit systems for public servants. The heads of the Judicial Yuan and the Examination Yuan are nominated by the president and approved by the Control Yuan. The Control Yuan is the highest supervision agency of Taiwan. The commissioners of the Control Yuan are elected by the councillors of the city and provincial councils.³³⁴

³³³ Not until 1986 were parliamentary elections restored in Taiwan. Ma, Qihua, *Sanmin zhuyi zhengzhi xue* (Taipei, 2003), pp.44-75.

³³⁴ Department of Statistics, Ministry of Interior, Executive Yuan, R.O.C. (Taiwan), *Statistical Year Book of R.O.C.*, (Taipei, 1991), pp.26-33.

Figure A5-1. The Central Structure of the Political Administration of the Republic of China, Taiwan



Source: Based upon the information of Directorate-General Budget, Accounting and Statistics, Executive Yuan R.O.C. (Taiwan), *Statistical Yearbook of the R.O.C* (Taipei, 1992), pp.26-27.

Appendix 5-2. The Members of the KMT Central Committee, 7th KMT National Convention 19 October 1952

Administrative officials	Military	Party affairs	Representatives/Legislators	Intellectual	Entrepreneurs	Others
蔣經國 Chiang, Ching Kuo	陳誠 Cheng Cheng	穀正綱 Gu, Zheng Gang	楊爾瑛 Yang, Er Ying	陶希聖 Tao, Xi Sheng		
吳國禎 Wu, Guo Zhen	黃少谷 Huang, Shao Gu	倪文亞 Ni, Wen Ya	王星舟 Wang Xing Zhou	陳雪屏 Cheng, Xyue Ping		
袁守謙 Yuan, Shou Qian	周至柔 Zhou, Zhi Rou	鄭彥棻 Zheng, Yan Fen	陳逸雲 Chen, Yi Yun	上官業佑 Shang Guan, Ye You		
張道藩 Chang, Dao Fan	彭孟緝 Peng, Meng Qi	唐縱 Tang, Zong	張子田 Zhang, Zi Tian			
張其昀 Zhang, Qiy Yun	郭寄嶠 Guo, Ji Qiao	蔣賜福 Chiang, Ci Fu	梅友卓 Mei, You Zhuo			
沈昌煥 Shen, Chang Huan	孫立人 Sun, Li Ren					
黃季陸 Huang, Ji Lu	王叔銘 Wang, Shu Ming					
*黃朝琴 Huang, Chao Qing	石覺 Shi, Jue					
吳化鵬 Wu, Hua Peng	胡璉 Hu, Lian					

Note: 1. Many of the administrative officials also hold important positions in party affairs. Members who are included in the category of 'party affairs' are the ones who mainly worked in the KMT.

*: This indicates the Bensheng ren administrative officials in the 1970s.

Source: Information based upon Liu, Wei Kai, ed, *Zhongguo kuomintang zhiming Lu* (Taipei, 1994).

Appendix 8-1. The Members of the KMT Central Committee, 11th KMT National Convention 17 November 1976

Administrative officials	Military	Party affairs	Representatives /Legislators	Intellectual	Entrepreneurs	Others
嚴家淦 Yan, Jia Gan	黃少谷 Huang, Shao Gu	穀正綱 Gu, Zheng Gang	郭驥 Guo, Ji	秦孝儀 Qing, Xiao Yi	王惕吾 Wang, Ti Wu	徐晴嵐 Xu, Qing Lan
李煥 Li, Huan	黃傑 Huang Je	張寶樹 Zhang, Bao Shu	陳建中 Chen, Jian Zhong	楚崧秋 Chu, Song Qiu	余紀忠 Yu, Ji Zhong	潘鎮球 Pan, Zhen Qiu
謝東閔 Xie, Dong Ming	高魁元 Gao, Kui Yuan	倪文亞 Ni, Wen Ya	錢劍秋 Qian, Jian Qiu	李鍾桂 Li, Zhong Gui	林挺生 Lin, Ting Sheng	易勁秋 Yi, Jin Qiu
趙聚鈺 Zhao, Ju Yu	王升 Wang Sheng	馬樹禮 Ma, Shu Li	毛松年 Mao, Song Nian	張希文 Zhang, Xi Wen	辜振甫 Gu, Zhen Fu	徐鼎 Xu, Ding
張其昀 Zhang, Qiyun	黎玉璽 Li, Yu Xi	鄭彥棻 Zheng, Yan Fen	趙自齊 Zhao, Zi Qi	陳水逢 Chen, Shui Fong	王玉雲 Wang Yu Yun	黎世芬 Li, Shi Fen
袁守謙 Yuan, Shou Qian	賴名湯 Lai, Ming Tan	曹聖芬 Cao, Sheng Fen	楊寶琳 Yang, Bao Ling	張希哲 Zhang, Xi Zhe		葉霞翟 Ye Xia Di
沈之岳 Shen, Zhi Yue	羅友倫 Luo, You Lun	陳裕清 Chen, Yu Qing	呂錦花 Lu, Jin Hua	吳俊才 Wu, Jin Cai		胡木蘭 Hu, Mu Lan
孫運璿 Sung, Yun Xian	馬紀壯 Ma, Ji Zhuang	上官業佑 Shang Guan, Ye You	羅衡 Luo, Heng	張宗良 Zhang, Zong Liang		許素玉 Xu, Su Yu
李國鼎 Li, Kuo Ting	彭孟緝 Peng, Meng	唐縱 Tang, Zong	蔡鴻文 Cai, Hong Wen	王唯農 Wang, Wei Nong		阿部都拉 A Bu Du La
*蔣彥士 Jiang, Yan Shi	劉玉章 Liu, Yu Zhang	孫治平 Sun, Zhi Ping	梁子衡 Liang, Zi Heng	倪超 Ni, Chao		胡建中 Hu, Jian Zhong
沈昌煥 Shen, Chang Huan	梁永章 Liang, Yong Zhang	宋時選 Sun, Shi Xuan	張建邦 Zhang, Bang Jian			柯淑寶 Ke Shu Bao
俞國華 Yu, Kuo Hua	胡璉 Hu, Lian	司徒福 Si Tu, Fu				王民 Wang Ming
鄧傳楷 Deng, Fu Kai	王任遠 Wang Ren Yuan	徐亨 Xu, Heng				倪文炯 Ni, Wen Jing
閻振興 Yan, Zheng Xing	唐君鉞 Tan Jun Bo	嚴孝章 Zhang, Xiao Yan				李白虹 Li, Bai Hong
周宏濤 Zhou, Hong Tao	王多年 Wang Due Nian					劉先雲 Liu, Shian Yun
周書楷 Zhou, Shu Kai	宋長志 Sun, Chang Zhi					陸寒波 Lu Han Po
楊西崑 Yang, Xi Kun	鄭為元 Zheng, Wei Yuan					蔣廉儒 Jiang, Liang Ru
瞿紹華 Qu, Shao Hua	馬安瀾 Ma, An Lan					趙曉梅 Zhao, Xiao Mei
*徐慶鐘 Xu, Qing Zhong	汪道淵 Wang, Dao Yuan					鄭玉麗 Zheng, Yu Li
劉季洪 Liu, Ji Hong	鄒堅 Zou, Jian					鄒懋時 Zou, Mao Shi
薛人仰 Xue, Ren Yang	陳守山 Chen, Shou Shan					官鏡峰 Guan, Jing Fong
郭澄 Kuo,						張訓舜

Cheng						Zhang, Xun Shun
羅雲平 Luo, Yun Ping						吳伯偉 Wu, Bo Wei
賴順生 Lai, Shun Sheng						梁尚勇 Liang, Shang Yong
沈劍虹 Shen, Jian Hong						蔡頌 Cai Ting
唐振楚 Tan, Zhen Chu						
谷鳳翔 Gu, Fong Xiang						
林金生 Lin, Jin Shen						
王亞權 Wang Ya Qian						
何宜武 He, Yi Wu						
夏功權 Xia, Gong Qiang						
連戰 Lian, Zhan						
費驊 Fei, Hua						
*林洋港 Ling, Yang Gang						
張繼正 Zhang, Ji Zheng						
錢復 Qian, Fu						
施啟揚 Shi, Qi Yang						
柯文福 Ke, Wen Fu						
張豐緒 Zhang, Fong Xu						
*邱創煥 Qiu, Chuang Huan						
周菊村 Zhou, Ju Cun						
*李元簇 Li, Yuan Cu						
陳履安 Chen, Lu An						
*李登輝 Li, Teng Hui						

Source: Information based upon Liu, Weikai, ed, *Zhongguo kuomintang zhiming Lu* (Taipei, 1994).

**Appendix 8-2. The Members of the KMT Central Committee,
13th National Convention 07 December 1988**

Administrative officials	Military	Party affairs	Representatives /Legislators	Intellectual	Entrepreneurs	Others
李煥 Li, Huan	郝柏村 Hao, Bo Cun	宋時選 Sun, Shi Auan	高育仁 Gao, Yu Ren	李鐘桂 Li, Zhuang Gui	王玉雲 Wang, Yu Yun	蔣孝勇 Chiang, Xiao Yong
孫運璿 Sun, Yun Xian	鄭為元 Zheng, Wie Yuan	倪文亞 Ni, Wen Ya	蘇南成 Su, Nan Cheng	鄭心雄 Zheng, Xin Xiong	王效蘭 Wang, Xiao Lan	羅 張 Luo, Zhang
宋楚瑜 Song, Chu Yu	陳守山 Chen, Shou Shan	何宜武 He, Yi Wu	陳金讓 Chen, Jin Rang	郭南宏 Kuo, Nan Hong	辜振甫 Gu, Zhen Fu	余范英 Yu, Fan Ying
*林洋港 Lin, Yang Gang	許曆農 Xu, Li Nong	簡漢生 Jian, Han Sheng	陳田錨 Chen, Tian Miao	魏 鏞 Wei, yong	萬永貴 Wan, Yong Gui	王家鏞 Wang, Jia Hua
*吳伯雄 Wu, Bo Xiong	宋長志 Sun, Chang Zhi	趙自齊 Zhao, Zi Qi	黃鏡峰 Huang, Jing Feng	邵玉銘 Shao, Yu Min	許勝發 Xu, Sheng Fa	錢 純 Qian, Chun
章孝嚴 Zhang, Xiao Yan	蔣仲 苓 Jiang, Zhong Ling	周宏濤 Zhou, Hong Tao	張子源 Zhang, Zi Yuan	夏漢民 Xia, Han Min	高青願 Gao, Qing Yuan	吳純義 Wu, Chun Yi
*邱創煥 Qiu, Chuang Huan	溫哈熊 Wen, Ha Xiong	郭 驥 Kuo, Ji	柯文福 Ke, Wen Fu	高銘輝 Gao, Min Hui	張平沼 Zhang, Ping Zhao	易勁秋 Yi, Jin Qiu
錢 複 Qian, Fu	孫 震 Sun, Zhen	華加志 Hua, Jia Zhi	洪冬桂 Hong, Dong Gui	王甲乙 Wang, Jia Yi	朱安雄 Zhu, An Xiong	武士嵩 Wu, Shi Song
黃尊秋 Huang, Zun Qiu	言百謙 Yan, Bai Qian	陳璽安 Chen, Xi An	陳庚全 Chen, Geng Qian	吳俊才 Wu, Jin Cai		戴端明 Dai, Duan Ming
章孝慈 Zhang, Xaio Ci	鄒 堅 Zou, Jian	李治民 Li, Zhi Min	周書府 Zhou, Su Fu	高惠宇 Gao, Hui Yu		吳健國 Wu, Jian Guo
關 中 Guan, Zhong	李志鵬 Li, Ji Peng		鄭逢時 Zheng, Feng Shi	林基源 Lin, Ji Yuan		林登飛 Lin, Deng Fei
謝東閔 Xie, Dong Ming	郭汝霖 Kuo, Ru Lin		許文志 Xu, Wen Zhi	阮大年 Ruan, Da Nian		郭 哲 Kuo, Zhe
陳履安 Chen, Lu An	郭宗清 Kuo, Zong Qing		吳金贊 Wu, Jin Zan	馬克任 Ma, Ke Run		黃順德 Huang, Shun De
馬英九 Ma, Ying Jiu	黃幸強 Huang, Xing Qiang		吳水雲 Wu, Shui Yun	秦孝儀 Qin, Xiao Yi		周曉天 Zhou, Xiao Tian
許水德 Xu, Shui De	葉昌桐 Ye, Chang Tong		黃鎮岳 Huang, Zhen Yue	喬寶泰 Qiao, Bao Tai		陳炯松 Chen, Jiong Song
蕭萬長 Xiao, Wan Chang	楊亭雲 Yang, Ting Yun		陳健治 Chen, Jian Zhi	朱堅章 Zhu, Jian Zhang		段宏俊 Duan, Hong Jun
施啟揚 Shi, Qi Yang	鐘湖濱 Zhong, Hu Bin		潘維綱 Pan, Wei Gang	梁尚勇 Liang, Shang Yong		蕭昌義 Xiao, Chang Yi
毛高文 Mao, Gao Wen			廖福本 Liao, Fu Ben	汪彛定 Wang, Yi Ding		張豫生 Zhang, Yu Sheng
連 戰 Lian, Zhan			黃澤青 Huang, Ze Qing	楊日旭 Yang, Ri Xu		呂秀惠 Lu, Xiu Hui
張建邦 Zhang, Bang Jian			張文獻 Zhang, Wen Xian			於建民 Yu, Jian Min
翁文維						黃天才

Wong, Wen Wei						Huang, Tian Cai
李國鼎 Li, Kuo Ting						蔡友士 Cai, You Shi
徐立德 Xu, Li De						谷家華 Gu, Jia Hua
蔣彥士 Jiang, Yan Shi						張家驥 Zhang, Jia Xiang
俞國華 Yu, Guo Hua						張祖治 Zhang, Zu Zhi
簡又新 Jian, You Xin						詹天性 Zhan, Tian Xin
丁懋時 Ding, Mao Shi						施純仁 Shi, Chun Ren
趙守博 Zhao, Shou Bo						沈 蓉 Shen, Rong
王昇 Wang, Sheng						陳桑齡 Chen, Sang Ling
楚崧秋 Chu, Song Qiu						梁子衡 Liang, Zi Heng
王建煊 Wang, Jian Xuan						許智偉 Xu, Zhi Wei
曾廣順 Zeng, Guang Shun						李海天 Li, Hai Tian
馬鎮方 Ma, Zhen Fang						張希哲 Zhang, Xi Zhe
蕭天讚 Xiao, Tian Zan						羅光端 Luo, Guang Rui
張京育 Zhang, Jing Yu						沈 岳 Shen, Yue
鐘榮吉 Zhong, Rong Ji						林秋山 Lin, Qiu Shan
黃昆輝 Huang, Kun Hui						侯彩飛 Hou, Cai Fei
林金生 Lin, Jin Sheng						
張豐緒 Zhang, Feng Xu						
謝深山 Xie, Shen Shan						
餘玉賢 Yu, Yu Xian						
林豐正 Lin, Feng Zheng						
黃大洲 Huang, Da Zhou						
宋心濂 Sun, Xin Lian						
鬱慕明 Yu, Mu Ming						
沈昌煥 Shen, Chang Huan						
郭婉容						

Kuo, Wan Rong 鄭水枝 Zheng, Shui Zhi						
張繼正 Zhang, Ji Zheng						
梅可望 Mei, Ke Wang						
蔣廉儒 Jiang, Lian Ru						
李厚高 Li, Ho Gao						
梁肅戎 Liang, Su Rong						
瞿韶華 Qu, Shao Hua						
施金池 Shi, Jin Chi						
楊西昆 Yang, Xi Kun						
郭為藩 Kuo, Wei Fan						
林振國 Lin, Zhen Kuo						
劉景義 Liu, Jin Yi						
張麗堂 Zhang, Li Tang						
葉金鳳, Ye, Jin Feng						
梁國樹 Liang, Kuo Shu						
王章清 Wang, Zhang Qing						
黎昌意 Li, Chang Yi						
卜達海 Pu, Da Hai						
王澍霖 Wang, Shu Lin						
徐靜淵 Xu, Jing Yuan						
塗德錡 Tu, De Qi						

Source: Information based upon Liu, Weikai, ed, *Zhongguo kuomintang zhiming Lu* (Taipei, 1994).

Appendix 8-4. Public Opinion Concerning the Cross-strait Relations (%)

Date	Friendly (%)	Unfriendly/Hostile(%)
06-1995	14	45
* 06-1995	4	69.5
**06-1995	11.9	48.3
07-1995	7.7	83.4
07-1995	18.9	38.6
07-1995	10	47
07-1995	8	53
07-1995	13.2	43.5
08-1995	8	56
* 08-1995	2.3	73.4
**08-1995	14	46.6
* 09-1995	3.8	88
**09-1995	16.6	68.8
01-1996	12	47
01-1996	18.9	31.9
* 02-1996	3.2	74.6
**02-1996	14.1	49.7
03-1996	8	53
03-1996	13.1	51.3
* 03-1996	4.6	76.1
**03-1996	14.8	53.9
04-1996	24.2	31
* 04-1996	20.3	69.4
**08-1996	36.1	46.5
09-1996	17	45
* 10-1996	4.5	60
**10-1996	18	43.3
01-1997	14	47
* 02-1997	9.8	74.6
**02-1997	27.6	50.6
* 02-1997	3.3	73.3
**02-1997	16	40.6
07-1997	17	46
* 08-1997	10.5	82.3
**08-1997	36.9	53
10-1997	16.1	39.5
12-1997	24	35.9
02-1998	21	39
* 04-1998	16.5	63.2
**04-1998	32.9	47.4
* 05-1998	10.1	64.3
**05-1998	22.9	48.7

06-1998	25.4	28.2
07-1998	15.2	48.9
* 07-1998	7.7	61.1
**07-1998	22.4	42.4
07-1998	10.1	50.6
* 08-1998	4.7	60.8
**08-1998	12.9	52.7
* 09-1998	6.8	68.3
**09-1998	18	52.8
10-1998	21.2	40.5
10-1998	20.5	41.3
* 10-1998	7.7	58.5
**10-1998	16.9	48.8
* 03-1999	8.5	63.6
**03-1999	19.6	47.5
07-1999	12.7	52.9
* 08-1999	8.4	88.5
**08-1999	27.3	66.7
09-1999	10	57.8
11-1999	15.1	48.5

Note: * the attitudes of the Chinese government towards the Taiwanese government; ** the attitudes of the Chinese government towards Taiwanese people.

Source: Mainland Affairs Council, Investigations on Public Opinion Polls,

<http://www.mac.gov.tw/public/Attachment/97711145462.htm>. (accessed 14 September 2010).

Appendix 8-5. People's Expectations of Future Cross-strait Relations (%)

Date	Immediate independence	Remaining status quo and independence in the future	Remain status quo forever	Remain status quo and decide in the future	Remain status quo and unification in the future	Immediate unification	N/A
01-1994	2.8	7.6	11.2	32.4	23.2	4.3	18.6
02-1994	4.4	8	12.3	32.2	23.3	4.1	15.7
04-1994	4	8.3	12.8	43.1	18.3	2.5	11
07-1994	3.2	8.4	9.9	42.2	17.2	3.5	15.6
09-1994	7.4	11.7	17	31.7	13.4	4.4	14.2
10-1994	4.6	7.1	12.7	36.6	18.9	3.7	16.4
02-1995	2.4	7.4	21.2	34.9	21.4	3.2	9.5
02-1995	3.1	7.5	16.2	29.8	16.1	2.7	24.6
06-1995	6.4	6.7	13.8	32.4	23.1	3.4	14.2
08-1995	5.9	9.9	11.1	35.4	22.7	2.8	12.2
09-1995	3.7	8	12.2	42.8	24.2	3.3	5.8
11-1995	3.4	10.6	12.3	32.4	23.9	1.9	15.5
02-1996	4.4	8.5	13.9	41.2	20.7	1.8	9.5
03-1996	7.8	12.7	16.8	33.9	17.3	1.5	10
08-1996	6.3	9.9	19.3	34.1	22	4.8	3.6
10-1996	5.5	10.9	15.5	30.4	22.6	2.2	12.9
11-1996	4.8	10.2	9.3	35.7	25.4	3.3	11.3
02-1997	8.7	12.6	21	24.8	21.7	5	6.3
08-1997	10	11.2	21.6	35.4	13.9	5.1	2.8
09-1997	9	10.7	13.8	34.3	21.5	3.1	7.6
11-1997	9.5	6.7	18.5	42	15.7	3.8	3.8
12-1997	7.5	12.4	19.6	29.7	16.3	3.3	11.2
04-1998	6.1	13	16	39.2	17.7	3.2	4.8
05-1998	6.7	11.6	16	36.6	17.2	3.9	8
05-1998	1	18.4	-	41.1	26.8	2.7	8
06-1998	19.3	15.2	20.9	*	24.1	10.2	10.4
07-1998	6	29.3	24.5	*	31.1	2.4	6.8
07-1998	4.3	37.5	18.3		30.4	1.3	8.1
07-1998	4.9	12.9	15.8	34.9	16.5	1.9	13.1
08-1998	7.4	12.9	15.3	30.5	14.9	8	18.2
08-1998	4.1	32.7	23.3	*	27.1	1.3	11.5
09-1998	18.1	15.5	17.5	*	21.1	11	16.8
09-1998	7.3	12.2	14.4	36	13.3	3.5	13.3
10-1998	12.4	11.6	25.3	*	20.2	9.5	20.9
10-1998	18.7	11.4	29	*	15.2	9.5	16.2
10-1998	7	12	17.5	35.6	13.5	2.4	12
03-1999	5.9	12.3	18.1	40.3	17.5	2.7	3.3
03-1999	14	10	27	*	16	7	*
03-1999	4.2	11.3	19.7	34.8	14.8	2.5	12.7

04-1999	17	12	32	*	17	9	*
04-1999	20.7	14.2	21.9	*	18.5	12.3	12.5
04-1999	16	14	29	*	15	8	*
04-1999	18	12	23	*	20	11	*
04-1999	17	14	28	*	16	9	*
04-1999	4.6	13.6	19.4	30.8	14.1	2.4	15.2
07-1999	19.4	14.8	24.7	*	14.8	10	16.3
07-1999	5.9	21	10.2	37.9	20.5	0.9	3.6
07-1999	19	14	29	*	19	8	*
08-1999	14.3	13.8	12.2	39.6	16.3	2.4	1.3
10-1999	4.6	17	15.6	36.6	14.9	1.6	8.8
10-1999	18	12	31	*	20	5	*
11-1999	19.8	12.8	25.8	*	14.2	8.7	18.7
12-1999	16	16	30	*	19	7	*

Note: * options not included in the interviews.

Source: Mainland Affairs Council, Investigation on Public Opinion Polls,

<http://www.mac.gov.tw/public/Attachment/9771115967.htm>. (accessed 14 September 2010).

Appendix 8-6. Public Opinion on China's Military Threats to Taiwan: Was it Possible that China Would Invade Taiwan by Military Force under Certain Circumstances? (%)

Date	Possible	Impossible
07-1995: before 1997	8.9	79.9
07-1995: Taiwan declares independence	59.1	27.5
07-1995: Taiwan refused 'one country, two system'	26.4	53.8
08-95: foreign force intervenes cross-strait political conflicts	43	29
10-1995: Taiwan declares independence	63.1	17.7
11-1995: Taiwan declares independence	53	18.5
01-1996	34	46
03-1996	9	68

Source: Mainland Affairs Council, Investigation on Public Opinion Polls, <http://www.mac.gov.tw/public/mmo/mac/tab2.htm>. (accessed 14 September 2010).

Appendix 8-7. Public Opinion on 'One Country, Two Systems' to Solve the Political Conflicts across the Strait (%)

Date	agree	disagree
01-1991	7.7	74.1
08-1991	8	53
06-1992	4.4	68.5
01-1993	9.1	78.9
08-1993	5.2	80.3
09-1993	6.1	68.8
10-1993	4.7	78.8
10-1993	3.3	91.7
02-1994	4.1	73.8
03-1995	7.8	84.5
07-1995	3.5	77.7
03-1996	3.9	71.5
12-1996	1.4	54
02-1997	6.2	74.5
05-1997	12.9	60.9
07-1997	21	62

Source: Mainland Affairs Council, Investigation on Public Opinion Polls, <http://www.mac.gov.tw/fp.asp?fpag=cpxtem=67599.htm>. (accessed 14 September 2010).

Appendix 8-8. Public Opinions on 'Special State-to-State Relations' (%)

Date	agree	disagree	N/A
10/Jun/99-11/Jul/99	48.9	29.6	21.6
12/Jun/99-12/Jul/99	56.1	22	1.9
13/Jul/99-14/Jul/99	60.9	26.6	*
14/Jul/99-15/Jul/99	43	18	20
14/Jul/99-15/Jul/99	73.3	17.3	9.4
15/Jul/99-15/Jul/99	45.9	26.5	27.6
16/Jul/99-17/Jul/99	55.2	23.4	*
17/Jul/99-18/Jul/99	57.3	27.5	*
19/Jul/99-20/Jul/99	78.4	15.3	6.3

Source: Mainland Affairs Council, Investigation on Public Opinion Polls,
<http://www.mac.gov.tw/public/Attachment/9771117977.htm>. (accessed 14 September 2010).

Appendix 8-9. Public Opinion on Taiwanese Investment in China (%)

Date	Questions					
09-1996	Do you agree that the government slow down investment in China?	Agree:50	Disagree:26			
02-1997	Concerning government's restrictions on Taiwanese investment in China:	More strict:55.3	Remain status quo:4	Loosen:17.9	Depends:12.9	
05-1997	The amount of Taiwanese investment in China has increased five times in the past five years.	Too fast:58.1	Moderate:33.8	Too slow:4.7		
05-1997	What do you think is the impact of the increasing investment scale of Taiwanese investment in China on Taiwan's economy?	Very beneficial:2.8	Beneficial:18.7	No influence:11.6	Harmful:46.5	Very harmful:18.6
05-1997	Should the government regulate Taiwanese investment in China?	Yes:83.8	No:13.8			
05-1997	Should the government's restrictions on investment in China be adjusted?	Increase restrictions:47.6	Loosen restrictions:27	Remain status quo:20.7		
11-1997	Will loosening the restrictions on Taiwanese investment in China influence Taiwan's economic development?	Yes:61	No:29.2			
09-1998	Should government's restrictions on investment in China be adjusted?	Increase restrictions:4.35	Loosen restrictions:50.32	Remain status quo:19.7	(1200 Enterprises that invest in China)	
09-1998	Do you agree that the government should prohibit investment the high-tech enterprises in China?	Very agree:35.9	Agree:30.7	Disagree:17.7	Very disagree:6.2	
10-1998	Do you agree that the government prohibit investment by the high-tech enterprises in China?	Very agree:54.9	Agree:22.8	Disagree:10.3	Very disagree:4.4	
03-1999	Should government's restrictions on investment in China be adjusted?	More strict:61.8	Remain status quo:3.2	Loosen restrictions:14.7	Depends:3.9	Others:17
11-1999	Should the government adjust the maximum amount (50 million dollars) of Taiwanese investment in China?	Continue:63.3	Loosen:23.2	No opinion:13.4		

Source: Mainland Affairs Council, Investigation on Public Opinion Polls, <http://www.mac.gov.tw/fp.asp?fpag=cpxtem=67610.htm>. (accessed 14 September 2010).

Appendix 8-10. Public Opinions on 'No hurry, Be patient' Policy (%)

Date	Agree	Disagree	Adjusted
19/Nov/97	56.4	30.8	
08/Dec/97	12.5		57.9
20/Apr/98-22/Apr/98	19		60
6/Aug/98-7/Aug/98	47	24.9	
08/Apr/99-10/Apr/99	22.6		56.6
29/Jun/99-1/Jul/99	45.4	36.2	

Source: Mainland Affairs Council, Investigation on Public Opinion Polls,
<http://www.mac.gov.tw/fp.asp?fpag=cpxtem=67608.htm>. (accessed 14 September 2010).

Appendix 8-11. Public Opinion on Direct Transport Links with China (%)

Date					
02-1994	Concerning direct flights?	Without conditions: 8.6	Under conditions: 61.5	Disagree : 8.5	No opinion : 21.5
02-1994	Concerning direct flights?	Without conditions: 5.3	Under conditions: 64	Disagree : 15.3	No opinion : 15.4
06-1994	Concerning direct flights?	Without conditions: 6.1	Under conditions: 58.6	Disagree : 20.8	No opinion : 14.6
07-1995	Concerning direct flights?	Without conditions: 7.3	Under conditions: 62	Disagree : 9.6	No opinion : 21.1
07-1995	Concerning direct flights?	Agree: 44.2	Disagree: 40.5	No opinion: 15.2	
04-1996	Concerning direct flights?	Agree: 45.3	Disagree: 26.5	No opinion: 21.1	
01-1997	Will direct transport links affect national security?	Yes: 48	No: 31		
15/Oct/97	Will direct transport links affect national security?	Yes: 47.8	No: 29.3		
02-1997	Will direct transport links affect national security?	Yes: 43.9	No: 43.3		
02-1997	Concerning direct flights?	Without conditions: 8.2	Under conditions: 79	Disagree : 1.2	Depends: 6.8
11-1997	Concerning direct flights?	Without conditions: 8.2	Under conditions: 79	Disagree : 4.6	Depends: 1.1
01-1997	Concerning direct flights?	Agree: 43	Disagree: 37		
10-1997	Concerning direct flights?	Agree: 41.7	Disagree: 34		
04-1998	Concerning direct flights?	Agree: 52	Disagree: 32		
06-1998	Concerning direct flights?	Agree: 69.2	Disagree: 16.8		
06-1998	Will direct transport links affect national security?	Yes: 46.4	No: 40.7		
03-1999	Concerning direct flights?	Without Conditions: 10.6	Under conditions: 72.7	Disagree : 2.5	No opinion : 14.2
11-1999	Concerning direct flights?	Agree: 46	Disagree: 42	No opinion: 12	
11-1999	Will direct transport links	Yes: 68	No: 22	No	

	affect national security?			opinion: 10	
11-1999	Concerning direct flights?	Agree: 45.9	Disagree: 34.4	No opinion: 19.7	

Source: Mainland Affairs Council, Investigation on Public Opinion Polls, www.mac.gov.tw/public/mmo/mac/tab7.htm. (accessed 14 September 2010).

Appendix 8-12 Public Opinions on Maneuvers of the PLA (%)

Date	Questions	No	Yes
03-1996	Do maneuvers of the PLA panic you?	73	14.3
02-1996	Do maneuvers influence your voting behaviour?	84.9	5.3
02-1996	Do maneuvers influence your voting behaviour?	83.3	4.2
04-1996	Do maneuvers influence your investment in China?	77	23

Source: Mainland Affairs Council, Investigation on Public Opinion Polls, www.mac.gov.tw/public/mmo/mac/tab4.htm. (accessed 14 September 2010).

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