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# The Political Economy of U.S.-Taiwanese Trade and Other International Economic Relations

Robert E. Baldwin and Douglas Nelson

In most systematic work by economists on the political economy of trade policy, the primary causal mechanism is the competing demands for different trade policies by various domestic pressure groups, who are motivated by economic self-interest.<sup>1</sup> The supply side is modeled quite simply. Politicians also pursue their economic self-interest by seeking to be reelected and, consequently, supply the trade policies desired by the group or groups who, by providing votes and campaign contributions, give them the best opportunity for being reelected. This framework has led to a substantial body of theoretical and empirical work that has significantly improved our understanding of trade policy.

This model does, however, mainly emphasize the “demand” side since the demands of pressure groups are weighted to determine the equilibrium level of protection. In the typical political economy model of economists, the supplying of particular forms of trade policy by politicians, bureaucrats, and, more generally, the state, as part of their efforts to promote such collective goals as national security, is ruled out. Moreover, voters are portrayed as responding favorably only to policies that promote their short-run economic self-interests and not to the pursuit of such foreign policy goals. In this paper, we seek to show that this political economy framework is too narrow and to illustrate the fundamental role of the state in some circumstances by focusing

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1. Baldwin (1984) and Marks and McCarthur (1990) provide overviews of the empirical research, while Nelson (1988) and Hillman (1989) provide overviews of the theoretical research on the political economy of trade policy.

on trade policy-making in the United States and Taiwan in the post-Second World War era.<sup>2</sup>

With the end of the Second World War, both the government of the United States and the government of the Republic of China (ROC) experienced major crises. In both cases, the appearance of an external threat caused a fundamental reassessment of the structural and institutional foundations of the state.<sup>3</sup> In both cases, the governments attempted to restructure the politics of trade policy by attaching trade policy to broader political goals. In both cases, the governments used their increased authority to pursue broadly liberal trade policies. Finally, in both cases the deterioration of the regimes erected in the postwar era has led to uncertainty about the sustainability of the commitment to a liberal trading order and greater unpredictability. Section 11.1 of the paper discusses the development of U.S. trade policy in general and its policy toward Taiwan in particular; section 11.2 discusses the development of Taiwan's trade policy in general and its policy toward the United States in particular; and section 11.3 summarizes our conclusions from the comparison of trade policy in the two countries.

## **11.1 External Threat, State Autonomy, and the Evolution of U.S. Trade Policy, 1945–91**

### **11.1.1 Introduction**

U.S. trade policies toward the Republic of China over the last fifty years illustrate very clearly the key shift in U.S. international economic policy in the post-World War II period, namely, the change from a pattern of policy-making largely shaped by foreign policy factors until the late 1960s (specifically, national security considerations) to one influenced mainly by domestic economic conditions.

Four features of this basic change are particularly relevant in analyzing U.S.-Taiwan trading relations. First, there has been a shift by the United States from an emphasis on reducing trade barriers in the world economy to achieving "fair" international trade. Today one frequently hears U.S. political leaders calling for "a level playing field," for foreign markets to be open as much as are U.S. markets, and for U.S. fair trade laws to be vigorously enforced. In recent years, there have been numerous charges of unfair trading practices against Taiwan by U.S. officials and leaders in the private sector,

2. In emphasizing the supply side, we recognize that voters and other political groups usually must approve of the policies initiated by the government if these policies are to be implemented successfully. The point we stress is that the government, rather than private pressure groups, sometimes initiates policy proposals and plays an important role in persuading the public of their merit.

3. The notion that external threats have been a significant force in the development of the nation-state is an old one. As examples of the large literature on this issue, see Hintze (1975), Lane (1958), and Tilly (1990).

including dumping and government subsidization, piracy of intellectual property rights, violation of worker rights, the maintenance of export requirements for foreign direct investors, and the manipulation of the exchange rate for export-promoting purposes.

A second major modification in U.S. trade policy is the greater use of unilateral and bilateral (or plurilateral) means, in contrast to multilateral mechanisms, to achieve its trading goals. For example, the number of antidumping and countervailing duties imposed unilaterally by the United States on other countries, including Taiwan, has increased dramatically since the early 1980s. Taiwan and other developing countries have also been pressured through such new measures as Section 301 of the 1974 Trade Act and Super-301 of the 1988 Trade Act. In recent years, the United States has also utilized bilateral negotiations as a means of resolving trade disputes with such countries as Taiwan to a much greater extent than in the early postwar period.

A third noteworthy characteristic of the "new" U.S. trade policy is a much greater willingness to use discriminatory nontariff measures, in contrast to most-favored-nation (MFN) tariffs, as a means of holding down imports. The orderly marketing agreement (OMAs) with Taiwan and Korea on nonrubber footwear put into effect in 1977, the more restrictive bilateral pact on exports of Taiwanese textiles and apparel to the United States agreed on in 1986, and the 1986 voluntary restraint agreement reached with Taiwan and Japan on machine tools are good examples.

The last change in U.S. trade policy that we wish to emphasize is the much greater role taken in recent years by Congress in shaping trade policy. Although the Constitution gives Congress the authority to regulate international commerce, beginning in 1934 Congress has authorized the president to enter into negotiations with other countries for the purpose of reducing tariffs by some maximum percentage (e.g., 50 percent) on a reciprocal basis. The president could decide which duties to cut. For many years after World War II, the president took the initiative in seeking additional tariff-cutting authority for new multilateral rounds of duty reductions and used his influence to secure congressional consent for this additional authority. However, this pattern changed drastically, beginning with the Trade Act of 1974. In that year, the administration proposed new authority for another GATT-sponsored multilateral round of trade negotiations, but Congress significantly altered the president's proposal. Since then, Congress has played the key role in writing trade legislation. In the 1988 Trade Act, for example, the role of the administration was reduced to one of trying to prevent the inclusion of some provisions that it strongly opposed. Congress has "taken charge" of U.S. trade policy in recent years, although the president still has considerable influence through veto power.

In an effort to understand better the difficulties faced by Taiwan and other newly industrializing nations in recent years in their economic relations with the United States, this paper analyzes the economic and political factors that

first caused U.S. trade policy to be largely shaped by foreign policy considerations and then led to domestic economic considerations becoming the major force influencing trade policy. This analysis is undertaken in section 11.1.2. Section 11.1.3 then examines the various trade policy actions initiated by the United States against Taiwan over the last five years or so. Section 11.1.4 discusses specific trade policy actions brought by the United States against Taiwan in recent years.

### 11.1.2 The Brief Period of U.S. Hegemony after World War II

In understanding U.S. trade policy during the early post-World War II years, it is important to emphasize that the United States was thrust into the leadership position of the non-Communist states rather than actively seeking it. Control of the three key international economic institutions agreed on even before the end of the war, namely, the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (the World Bank), and the ill-fated International Trade Organization, which became the General Agreement on Tariffs and Trade (GATT), is based on the notion of collective leadership by a small number of industrial powers. U.S. political leaders wished to participate actively in the process of creating a prosperous world economy, however. For example, in a 26 March 1945 message to Congress asking for an additional 50 percent duty-cutting authority, President Roosevelt stated, "If the economic foundations of peace are to be as secure as the political foundations, it is clear that this effort [the trade liberalization process associated with the reciprocal trade agreements program] must be continued vigorously." The \$3.75 billion U.S. loan to the United Kingdom in 1946 is a financial illustration of this commitment.

Two developments prevented the new international organizations from operating in the manner intended by their founders. The first was the much greater economic destruction in the major countries than had been anticipated, while the second was the emergence of a new struggle for political and economic domination in the world. Restoring prewar production levels in such victorious countries as the United Kingdom and France as well as in countries such as Germany and Japan, who were on the losing side, proved to be a much more difficult task than imagined. The resources of the World Bank and the IMF were much too small to meet the reconstruction and balance-of-payments problems of these countries, to say nothing of the development needs of the less developed nations. Only the United States, whose industrial capacity at the end of the war was much larger than at the beginning, was capable of meeting even the most essential needs of these countries. Most U.S. political leaders argued that it was necessary to assist these countries to ensure the economic as well as the political benefits of the victory of the Allies.

Another, more compelling reason why the United States assumed a leadership role in the immediate postwar period was the political threat posed by the Soviet Union. The expansion of Soviet political influence into Eastern Eu-

rope, Manchuria, and northern Korea and the threat of Communist takeover in such nations as Turkey and Greece endangered the political benefits of the military victory.

As those political scientists who stress the importance of the state in explaining international relations (e.g., Krasner 1978, 1984; Evans, Rueschmeyer, and Skocpol 1985) point out, some political and economic actions of political leaders cannot, it seems, be explained in terms of the popular political economy model in which politicians, who wish to remain in office, shape their policies to reflect the interests of various pressure groups, who provide the funds and votes needed to ensure a high probability of reelection. Some policies, especially those related to national security, are taken well before the various political pressure groups are fully aware of the nature of the problem and have determined what policy action furthers their self-interests. The chief executive is invariably given the prime responsibility for initiating such decisions and, by the very nature of such matters, is provided information needed for decision making at a much earlier time than the general public. As Nelson (1990) states, the nature of these executive decisions and the extent to which they are accepted by others depends on the degree of the government's autonomy from direct social pressure, the degree of unity among government officials, and the degree of legitimacy granted to the government by society.

President Truman's first effort to counter the perceived threat by the Soviet Union to peace and stability was to provide military and economic assistance to Greece and Turkey, where there was a strong possibility of a Communist takeover. The president and his secretary of state, George Marshall, also moved on the economic front by initiating a massive foreign aid program aimed at strengthening Western European countries so that they could better resist internal and external pressures from the Communists. At the same time, the United States began to enter into a series of defensive military alliances, such as the Atlantic Treaty, with countries around the world in order to carry out a policy of containment of Soviet expansion. These policies toward the Soviet Union were accepted by leaders of both the Republican and the Democratic parties.

U.S. policy toward the Communists in China was quite different, at least until the Korean War. The decision had been made in World War II to concentrate on achieving victory in Western Europe first. Furthermore, the plan selected to defeat the Japanese was one involving island-hopping procedures led by U.S. forces rather than one based on defeating the Japanese forces in China and Korea and then invading Japan. Consequently, military and economic aid to the Nationalist government in China was modest in comparison with other theaters of operation. The view also seemed to be widely held in the U.S. government that corruption in Chiang Kai-shek's government was widespread and that aid from the United States was not effectively used (Koen 1974).

As it became apparent that the Communists were likely to be victorious in China against the Nationalist government, a decision was apparently made in

the U.S. government to cease further military assistance to the Nationalist government and to try to reach an accommodation with the Chinese Communists.<sup>4</sup> After the victory on the mainland of Mao Tse-tung's forces in 1949, there were also apparently a number of important officials in the executive branch who wanted to recognize the new regime. But there was also an influential group in Congress and in the private sector, the so-called China Lobby, who strongly opposed any accommodation efforts. President Truman did, however, state in January 1950 that the U.S. government would not provide military aid or advice to the Chinese forces on Taiwan.

The Korean War, which started in June 1950 with the invasion of South Korea by North Korean forces, and especially the entrance of the People's Republic of China into the war after UN forces had reached the border of North Korea and China, dramatically changed U.S. policy toward the Republic of China (ROC) on Taiwan. The president took the lead under UN sponsorship in resisting this aggression by committing U.S. forces to combat in Korea and ordering the U.S. Seventh Fleet to patrol the Taiwan Strait to protect Taiwan from invasion by Red China. A large-scale program of both military and economic aid to Taiwan was also initiated in the latter part of 1950. The shift in policy was readily accepted by most voters, and Red China was lumped with the Soviet Union as a hostile power.

This incident again illustrates the autonomy of the state in international economic matters under some circumstances as well as the theme that international economic policy is sometimes shaped by foreign policy considerations. However, political pressure from the China Lobby also quite likely led to more economic assistance than otherwise would have been forthcoming. This economic aid lasted until 1965.

As far as trade policy is concerned, Taiwan did not receive any special treatment in the early postwar years. However, since part of the U.S. strategy of strengthening non-Communist countries was to engage in trade-liberalizing negotiations through the GATT process, and since developing countries were not required to make reciprocal cuts in their duties, Taiwan and other developing countries enjoyed improved access to U.S. markets without having to open up their own markets. Beginning in 1976, developing countries were also given duty-free treatment in the United States on many manufactured goods.

One important indirect U.S. influence on Taiwan's trade policy operated through the technical assistance provided by the U.S. AID Mission. As the easy phase of the import-substitution approach adopted in the early 1950s came to an end in the mid-1950s and growth began to slow down, U.S. AID officials pressed for liberalization of the trade and exchange rate regimes and for greater emphasis on private enterprise as the source of growth (Jacoby

4. This statement and the ones that follow are based on material in Koen (1974) and Davis and Hunter (1963).

1966, chap. 10; Ho 1978, chap. 10). Financial aid provided under the program was also important in facilitating this shift in policy.

U.S. hegemony in economic matters manifested itself in many ways in the late 1940s and the 1950s. The dollar became the main currency used in making international payments and replaced gold as the main means of holding reserves for balance-of-payments purposes. Between 1946 and 1949, U.S. exports were about twice as large as U.S. imports as a so-called dollar shortage emerged after the war, requiring the imposition of exchange controls in most countries. The U.S. share of total exports of the industrial countries rose to 35.2 percent in 1953, compared to 25.6 percent in 1938 (Baldwin 1958). In contrast, the combined share of Germany and Japan fell from 24.0 percent to 11.4 percent between those years.

U.S. economic dominance in the early postwar years was based to some extent on technological leadership but, more fundamentally, on the fact that the industrial capacity of most of its international competitors had been destroyed to a considerable extent or become obsolete. These countries still possessed the human skills and organizational abilities to restore their industrial capacities and adopt new technologies, however. With the help of the United States through its aid program, most industrial countries regained their prewar export shares by 1960 and were able to lift exchange controls by that date. The U.S. export share had fallen from its 35.2 percent level in 1953 to 29.4 percent in 1959. For manufacturing alone the decline was from 29.4 percent in 1953 to 18.7 percent in 1959. By 1971, the U.S. share of world exports of manufactures had fallen to 13.4 percent.

Another indication of the end of U.S. economic hegemony was growing dissatisfaction with the international monetary system based on the dollar. Countries' unwillingness to hold an increasing supply of dollars led to the collapse of the Bretton Woods system in the early 1970s and the introduction of a flexible exchange rate system.

### 11.1.3 U.S. Trade Policy after Hegemony

By the late 1960s it became clear that U.S. dominance in the trade area had come to an end. There was a sharp increase in import penetration ratios in such important product lines as wool and man-made textile products, footwear, automobiles, steel, and electrical consumers goods (e.g., television sets, radios, and phonographs). In view of this increasing import competition, Congress and important parts of the private sector were less willing to open U.S. markets for foreign policy reasons. Furthermore, it was apparent that the dangers of Communist expansion from both internal and external takeovers had decreased greatly from the late 1940s and 1950s. The aid and trade policies had been highly successful not only in strengthening the non-Communist nations so that they could better resist Communist expansionary pressures but also in turning some of these nations into very effective economic competitors to the United States.



When, for example, President Johnson proposed a new trade bill in 1968 extending the duty-cutting authority granted for the Kennedy Round of trade negotiations until 1970 and eliminating the American selling price (ASP) provision of U.S. trade law, not only was the request rejected, but the administration had to work hard to prevent the passage of legislation that would establish import quotas in such sectors as textiles, dairy products, steel, leather, and petroleum.<sup>5</sup> However, under the threat that Congress would pass legislation mandating import quotas for steel, the administration did negotiate a voluntary export restraint program with European and Japanese steel producers. Another general quota bill was approved by the two key committees in the House and Senate in 1970 and failed only because of a threat by some free trade-oriented members of Congress to filibuster against it on the floor of the Senate. The major national labor organization, the AFL-CIO, which had supported a liberal trade policy since the early 1930s, joined the ranks of those supporting this protectionist bill. Arguing, as the 1962 Trade Expansion Act did, that a major purpose of continuing multilateral trade liberalization is "to prevent Communist economic penetration" was no longer effective in persuading Congress to go along with the president's goal of using trade policy for foreign policy purposes.

Thus, when for the first time in the postwar period the United States began to face significant import competition over a wide range of commodities, it responded by rejecting increased protectionism. Instead, a new theme began to gain support, especially within the private sector and in Congress, namely, that unfair trade practices by foreign countries were the source of most of the competitive problems of U.S. industry. When in 1973 the Nixon administration requested broad authority to engage in reciprocal tariff-reducing negotiations and conclude international agreements on nontariff trade barriers, Congress completely reshaped the proposal, making its objective the tightening of GATT provisions dealing with unfair trade practices. These covered unfair practices leading both to increased U.S. imports and to reduced U.S. exports. Among the purposes of the legislation that emerged, namely, the Trade Act of 1974, are "to harmonize, reduce, and eliminate barriers to trade on a basis which assures substantially equivalent competitive opportunities for the commerce of the United States" and "to establish fairness and equity in international trading relations, including reform of the General Agreement on Tariffs and Trade."

In the GATT multilateral trade negotiations that followed the Tokyo Round, six major GATT codes were agreed on, covering customs valuation practices, government procurement policies, import licensing procedures, technical bar-

5. Under ASP, imports of benzenoid chemicals, rubber-soled footwear, canned clams, and certain woolen knit gloves were valued for duty-levying purposes, not at the export value of the goods (as stipulated under the GATT), but at the selling price of similar goods produced in the United States.

riers to trade, subsidies and countervailing duties, and dumping and anti-dumping duties. Tariffs on industrial products were also cut another 30 percent on the average.

The U.S. objective of bringing cases based on the new codes before GATT panels and gradually building up a body of "case law" that would curtail unfair practices by foreign countries did not work out as planned. In order to obtain agreement among the major participants, the codes were phrased in such a general and, sometimes, seemingly contradictory manner that the panels did not reach the strict decisions desired by U.S. trade negotiators. Other aspects of the dispute settlements procedures, especially those relating to the ability of a single GATT member to prevent adoption of a panel report and to the ability of a member to refrain from implementing a panel's decision, even if adopted, also proved to be very disappointing to the United States.

There was one feature of the U.S. legislation implementing the Tokyo Round codes that has proved to be very important in shaping U.S. trade policy. Congress insisted that the administration of the antidumping and countervailing duty laws be taken away from the Treasury Department, and the president agreed to shift these responsibilities to the Commerce Department. This change illustrates how institutional changes can sometimes have significant effects on economic policy. Because the secretary of the Treasury deals extensively with international financial matters, such as exchange rate and international tax policy, he generally must be acceptable to international business and financial groups, who tend to want as little regulation of trade and financial flows as possible. Consequently, the Treasury secretary usually favors a liberal trading system. The secretary of commerce, in contrast, is more oriented toward domestic business interests and is more likely to have protectionist leanings.

Although U.S. officials were disappointed with the way the Tokyo codes were administered by the GATT, they still emphasized the multilateral route as the main means of achieving their trade objectives. Under the urging of the United States, a GATT ministerial meeting was held in November 1982. At this meeting, the United States proposed a new round of negotiations to deal not only with such well-known issues as agriculture, safeguards, and dispute settlement procedures but also with new issues involving liberalizing trade in services, preventing trade-related investment measures from distorting trade, and expanding trade in high-technology products. Unfortunately, partly because of inadequate preparation and consultation with other participants by the United States, the meeting was a failure, with no new round of trade negotiations being agreed on.

There is considerable evidence to indicate that this failure marked a turning point in U.S. trade policy (Richardson 1991). U.S. trade policy officials decided to emphasize to a greater extent bilateral and plurilateral negotiations as a means of achieving U.S. trade policy objectives, although they did not aban-

don the multilateral approach. In particular, they decided to use some of the broad powers that Congress had previously granted the president to undertake more bilateral negotiations with such countries as Japan and the newly industrializing nations in order to gain greater access to their markets for U.S. exports and to begin to negotiate special regional agreements.

Significant macroeconomic developments also emerged in the 1980s that provided additional incentives for pursuing nonmultilateral means of achieving trade policy goals. A massive trade deficit emerged in the 1980s with the excess of merchandise imports over exports rising from \$25 billion in 1980 to \$160 billion in 1987. The causes are so well known that they need not be spelled out in detail here. In essence, the main cause was the rapid rise in government expenditures relative to tax revenues as the Reagan administration increased defense spending significantly while reducing tax rates. The rise in interest rates as the government bid for funds and the Federal Reserve pursued a tight monetary policy to control inflation attracted a substantial inflow of foreign funds, thereby bidding up the price of the dollar in terms of foreign currencies by about 55 percent in real terms between 1980 and 1985. The drop in private savings in the United States and the elimination of certain controls over foreign investment by the Japanese government contributed to the dollar appreciation.

The dollar appreciation made both U.S. exports much more expensive and imports from foreign countries much cheaper. The outcome was the massive trade deficit. Not only were industries that traditionally found it difficult to compete against foreign producers hurt badly, but many sectors that were usually highly competitive were faced with profit problems. Since the administration seemed unwilling to deal with the complaints from import-competing and export-oriented industries, these sectors turned to Congress for assistance. Raising taxes and reducing government expenditures were not popular, so more and more members of Congress and business leaders began to blame foreigners for their problems. In particular, they claimed that unfair trade practices by foreign producers caused imports to be excessive and reduced U.S. export opportunities significantly.

With its tightening of the countervailing duty and antidumping laws, special provisions for the steel and wine industries, authorization of a free trade agreement with Israel, and emphasis on reducing barriers to trade in services, the 1984 Trade Act was a product of an environment of congressional dissatisfaction with the operation of the fair trade laws and the administration's frustration with the multilateral approach. The 1988 Trade and Competitiveness Act is also a manifestation of the dissatisfaction by Congress with the way members of Congress perceived the trading system to be operating. Pressure on the president to retaliate against unfair trade actions was increased through the strengthening of Section 301 of the 1974 Trade Act and the enactment of the so-called Super-301 provision, which requires the administration

to identify priority countries in terms of having policies that constitute significant barriers to U.S. exports and then to undertake negotiations with these countries aimed at eliminating or reducing these barriers. The countervailing duty and antidumping laws were further tightened.

The administration did succeed in obtaining authority to negotiate multilaterally on the various new and old issues they had raised in the 1982 GATT ministerial meeting, plus several more. Most of the countries who had opposed the 1982 initiative agreed in 1986 to undertake new multilateral negotiations, the Uruguay Round. Their acceptance of such negotiations appears to have been influenced by a fear that the United States would use unilateral, bilateral, and plurilateral means to achieve their objectives more than these other countries wished to see.

#### 11.1.4 U.S. Trade Actions against Taiwan

Taiwan and such other countries as Korea and Brazil have taken the brunt of the aggressive unilateralism and bilateralism practiced by the United States against developing countries in recent years with regard to trade matters.<sup>6</sup> The elimination of the zero-duty status of Taiwan, Korea, Hong Kong, and Singapore in 1988 is a good example of the efforts to curtail imports from the industrializing developing countries. Another important example is the stricter enforcement of the countervailing duty and antidumping laws. After the Trade Act of 1979, these cases increased dramatically. In 1980 alone, U.S. industries filed petitions leading to sixty-eight countervailing duty (CVD) cases and thirty-seven antidumping (AD) cases. Between 1 January 1980 and the end of 1990, 313 CVD and 469 AD investigations were undertaken. In this period, there were seven CVD and twenty-nine AD cases filed against Taiwan. The number of CVD and AD cases against Korea were seventeen and twenty-eight, respectively, while the CVD and AD cases against Brazil during this period were thirty-six and twenty-five, respectively. The cases against these three countries constituted 76 percent of all CVD investigations against developing countries and 41 percent of the AD investigations against these countries. However, a statistical analysis of the economic factors influencing International Trade Commission injury determinations in these cases does not indicate that Taiwan is being treated differently than other countries (Baldwin 1991).

Another import-reducing measure used against Taiwan that illustrates U.S. policy very well is the bilateral textile agreement reached in 1986. Imports of textiles into the United States that had been growing at about 15 percent annually were projected to increase at only about one-half of 1 percent under the

6. Much of the following account of trade policy actions is taken from various issues of the weekly *International Trade Reporter* published by the Bureau of National Affairs, Washington, D.C.

two-year agreement. In announcing the agreement, the U.S. negotiator stated that it was only for two years because Taiwan maintained high duties on textiles. He also hinted that, if these were lowered, the growth rate of imports from Taiwan might be increased. In 1987, the agreement was extended for another year after Taiwan did cut its textile tariffs.

Much of the pressure has been directed at further opening Taiwanese markets to U.S. exports. Section 301 has been effectively used for this purpose. For example, in one instance, President Reagan stated in 1986 he would retaliate under Section 301 as long as Taiwan maintained a valuation process for duty-levying purposes that was based on an administrative valuation of goods rather than on their actual export prices. Taiwan quickly changed its customs valuation procedures (it had promised earlier to do so but had not met the date initially set), and the case was dropped. In 1991, a Section 301 case covering distilled spirits was dropped after Taiwan agreed to open this market to the United States and the European Community. The threat of a 301 action also hastened the opening of the Taiwanese market for beer, wine, and cigarettes to U.S. exporters.

The first case brought under Section 307 of the 1984 Trade Act, which aimed at preventing countries from imposing export performance requirements, was brought against Taiwan in 1986. A Japanese automobile firm investing in the country had been assigned an export requirement that U.S. negotiators thought could rise from 12.5 percent to 50 percent. Taiwan responded by dropping this requirement.

Using the threat of retaliation, the United States also pressed Taiwan to tighten its laws protecting intellectual property rights, to open its market for such services as insurance and construction, and reduce its duties on various manufactured and agricultural products. U.S. negotiators have praised the country's response on the intellectual property front but are still pressuring in the services area. Taiwan has significantly lowered its duties on many products in recent years, but the United States would like to see much greater liberalization in agriculture.

U.S. officials have also expressed dissatisfaction on many occasions with the exchange rate policy of Taiwan. The global current account surplus of Taiwan reached almost \$14 billion in 1987, and its export surplus with the United States in that year was over \$15 billion. Rather than allowing the Taiwanese dollar to appreciate, the monetary authorities increased their reserves holdings. These reached \$65 billion in 1987 and made the country one of the largest holders of international reserves in the world. In response to U.S. pressure, Taiwanese authorities have allowed their currency to appreciate somewhat, but U.S. officials still believe the Taiwanese dollar to be significantly undervalued.

## 11.2 External Threat, State Building, and the Evolution of ROC Trade Policy

### 11.2.1 Introduction

Where the U.S. government faced what might be thought of as an “identity crisis” in the immediate postwar years, the government of the ROC and the dominant Kuomintang (KMT) party were threatened with total destruction. From outside, the KMT was threatened by the Communist government of the Peoples’ Republic of China (PRC), while inside it perceived a threat from the Taiwanese people, who had good reason to consider the KMT a foreign conqueror. An understanding of this situation, and of the lessons that the KMT drew from its failure on the mainland, is essential to understanding ROC economic policy-making. Thus, before considering the evolution of Taiwanese trade policy, we briefly discuss the broader political-economic context.

### 11.2.2 The Foundations of State Autonomy in Postwar Taiwan

With the collapse of the Ch’ing empire in 1911, China entered a period of internal turmoil, the final outcome of which is still unclear. In the immediate aftermath of the revolution, central authority disappeared completely as warlords established local authority that was politically unresponsive to the center. Following the Northern Expedition and the establishment of a new government at Nanking by the KMT in 1927, and despite the brutality of their earlier purge of Communists, there was a brief period of high expectations.<sup>7</sup> Unfortunately, corruption, incompetence, foreign invasion, and civil war combined to render such expectations unachievable. While its failures in political discipline and social mobilization are of considerable interest in themselves, their relation to the economic policies (or lack thereof) of the KMT during the Nanking decade are of more immediate concern.

The Nationalist government in Nanking was in a constant state of fiscal crisis. On the one hand, the ROC faced the substantial costs of defense against foreign aggression and suppression of domestic rebellion. On the other hand, as part of the attempt to buy the allegiance of the KMT “warlords,” the Nanking government ceded the proceeds of most of the land tax to the regional governments. Furthermore, until 1930, the revenues from customs and the salt tax were directly controlled by foreign governments. As a result, the central government relied heavily on foreign borrowing and virtually expropriatory taxation of the urban formal sector. Even after the government gained control of customs and salt tax revenues, the need to fund its borrowing costs as well as its military costs led the government to pursue a policy of revenue maximization via import and export taxes rather than a development-oriented policy of infant-industry protection. Thus, although the KMT was rhetorically

7. For excellent treatments of the KMT on the mainland, see Eastman (1974, 1984).

committed to industrial development, and although its policies of unifying both money and weights and measures did lower the transaction costs of business, it is difficult to avoid the conclusion that the overall effects of KMT economic policy were negative.<sup>8</sup>

It is particularly notable that, although the KMT (and Chiang Kai-shek in particular) commanded broad support during the war with Japan, the end of the war and the emergence of civil war with the Communists revealed that virtually no significant segment of society strongly supported the Nationalists. In the cities, while attempts to mobilize urban labor had effectively ended with the anti-Communist purges of 1927, shared anti-Communism was insufficient to overcome the fundamental distrust between Chinese capitalists and the KMT, as Coble (1980) demonstrates. In the countryside, land reform, like tax reform, was impossible if provincial “warlords” were to be kept in the Nationalist coalition. This left the peasants to the Communists without developing any strong commitment on the part of the rural elites. Thus, in retrospect, it is hardly surprising that, with the removal of the external threat, the KMT’s popular support and its capacity to resist the Communist forces collapsed.

With the end of the war in the Pacific, Taiwan, which had been ceded to Japan in 1895 (making it Japan’s first colony), was retroceded to the ROC in 1945. As a colony, although it was economically and politically dominated by Japan, Taiwan experienced considerable social and economic development. In an effort to impose order and increase agricultural productivity, the Japanese authorities undertook a cadastral survey followed by a modest land reform, the introduction of improved production techniques, and the organization of farmers into farmers’ associations. In the more urban areas, the Japanese extended education, developed the processing and shipping industries to support the export of rice and sugar, and, with the onset of the Second World War, began to develop heavy industry for export to the Japanese market and a wide range of import-substituting goods. Although Taiwan sustained heavy damage toward the end of the war, it was probably the most agriculturally and industrially advanced province in China.<sup>9</sup> Furthermore, it was an economy with a strong orientation to modern market relations.

When the Nationalist government took control of Taiwan in 1945, it was not with the expectation that it might be a safe haven. Thus, instead of moving to integrate Taiwan politically and economically with the mainland, the ROC treated Taiwan as captured, hostile territory. Politically, the Japanese admin-

8. For a useful review of the basic economic data of the period 1912–49, see Feuerwerker (1977). For a more systematic discussion of economic performance in these years, see Hou (1965) and Young (1971). The negative effects of KMT monetary policy are too well known to require additional comment.

9. Amsden (1979) and Gold (1986, chap. 3) provide useful short accounts of the effects of Japanese colonialism on Taiwanese development.

istration was replaced by a Mainlander administration, and a nascent reform movement was brutally repressed (Mendel 1970).<sup>10</sup> Economically, ROC/KMT officials systematically dismantled what remained of the Japanese/Taiwanese industrial plant and seized the stocks of sugar and rice, generally for shipment to the mainland. Neither the political nor the economic actions of the ROC/KMT officials appear to have been intended to lay the foundation for complete economic integration or even efficient colonial administration. On the contrary, contemporary accounts stress their corruption, vindictiveness, and brutality (Kerr 1965; Peng 1972). That is, the ROC/KMT acted in Taiwan more or less as it did in the rest of China. The result was that, to use Gold's (1986, 49) felicitous description, "Taiwan's formal retrocession to China on October 25, 1945 inaugurated a period of rapid underdevelopment."

By the end of 1949, the ROC and the KMT were clearly faced with destruction by the Red Army. The Nationalists had been steadily pushed back and were preparing to retreat to Taiwan to make their last stand. Contrary to the politically self-serving rhetoric in both the United States and Taiwan to the effect that the United States was somehow responsible for the "loss of China," it appears to have been clear to Chiang Kai-shek that the most fundamental problem was the incompetence, lack of discipline, and corruption of the ROC army and the KMT (Eastman 1984, chap. 9). It also appears to have been clear to Chiang Kai-shek that dramatic changes were necessary in the ROC and KMT institutions and policies if they were going to survive. Thus, in 1948, Chiang Kai-shek entrusted the tasks of preparing Taiwan politically, militarily, and economically to a trusted comrade (General Ch'en Ch'eng) and to his son (Chiang Ching-kuo). Although these efforts continued to involve the ruthless suppression of political dissent, unlike the period from 1945 to 1947, internal reform of political and party institutions was equally important.

In broad outline, then, by 1950 the KMT had established itself on Taiwan, apparently with the genuine expectation of launching a counterattack on the now Communist-controlled Mainland. Ironically, the fact that the KMT had no organic relationships to the political structures of Taiwan (such as they were after half a century of Japanese rule combined with the recent KMT excesses) meant that it was now possible to implement the microeconomic and macroeconomic reforms that had been politically impossible on the mainland. Chiang Kai-shek implicitly proposed a classic state-building gamble: the external emergency would be used to justify direct repression of political dissent, while legitimacy was built on a foundation of rapid economic development. Absolutely essential to the success of this gamble was the transformation of the KMT into a disciplined, honest, and efficient instrument of Chiang's will.

10. This repression was to have long-term consequences for the politics of Taiwan since a substantial proportion of Taiwanese political activists were among the ten to twenty thousand Taiwanese people killed by ROC troops in the aftermath of the "28 February 1947 Incident."



Perhaps the greatest irony of all was the indirect role of the PRC in bringing the U.S. government back as a major player in the political-economic development of Taiwan. The U.S. government had been a substantial supporter of the Nationalist war effort against Japan. With the end of the war, however, the continued commitment of the United States was in substantial doubt. Not only was it not clear whether the United States would choose to pursue a hegemonic role in the postwar era or, following its historical traditions, revert to a more isolationist stance, but, even after that battle had been won by what Yergin (1977) calls the cold war realists, there was continuing doubt about America's commitment to the Nationalists. In fact, by 1949, the U.S. government had concluded that, short of a massive military effort on the part of the United States, the KMT could not be saved. Furthermore, many believed that, as a result of internal corruption and incompetence, it was not worth saving. Finally, some members of the administration thought that a Chinese Communist regime might eventually be a valuable ally against the Soviet Union and that continued support of the KMT would simply make such a strategy harder to realize.<sup>11</sup> As a result, by late 1949, the United States had decided not to reinstitute military aid and not to undertake a massive economic aid program, and it had secretly informed embassy officials to expect the fall of Taiwan. By the end of January 1950, both President Truman and Secretary of State Acheson had publicly announced that the United States would not become militarily involved in the defense of Taiwan. All this changed on 25 June, when North Korean troops invaded South Korea and any hope of normalized relations with the PRC ended when Chinese "volunteers" entered the conflict in November.

The decision by the United States to support the KMT government on Taiwan did nothing to change its dubious opinion of that government. As a result, the U.S. government sought to stiffen Chiang Kai-shek's resolve with respect to both political and economic reforms. Given the large commitment of economic and military aid and the large number of U.S. government personnel associated with that aid, the United States was a significant force for reform. It is important to recall, however, that, unlike, say, Vietnam, the ROC under Chiang Kai-shek appears to have been genuinely committed to reform.

Thus, for a variety of historically unique reasons, the government of the ROC on Taiwan was able to adopt and implement economic (as well as social and political) policy relatively free from direct pressure by Taiwanese economic interest groups. The modifier *relatively* should be taken very seriously. The point is certainly not that corruption, incompetence and internal conflict disappeared overnight. The point is that, within the government, the external threat and the experiences of the preceding twenty or so years made it possible to impose the sort of internal discipline that had been lacking on the mainland.

11. Barrett (1988) gives an excellent short account of the various positions in the postwar U.S. government with respect to Taiwan.

Similarly, in the relation between the state and civil society, there were no effective elites outside the state: the rural elites had been eliminated in the land reform (1949–53); Taiwanese industrial elites were few in number, tarred by their association with the Japanese, and dependent on the state; Taiwanese political elites had been either murdered or driven from political activity; and Chinese industrial elites had a long history of enmity toward the KMT, most having chosen not to follow the KMT to Taiwan but to relocate in Hong Kong and other overseas Chinese communities. As a result, there was an unusual degree of separation between the state and the civil society. With the exception of the parts of the economy under the direct control of the government, the military, and the party (a nontrivial part of the economy), the links between the economy and the various parts of the state tended to be informal and based on personal relationships (Winckler 1981, 1987, 1988). Furthermore, as a result of the genuine attempts to maintain internal discipline, these relationships, while locally significant, did not dominate policy in broad outlines (again, the state sector is an exception).

### 11.2.3 State Autonomy and Trade Policy in the ROC on Taiwan<sup>12</sup>

The previous section argued that, as the result of a unique conjuncture of domestic and international events, the government of the ROC on Taiwan possessed an unusually high level of autonomy that could be applied to economic policy. In this section we consider the particular case of international trade policy. As with most treatments, we will consider major stages in the development of Taiwan's trade policy: first-stage import-substituting industrialization (ISI); first-stage export-led growth (XLG); second-stage ISI; and second-stage XLG. The following section will then consider the effects of recent political developments on the future directions of Taiwan's trade policy.

Taiwan's experience with import-substituting industrialization was classic.<sup>13</sup> In the late 1940s and early 1950s, the Taiwanese economy was in a state of profound disequilibrium: hyperinflation, large trade deficits, a severe shortage of foreign exchange, an increase in population of nearly 30 percent, shortages of producer and consumer goods, and a devastated private and social physical plant. As part of the response to this disequilibrium, the government of the ROC adopted the ISI policy that was the standard policy recommendation of the period: strict licensing of imports; multiple exchange rates; high tariffs; and discrimination in favor of capital and intermediate good imports.

12. Given the dramatic success of Taiwan's trade and development policies, it is not surprising that these policies are well studied. Useful sources on the economics of trade and development in Taiwan are Ho (1978), Hou (1988), Hou and Chen (1989), Kuo and Wea (1988), Kuo (1983, pt. 3), Kuo and Fei (1985), Lee and Liang (1982), Li (1988), Liang and Liang (1982, 1988), Lin (1973), Schive (1990), Scitovsky (1986), and Tsiang (1984). On the politics and political economy, see Chen (1990), Chu (1989); Deyo (1987), Gereffi (1990), Gold (1986), Haggard (1990, chap. 4), Koo (1987), and, esp., Wade (1990).

13. Balassa (1980) gives an excellent short account of the received version of trade and development policy.

As with all programs of this sort, the existence of strong government controls and the rationing of scarce goods meant allocation on the grounds of political accommodation and/or direct venality. Without denying the existence of corruption, the need of the KMT to develop a new image (for both the Taiwanese civil society and the increasingly important U.S. aid establishment) restricted pure venality to relatively low levels.

In this period, however, the ROC government did find it necessary for political reasons to accommodate two important classes of person. The most important class was the 1–2 million Mainlanders (both military and civilian) that followed Chiang Kai-shek and the KMT to Taiwan. In addition to a dramatic expansion in the state apparatus per se, the ROC government absorbed a large number of Mainlanders in the state/party-owned enterprise sector (accounting for 50 percent of industrial production) and granted privileged access to the main ISI sectors (especially textiles). The other, much smaller group was the large landlords and comprador capitalists of the Japanese colonial era. The small number of these that were willing and able to form some relationships with the KMT state tended to gravitate to the four previously Japanese state enterprises whose shares had been allocated to landlords in partial compensation during the third stage of the land reform (“land to the tiller”).<sup>14</sup>

A couple of patterns characteristic of the Taiwanese political economy were emerging even at this early stage. First, the weak political organization of economic interests permitted government officials and technocrats to dominate the policy process. Even potentially powerful groups (e.g., the Chinese military and Taiwanese landlords and capitalists) were related to the KMT state in a clearly subordinate way. Second, large-scale firms, both state owned and new or newly private, tended to be oriented to the local market. In addition to using these firms for political purposes, state planners sought to maintain control of sectors with significant linkage effects.

By the late 1950s, first-stage ISI entered a textbook crisis characterized by excess capacity in the main import-substitution sectors due to saturation of the small protected domestic market, a severe foreign exchange shortage due to the disincentives to export, and continuing balance-of-payments problems. Although the ROC government had pursued some export promotion in the context of its overall strategy of ISI, the end of the “easy” period of ISI led to a fundamental reorientation of strategy toward XLG. In addition to simplifying the exchange rate system, a variety of export-promotion measures were adopted, including subsidized credit for exporters; the liberalization of import restrictions for inputs to the export-producing sectors; a variety of tax exemptions and rebates granted to export production; the provision of information on foreign markets (thus reducing the transaction costs of exporting); and the liberalization of the foreign investment environment, permitting a wide range

14. The four state-owned firms were Taiwan Cement, Taiwan Agricultural and Forestry Products, Taiwan Industrial Machinery and Mining, and Taiwan Pulp and Paper.

of relationships between foreign (especially Japanese and U.S.) and Taiwanese firms engaged in production for export.<sup>15</sup> Like many XLG programs, however, the policy thrust was clearly toward export promotion, not general liberalization of the import control regime.<sup>16</sup> Tariffs and other controls on consumer goods remained high (in fact, many tariffs were increased for revenue reasons), while government policy continued to protect state- and KMT-owned enterprises from domestic and foreign competition.

Compared with export-promotion programs in many countries, the most notable aspect of the Taiwanese program was the relatively strong reliance on general promotion schemes (as opposed to firm and sector targeting). By creating a mechanism that was sensitive to market signals, Taiwan's export promotion schemes tended to select for global comparative advantage. The results were clear and dramatic. Where exports grew by 4.4 percent during the period of ISI (1952–60), the growth rate of exports was 25.3 percent from 1961 to 1970 and 27.1 percent from 1971 to 1981 (Kuo and Fei 1985). Perhaps more significant, on the basis of input-output data Kuo and Fei estimate that export expansion's contribution to the expansion of total output was 22.5 percent in 1956–61, 35 percent in 1961–66, 45.9 percent in 1966–71, and 67.7 percent in 1971–76.

As comparative research on the evolution of trade and development strategies suggests, the end of first-stage ISI need not have resulted in either liberalization or XLG. In Taiwan, the crisis of first-stage ISI generated substantial support for a package of policies that would stabilize the existing import-substitution sectors while moving directly to second-stage ISI. Particularly prominent among the policies suggested were the creation of government cartels and the identification and promotion of second-stage import-substitution sectors. The potential members of the coalition supporting some form of continued commitment to state-led ISI constitute an impressive list: many state technocrats charged with financial and banking policy were concerned about the effects of liberalization on price stability; managers and workers in the state/party sector were worried about the effect of reforms (there was talk of privatization among reformers); the military was committed to a fairly strong form of self-sufficiency; and, finally, some KMT leaders were concerned about the effects of liberalization on the creation of a Taiwanese (as opposed to Mainlander) business class, and some were worried about the creation of an independent capitalist class of any kind. These are precisely the groups that rent-seeking/endogenous policy theory suggests should dominate the policy-making process: they had concentrated benefits from resisting the policy, and they were already well organized within the state apparatus. Not only were

15. The major government programs implementing the XLG program were the Regulations for the Rebate of Taxes on Export Products (1955), the Program for the Improvement of Foreign-Exchange and Trade Control (1958), and the Statute for the Encouragement of Investment (1960).

16. Krueger (1978) is a standard source on liberalization programs.

the gainers from the switch to XLG diffused, but they were also virtually excluded from the political system.

The decision by the government of the ROC on Taiwan to respond to the crisis of ISI by a switch to XLG can be understood only in terms of *raison d'état*, both domestic and international.<sup>17</sup> It will be recalled that part of the strategy of the KMT on Taiwan was to develop political legitimacy via a policy of economic growth with political exclusion. When we recall that the highly concentrated power structure of the state makes persuasion potentially effective in struggles over policy, the notion that the intellectual arguments for export orientation and liberalization dominated those in favor of ISI deepening as a means of growth maximization seems quite plausible.<sup>18</sup> At the same time, U.S. representatives were promoting both XLG and expansion of the economic role of Taiwanese nationals. This was a nontrivial consideration in a period when U.S. military might was protecting Taiwan from a bellicose PRC and U.S. aid was funding both projects and macroeconomic imbalances. Furthermore, even if Chiang Kai-shek and his intimates had already decided to pursue XLG, U.S. preferences for that policy could be used to restrain the proponents of ISI deepening (especially the military).

In the event, as we have already noted, the policy was something of a compromise between ISI deepening and generalized liberalization. The structural features we identified with respect to the ISI policy are even clearer after the adoption of the XLG policy. Continued support/protection of import-substitution sectors meant large (especially state- and party-owned) firms serving the domestic market for consumer and intermediate goods. This support reflected not only a continuing need to provide a livelihood for Mainlanders who had followed Chiang Kai-shek in retreat but also a continuing belief in the need to control certain "strategic" sectors. On the other hand, the use of general instruments with relatively small industrial targeting meant expansion of small, Taiwanese-owned firms in the export sector. This reflects the second point, that the major beneficiaries of the XLG program were not the more effectively organized groups (Mainlanders and compradors) but local Taiwanese. This is consistent with a state-building view of policy, but not with a mechanical "rent-seeking" view.

By the early 1970s, the international political-economic environment of Taiwan's XLG policy was becoming increasingly uncertain: protectionism

17. We have already explained the state's *capacity* to take independent action in terms of the external and internal threats to KMT hegemony over the Taiwanese political system. These threats were used to justify a highly centralized power structure with tight discipline over the incumbents of both state and party positions and the application of tight control on the political activity of Taiwanese civil society. The issue here is why the individuals controlling the state (i.e., Chiang Kai-shek and his closest colleagues) chose to use this capacity for independent action to pursue XLG instead of ISI "deepening."

18. For the argument that intellectual persuasion was significant in this policy decision, see, among others, Haggard (1990) and Chen (1990). If this argument is accepted, the role of S. C. Tsiang and T. C. Liu would seem to be particularly important.

seemed to be on the rise in major export markets, as was actual protection; a second generation of newly industrialized countries (NICs) was beginning to compete for the same export markets; oil and other commodity prices that were inputs to Taiwan's production process rose dramatically; Taiwan was expelled from the United Nations in 1971; major-trading-partner Japan derecognized Taiwan in 1972; and improved relations between the United States and the PRC made Taiwan's "special relationship" with the United States appear increasingly uncertain. On the home front, the very success of the XLG policy tended to undermine comparative advantage in labor-intensive manufactures via its labor-market effects. In this situation, the government of the ROC on Taiwan opted for a period of second-stage ISI, including the expansion of state investment in both infrastructure and key intermediate products,<sup>19</sup> a brief flirtation with industrial rationalization and domestic content schemes for the automobile sector, and some attempts to micromanage the tariff structure and the foreign exchange market.

Once again, this decision is difficult to understand from a social demand point of view. By comparison with the previous period, it seems reasonable to assume that the proponents of ISI had grown relatively weaker. On the one hand, economic development and the passage of time were reducing the need for policies to ease the adjustment of Mainlanders to life on Taiwan. With respect to the military, while the diplomatic situation was uncertain, it is difficult to conceive of the PRC in the 1970s as a greater military threat than at the beginning of the previous period, when the U.S. navy was necessary to forestall an imminent invasion. On the other hand, the dramatic increase in the export sector should surely have increased the stake of that sector in a continuation of the policy of XLG. Nonetheless, diplomatic isolation and (the risk of) economic isolation appear to have been sufficient to induce the government to adopt the second-stage ISI policies characteristic of the other small, semiopen "pariah" states: Israel and South Africa.

#### 11.2.4 Domestic Political Liberalization and the Politicization of Trade Policy

To this point we have argued that the central fact in the political economy of Taiwanese trade policy was the capacity of the ROC/KMT state to act independently of political pressure from Taiwanese civil society. The very genuine state of emergency permitted the KMT leadership to maintain discipline within the state/party apparatus and to restrict the political activity of Taiwanese civil society. Furthermore, the KMT state chose to use its autonomy to override effectively organized interests seeking broadly protectionist trade and development policies. The most recent phase in the political economy of trade and development policy is ushered in by a devastating external shock in

19. This involved heavy state involvement in petrochemicals as well as the creation of large, public-sector firms like China Steel and China Shipbuilding.

the context of fundamental change in the domestic political environment. The shock, of course, was derecognition by the United States on 15 December 1978. In this section, we consider the effects of the current trends toward political liberalization on the future of Taiwan's trade policy.

The domestic political implications of derecognition in Taiwan were profound, not so much because of any increased risk of aggression by the PRC or even of a dramatic worsening of relations with the United States,<sup>20</sup> but because of the politicizing effect of the change on Taiwanese civil society. It has been suggested that Taiwanese civil society in general, and business in particular, drew three important lessons from derecognition: "We can't trust the United States, we can't trust the government, so we must 'trust ourselves.'" <sup>21</sup> That is, there was a perceived need for direct, self-interested, collective political action by economic (as well as other) interest groups. This realization occurred in an environment of increasing liberalization both within the KMT and in Taiwanese civil society.<sup>22</sup>

The initial implication of the politicization of those parts of Taiwanese business that had not been previously directly organized by the state (i.e., primarily the Taiwanese nationals involved in exporting) in the context of a political opening was a move back toward export orientation. Specifically, the government of the ROC pursued a more substantial liberalization of the trade control regime (especially tariffs and licensing); a liberalization of exchange controls, considerably easing the process of foreign direct investment by Taiwanese firms; and a substantial financial liberalization. This outcome begins to look very much like demand-based politics of the familiar sort: Taiwanese export interests become organized and active, while the state/party-connected sectors are still frozen by the centralized state/party structure.

The end of martial law (1987), the death of Chiang Ching-kuo (13 January 1988) without a clearly dominant successor, and the end of the state of emergency all imply the emergence of genuinely competitive politics in Taiwan. At the same time, the conditions that gave rise to the dramatic separation of the Mainlander-dominated government from Taiwanese civil society have also substantially eroded: increasing numbers of native Taiwanese have entered the highest levels of the state (including, of course, the presidency); in addition, with the passage of time, native Taiwanese have developed closer relations with the KMT government; and most Mainlanders, especially of younger gen-

20. It is important to recall that it took Congress less than a week to pass the Taiwan Relations Act (1 January 1979), maintaining in existence all treaties between the United States and the ROC and ensuring continued equal treatment of the ROC under all relevant law.

21. Any residual hope that the election of a president from the right wing of the Republican party (traditional supporters of the Nationalist government as part of its strong anti-Communist, Asia-oriented foreign policy) would improve matters was quickly dashed by Reagan administration decisions not to export advanced military hardware to Taiwan.

22. For useful treatments of political liberalization in Taiwan, see Chen (1989), Tien (1989), and Winckler (1984).

erations, have adjusted to being, at least geographically, Taiwanese.<sup>23</sup> This has meant that it is increasingly difficult to maintain the kind of internal discipline within the state that characterized the Emergency years.

At least as important as the decrease in internal discipline, however, is the increase in competitive politics. Given the continuing differences in the concentrations of Mainlanders and native Taiwanese in import-substitution versus export-orientation sectors, this suggests that the politics of trade and development policy could become embroiled in communal politics. In the context of increasingly competitive politics, the development of multiparty competition and increased participation of the legislative Yuan in the trade policy process becomes quite significant. Without a strongman at the top of the political hierarchy to manage the system, and with increasingly organized and active interest groups, the capacity of the state to control trade policy is substantially reduced. While the export interests are better organized now than at previous points in the modern history of Taiwan, they will increasingly face political competition from the well-organized import-substitution sector. As in all competitive political systems, competition for office is costly and tends to breed close relations between suppliers of campaign finance and interests with money to give. The legislative Yuan is already becoming more active on trade policy issues.

Perhaps the safest conclusion is that, as with the United States, trade policy in Taiwan will become increasingly dominated by the politics of special interests, more prone to large and unpredictable changes, and more prone to politically driven protectionism reflecting the inherent biases in the politics of protection. At a time when Taiwan has a massive trade surplus in its major export market, this certainly suggests the potential for increasing conflict between the United States and Taiwan. As a response to this, the government of the ROC is pursuing a two-track strategy. The first track is an attempt to diversify export markets, especially with respect to Europe and the oil-exporting nations. The second track is the attempt to gain admission to the GATT. In an increasingly uncertain political-economic environment, the GATT is seen as some insurance for a country that relies extensively on trade. As part of this strategy, the most recent trend in Taiwan's trade policy is a move toward genuine liberalization: reduction of tariffs; dismantling of licensing schemes; and adoption of GATT-compatible domestic regulations. The stability of this strategy in the face of increasingly competitive politics is an interesting question.

23. The last of these should not be taken to mean that the distinction between Mainlander and native Taiwanese has lost political significance. In fact, with the realization that Mainlanders will not be going back to the mainland, both sides have recognized that their political struggles are of a longer-run sort. Furthermore, because these two groups have, to this point, been organized (politically and economically) in different ways, this suggests the possibility of increased communal conflicts in the future.



### 11.3 Conclusions

The United States and the Republic of China are paradigm cases of different types of trade liberalization (the United States as a hegemonic leader and the ROC as a peripheral or semiperipheral client). We have argued that, in both cases, the successful implementation of such a policy rested, at least in part, on historically unusual degrees of state autonomy from direct social pressure. This should not be a surprising conclusion. A fundamental part of the standard account of the political economy of protection is the asymmetry of protection-seeking forces vis-à-vis liberalization-seeking forces. While this balance may change at the margin, the underlying asymmetry is unlikely to change.<sup>24</sup> Thus, the discontinuous shift to liberalization in both the United States and the ROC must be accounted for, at least in part, by something outside simple pressure politics. An argument of this sort requires an answer to two questions: How did the state develop substantial autonomy with respect to trade policy (an area that had not been characterized by such autonomy in the past in either country)? Why did it choose to apply its autonomy to liberalization? We have focused primarily on the first question in this paper because it seems to be logically prior, but the second question is also of considerable significance. After all, a number of countries have experienced crises producing a substantial, if not quite equal, level of state autonomy without generating a commitment of liberalization (an obvious hegemonic example is the Soviet Union in the cold war era, while Tanzania and Ghana in the postindependence era are examples of peripheral states). An answer to the second question is well beyond the limits of this paper but would seem to be a research question of considerable importance.

A question of more immediate policy importance is raised by the argument developed in the paper. If liberalization rests on a political foundation of state autonomy, what happens when that base is eroded? In both the United States and the ROC, the emergence of increasingly democratic politics in the institutions controlling trade policy suggests, at a minimum, that trade policy will become decreasingly predictable in the future. In both countries, politicians have begun to recognize that international trade and competition are potent public political issues. This has reopened trade as a public issue in a way that we have not seen for nearly half a century. Whether we are interested in the positive or the normative implications of these changes, it seems clear to us that we will not make much progress until we begin a more serious, systematic study of the “supply side” of the political market and the way in which it interacts with demand.

24. Nelson (1989) develops this argument in detail for the case of U.S. trade policy since 1930.

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## Comment Koichi Hamada

This paper is a lucid, systematic account of political economy on both sides of the Pacific—in the United States and the Republic of China (ROC). Methodologically, the study of the supply side of public goods is as important as the demand side. Just to say that the state is the supply side is oversimplistic. Political entrepreneurship, leadership, and exploitation should be explicitly analyzed. Also, one should not neglect the intricate structure of trade conflicts

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because trade conflicts can be regarded as a layer of games at both the international and the domestic levels. As Robert Putnam emphasizes (see Putnam and Bayne 1987), international economics can be analyzed as a two-level game. The interaction between international conflict and domestic conflict is tighter in trade disputes than in the macroeconomic coordination attempts that he focuses on because losers and winners in trade disputes are quite distinct groups of people. As illustrated in figure 11C.1, the game of trade issues between the United States and the ROC is of the two-level type, level 1 being international negotiations between representatives and level 2 domestic economic conflicts between groups within a country. Export industries in a country share the same interests with consumers in the other country. Since the countervailing power of consumers is weak, the outcome of the political interplay of domestic producer interests is often a protectionistic world trade regime.

Let us look at the game at the international level. When the United States held full hegemony over the world, it could serve as a leader in multilateral worldwide decisions relying on the rule of established international organizations. However, with its declining hegemony—the United States in the Gulf War was like *samurai* (warriors), who had military authority and leadership but no economic power during the late Edo period before the Meiji Restoration, and Japan was like *chonin* (merchants), who had money but no leadership—the United States cannot afford to rely exclusively on a multilateral approach. Thus, the bilateral approach to VERs (voluntary import restraints) or OMAs (orderly marketing agreements) as well as the regional approach to the North American Free Trade Area (NAFTA) came to the surface.

At the domestic level, the description of the power balance between the U.S. Congress and the president is illuminating. I understand that the U.S. Constitution sets a stage for the balance-of-power game between the legislative branch and the executive branch. This political structure gives the U.S. trade representative the power to threaten its trading partners that the Congress

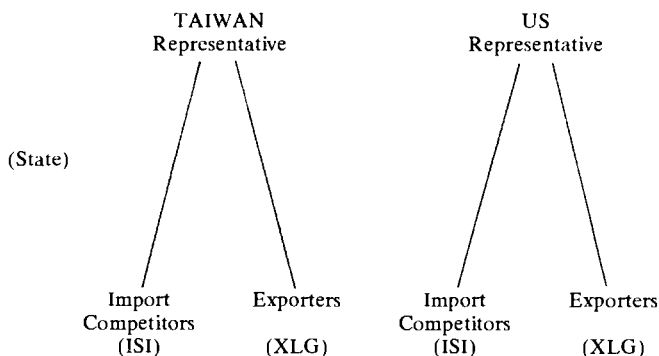


Fig. 11C.1 Structure of a two-level game

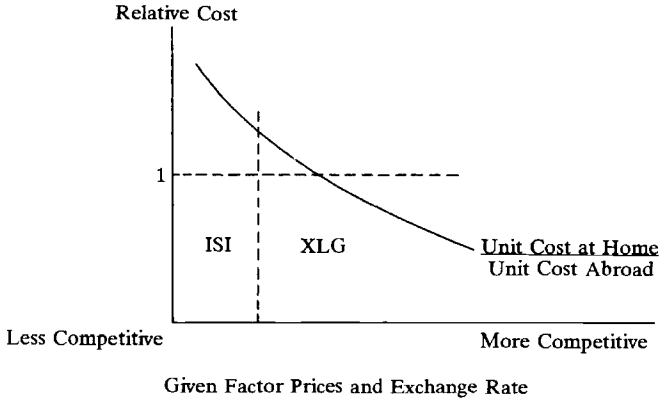


Fig. 11C.2 ISI vs. XLG policy

will retaliate unless the partner accepts U.S. proposals, and it allows U.S. trade policy to be free of foreign pressure.

For Taiwan, I have two questions. The first is, Why did the corrupt KMT turn into a rather disciplined, honest institution? Incidentally, the success of the power elite in civil society reminds me of the success of occupational reform by the supreme commander of the Allied power in the Occupation period in postwar Japan. The second is, Given the fact that the government cannot subsidize all industries, how can you draw the line between ISI (import-substituting industrialization) policy and XLG (export-led growth) policy? Figure 11C.2 ranks on the horizontal axis the relative competence of industries in the fashion that the Dornbusch-Fischer-Samuelson version of the Ricardo model would indicate. ISI policy protects the least competent or incompetent in the future. XLG policy is to subsidize the most competent or the most promising in the future. With limited resources, the government must choose some pattern of protection or subsidization. I wonder if there is some optimal pattern for conducting this and if indeed the ROC followed such a policy.

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## Comment Richard H. Snape

I found this paper very instructive on the course of Taiwan's trade policy and on U.S.-Taiwan relations.

The paper opens with an emphasis on the "supply" of trade policies, as distinct from demand, and argues that the role of the state (politicians, bureaucrats, etc.) in supplying trade policies that address collective goals has been ignored in political economy models. I think that there could be more consideration of this *supply* of collective goals and their relation to demand. Presumably, these collective goods are demanded by the electorate in some manner—voters, funders, and lobby groups certainly include defense and, in the United States and Taiwan, anti-Communism in their demands. Politicians seeking legitimacy and hence retention of their positions can lead, follow, or anticipate public opinion. Following opinion is obviously responding to demand. Leading or anticipating is also demand oriented, although to future rather than present demand—just like any product innovator. A product innovator hopes to convert people to his product—if he does not get the demand, he fails; a visionary politician hopes to convert people to his vision—if he does not get the demand, *he* fails. In some situations, demanders may be the military rather than the voters.

In describing and analyzing U.S. policy, four key changes are identified: (1) a shift to "fair" trade (about 1970); (2) greater use of unilateral/bilateral/plurilateral policies (1982); (3) discriminatory nontariff barriers (from the early 1960s but momentum in late 1970s and the 1980s); and (4) the greater role of Congress (from 1974). This list is generated by a focus on manufacturing industry. If agriculture were to be included, things would look a bit different. The first point—fair trade—would remain. With respect to points 2 and 3, unilateral and bilateral policies and plurilateral restrictive agreements came much earlier. At the insistence of the United States, the original GATT contained provisions for import quotas when there was domestic agricultural price support combined with production limitations—as in the postwar United States. In the 1950s, there was the GATT waiver for many U.S. agricultural products, and sugar quotas, for example, clearly discriminated among suppliers on foreign policy grounds. Finally, on the fourth point, the role of Congress in trade policy, Congress was right in there from 1951 at least. An amendment of the Trade Agreements Extension Act of 1951 provided that "no trade agreement . . . shall be applied in a manner inconsistent with the requirements of this section," those requirements in fact being inconsistent with GATT (Gardner 1980, 375; Dam 1970, 260). Thus, the focus could be broadened to include agriculture in the story, even though it is not particularly relevant to Taiwan as such, and one could then see how the story with agriculture included meets the hypotheses.

On the switch of responsibility for countervailing duty and anti-dumping from Treasury to Commerce, I would suggest that it is not just that Treasury deals with *international* finance but rather that Treasury has an overview role with a general constituency, whereas Commerce is a client department with a specific constituency.

There is one irony in the paper that perhaps should not be passed unnoticed in view of Ken Flamm's paper. The United States targeted Taiwan for using "constructed values" for calculating import tariffs, just when it was using constructed values for antidumping purposes for semiconductors. Also, it was less than a decade after the United States had, in the Tokyo Round, been induced to give up the American selling price as a basis for duty calculation and the highly protective "wine gallon."

It would be instructive to compare changes in Taiwan's policy in the 1970s, and indeed all the time after 1960, with Korea's. Taiwan adopted the "second" import-substitution policy at about the same time as Korea implemented its heavy and chemical industry policy and abandoned it at about the same time as Korea switched back to less discriminatory support. It would be interesting to see whether the changes were related.

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