

PART II

# Political Economy



# Varieties of State Capitalism across the Taiwan Strait

## *A Comparison and Its Implications*

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The past few years have seen an upsurge in interest, both practically and academically, in state capitalism.<sup>1</sup> While state capitalism is not a new phenomenon, the 2008 global financial crisis sweeping through a large part of liberal capitalist system made it a viable alternative approach to economic development. A number of developing economies with a relatively large state sector, such as Brazil, China, India, and Russia, outperformed their liberal developed counterparts.<sup>2</sup> These economies had the state's heavy hand involved and relied on their state-owned enterprises (SOEs) to stand against and buffer the impact of the crisis. Yet if we take a closer look at these economies, the SOE sector is not the only player in the game. Different from the old model of state capitalism in the 1970s, new varieties of state capitalist economies sprouted in the late 1990s and flourished in the late 2000s. These new varieties have witnessed more strategic cooperation between their SOE and non-SOE sectors.<sup>3</sup>

Most scholars, policy makers, and journalists pay attention only to how such strategic cooperation associated with the new species of state capitalism effectively challenges Western capitalist systems. There has been little investigation of the variations in domestic market structures within the group of state capitalist regimes—as if they were all the same. However, as the cases of China's state capitalism in the post-1990s period and Taiwan's state capitalism from the 1960s to the 2000s show, there is obvious heterogeneity in their ownership structures. Under China's state capitalist regime there is a political pecking order where SOEs occupy the top of the hierarchy and private firms are relatively small, numerous, and weak.<sup>4</sup> On the other hand, Taiwan's state capitalist regime is characterized by small and medium-size private firms holding equal footing in the governmental

industrial policy.<sup>5</sup> What explains this variation? In particular, given that state capitalism is a political-economic regime for the sake of national development, it is reasonable to expect that the economies under state capitalism will share similarities in their domestic ownership structure, specifically an emphasis on the SOE sector. While China's state capitalism conforms to such an expectation, Taiwan's state capitalism does not. These variations in domestic ownership structures are puzzling. This chapter aims to analyze the rationale behind the variations in domestic market structure across the Taiwan Strait and its implications for understanding cross-Strait economic interaction.

This chapter uses Aldo Musacchio and Sergio G. Lazzarini's work to define state capitalism. Musacchio and Lazzarini define state capitalism as "the widespread influence of the government in the economy, either by owning majority or minority equity positions in companies or by providing subsidized credit and/or other privileges to private companies." On the basis of this definition, there are three subtypes of state capitalism: "leviathan as an entrepreneur"; "leviathan as a majority investor"; and "leviathan as a minority investor."<sup>6</sup> The first model refers to the old model of state capitalism existing primarily in the 1970s, and the second and third models refer to the latest wave of state capitalism that we observe today. According to their definition, Musacchio and Lazzarini put China's state capitalism in the category of "leviathan as a majority investor" and Taiwan's state capitalism in the category of "leviathan as a minority investor." To be specific, Taiwan's state capitalism has experienced a transformation from "leviathan as entrepreneur" in the pre-1989 period to "leviathan as a minority investor" with the agenda of democratization in the late 1980s.<sup>7</sup>

One justification makes China's and Taiwan's state capitalism models a comparable fit. That is, both China's and Taiwan's industries have experienced a Leninist model of control.<sup>8</sup> Compared to the prereform era, when Chinese Communist Party (CCP) control penetrated every work unit in China, the Chinese party-state of the reform period has loosened its grip over industry through various SOE reform agendas.<sup>9</sup> Industrial policy still favors the SOE sector over other types of ownership, however, and China is a "commanding-heights economy," in which the CCP's Leninist model of control still has its place in the Chinese political economic system.<sup>10</sup> Leninism was also once an essential part of the Kuomintang's (KMT)'s governance of Taiwan's political-economic system during its nearly four decades of authoritarian rule.<sup>11</sup> A decade after Taiwan made its democratic transition, the KMT's Leninist control model has yet to fade from the decision-making process.<sup>12</sup> In short, both China's and Taiwan's state capitalism have their roots in the Leninist legacy.

My central argument regarding the rationale behind the variations in domestic market structure between China's and Taiwan's state capitalist regimes and its implications has three parts. First, the similar institutional foundations of the

Leninist legacy do not necessarily determine the evolution of state capitalism in authoritarian China and Taiwan. Second, the evolution of state capitalism in both authoritarian regimes hinges on the resources that the leaders have at their disposal in the pursuit of national development. During the time when leaders in Taiwan cultivated the state capitalist system, the authoritarian KMT regime had just been defeated in the civil war and could rely only on assistance from the United States to build its economy. The ideology of market liberalism associated with US assistance supported private ownership rather than public ownership. Private ownership was thus not discriminated against under Taiwan's state capitalism in the first place. In contrast, during the time when leaders in China cultivated their state capitalist system in the post-1990s period, China had tense relations with other major powers in the global community. Backed by a gigantic state-owned banking system, various state actors, including state firms, a diverse array of bureaucratic agencies, and state research institutes, provided reliable and efficient assistance to develop the state capitalist system. Public ownership functioned as the bedrock of China's state capitalism. Third, China's preference for state ownership over private ownership has caused concerns about unfair competition and security issues in Taiwan, making economic interaction in the region more complicated and unstable.

This chapter is structured as follows. I begin by examining how state capitalism evolved in Taiwan from the 1960s to the 2000s. I then look in detail at the development of China's state capitalism since 2003. I end by discussing implications of variations in domestic market structure across state capitalist systems in Taiwan and China for understanding cross-Strait relations.

#### STATE CAPITALISM IN TAIWAN

Before studying the case of Taiwan, I need to clarify that the state capitalist regime in Taiwan lasted nearly four decades, from the 1960s to the beginning of the 2000s. Before the privatization agenda was initiated in 1989, Taiwan's state capitalism fell into the category of "leviathan as an entrepreneur," the primitive type of state capitalism under Musacchio and Lazzarini's definition.<sup>13</sup> As the agendas of democratization and its consolidation proceeded throughout the second half of the 1980s and the 1990s, the Taiwanese government revamped its own role in the marketplace and started to privatize state firms, resulting in what Musacchio and Lazzarini label "leviathan as a minority investor."<sup>14</sup>

The democratic impetus continued to grow, and the state's penetration into society and intervention into the marketplace finally ended with the first party turnover from the KMT to the Democratic Progressive Party (DPP) in 2000,<sup>15</sup> signifying the breakdown of the state capitalist regime in Taiwan. The continuous efforts put forth by the Taiwanese government on the privatization agenda finally marginalized the importance of state ownership in Taiwan's domestic market. Although

the Taiwanese state capitalist regime experienced a transformation from “leviathan as an entrepreneur” to “leviathan as a minority investor” during four decades, it is worth pointing out that the private sector had always been significant throughout this time (see table 8). Below I tackle the reason why the private sector was the dominant component under Taiwan’s state capitalism by looking at the international and domestic environments in which the authoritarian KMT leaders operated and from which they could extract resources to engage in economic buildup.

Once Chiang Kai-shek and his KMT regime retreated to Taiwan in 1949, the United States became the most important ally of the Taiwanese government. For the KMT authoritarian regime in Taiwan, China’s potential invasion has always been the biggest threat to its survival, especially because China has never abandoned its ambition to liberate the island. Nonetheless, ties with the United States have lessened such pressures. Keeping Taiwan from being taken over by the communist camp was one of the most important agendas in American grand strategy during the first half of the Cold War period.<sup>16</sup> Even when the American domestic political atmosphere played down the strategic importance of Taiwan after the Sino-US rapprochement in the 1970s, the United States continued to provide Taiwan security assurance on an unofficial basis.<sup>17</sup> American development assistance, security assurance, and access to the US market gave the authoritarian Taiwanese government more leverage at its disposal to build up its economy during the 1950s and 1960s, when the Taiwanese state capitalist regime began to take root. Putting it differently, during Taiwan’s early stage of state capitalism the authoritarian Taiwanese government was brought into the American security orbit and was under no pressure to rely on its own security. Thus, constructing a team of national champions to play catch-up was desirable but not imperative.

Influence from the United States was also translated into Taiwan’s domestic economic agenda. As discussed, Taiwan’s authoritarian regime relied heavily on assistance from the United States, both economically and militarily. This gave the United States leverage to influence Taiwan’s political-economic system by imposing its liberal market ideology. During most of the aid period from 1950 to 1965, the SOE sector as part of the KMT regime was under constant pressure from the United States to reduce state shares in public firms.<sup>18</sup> In the meantime, the US government also pushed the KMT government to carry out land reform, which transformed a large number of landowners into private entrepreneurs who were later sponsored by the KMT government to engage in export-led development.<sup>19</sup> Specifically, because the KMT authoritarian government was a non-native regime, it needed to cultivate local networks to consolidate its rule. In this respect, private entrepreneurs, mostly native Taiwanese, were good candidates for becoming part of KMT’s patron-client system. Advised by the United States, the KMT authoritarian government gave private entrepreneurs numerous privileges in doing businesses in exchange for their political support.

TABLE 8 The privatization agenda in Taiwan

Firm	Time of privatization	Revenue (NT\$100 million)
China Petrochemical Development Corporation	6/20/1994	170.95
BES Engineering Corporation	6/22/1994	113.69
China Steel Corporation	4/12/1995	1195.08
Taiwan Machinery Manufacturing Corporation (Steel Production Plant)	5/20/1996	48.24
Taiwan Machinery Manufacturing Corporation (Shipbuilding Plant)	1/10/1997	22.75
Taiwan Machinery Manufacturing Corporation (Alloy Steel Production Plant)	6/30/1997	3.54
Taiwan Fertilizer Co., Ltd.	9/1/1999	170.29
Taiwan Hsing Chung Paper Co., Ltd.	10/16/2001	0.05
Taiwan Machinery Manufacturing Corporation (Head Office & Manufacturing Plant)	11/19/2001	35.09
Tang Eng Iron Works Co., Ltd. (Transportation division)	8/1/2002	0.2
Tang Eng Iron Works Co., Ltd. (Steel Plan, Machinery Plant)	9/1/2002	0.198
Taiwan Agricultural and Industrial Development Corporation (Chiayi Machinery Plant)	12/31/2002	0.078
Taiwan Salt Industrial Corporation	11/14/2003	28.36

SOURCE: State-Owned Enterprise Commission, Ministry of Economic Affairs, ROC, *Jingjibu suoshu shiye minyinghua* [Privatization of state-owned enterprises in Taiwan] (Taipei: Ministry of Economic Affairs, ROC, 1996), 179.

Moreover, their failure during the civil war shaped KMT leaders' perception of the market. Before retreating to Taiwan, the KMT regime had suffered from hyperinflation during the second half of 1940s. Learning from the financial disaster, decision makers in the KMT government in Taiwan respected market mechanisms in managing its economy.<sup>20</sup> Hence, while adopting Leninist control over its economy, Taiwan's authoritarian regime had no ideological commitment to state ownership and never used bureaucratic coordination to replace market mechanisms as communist regimes did. As a result, the KMT regime did not discriminate against private ownership, one of the core elements of a liberal market economy, in its development programs.

Admittedly, compared to other newly industrialized economies in East Asia such as South Korea, bonding between the KMT regime and private capitalists was relatively loose because of mistrust between the former, a non-native regime dominated by mainlanders, and the latter, composed of local Taiwanese.<sup>21</sup> The distrust, however, was mediated by two factors: the above-mentioned US pressure and the fragmentation of local elites following the February 28 incident of 1947 (an uprising in Taiwan that was violently suppressed by the KMT-led ROC government).<sup>22</sup>

Within this context the private sector was picked by the KMT authoritarian government to play an essential role in the transformation of Taiwan's development pattern from an import substitution strategy to a strategy of export-led economic growth.<sup>23</sup>

Finally, it is important to keep in mind that the activism of the private sector would not be possible without a meritocratic and Weberian bureaucracy in Taiwan. As Peter Evans has demonstrated, bureaucracy in Taiwan enjoyed "embedded autonomy" that enabled it to formulate and implement policy goals independent of any special interests while remaining connected to those interests by various social ties.<sup>24</sup> Such bureaucratic capability kept the authoritarian KMT regime from overprotecting its SOEs at the expense of the private sector in its industrial policy. The high-tech industry is a good example. With a variety of policy preferences such as tax breaks and financial and infrastructure support, the Taiwanese government started to engage in industrial upgrading in the 1970s. It then established the Hsinchu Science Park in 1980 to assist high-tech firms, mostly composed of private capital, to operate businesses. Numerous economic technocrats such as Kwoh-ting Li played an essential role during the whole process. It is not an exaggeration to say that private firms have an equal footing in Taiwan's industrial policy, as is not the case of China.

#### STATE CAPITALISM IN CHINA

State capitalism in China is a different story. Given that China is a transitional economy, it is useful to specify when state capitalism became the major feature of China's political-economic system. While Chinese reformers have repeatedly initiated policies to separate SOEs from the state since the early stage of economic reform, it was not until the second half of the 1990s that the reform program of "grasping the large, releasing the small" paved the way for corporatization of the remaining state firms. Instead of managing the corporatized SOEs by itself, the Chinese state delegated the authority to managers of the corporatized firms, who were ministerial-level cadres selected by the central organization department of the CCP. At the same time Chinese reformers further diversified these firms' ownerships through public listing and transformed them into shareholding entities. Parallel to the corporatization agenda in the SOE sector, in 2003 the Chinese state created the State-Owned Assets Supervision and Administration Commission (SASAC) to supervise the operations of the SOEs. It is fair to claim that the engineering of China's state capitalist regime was initiated in the late 1990s and completed in 2003 upon the creation of the SASAC (see table 9). Since 2003 the Chinese political economy has been a good example of state capitalism with the feature of "leviathan as a majority investor."<sup>25</sup>

Like Taiwan, the Chinese state created the state capitalist regime in its pursuit of national development. Yet rather than relying on a large number of private

TABLE 9 Distribution of industrial production by ownership in China (%)

Year	State-owned and state-holding enterprises	Collective enterprises	Private enterprises	Others
1957	53.77	19.03	0.83	26.37
1963	89.33	10.67		
1964	89.54	10.46		
1965	90.07	9.93		
1966	90.18	9.82		
1967	88.46	11.54		
1968	88.42	11.58		
1969	88.71	11.29		
1970	87.61	12.39		
1971	85.91	14.09		
1972	84.88	15.12		
1973	84.02	15.98		
1974	82.41	17.59		
1975	81.09	18.91		
1976	78.33	21.67		
1977	77.03	22.97		
1978	77.63	22.37		
1979	78.47	21.53		
1980	75.97	23.54	0.02	0.47
1981	74.76	24.62	0.04	0.58
1982	74.44	24.82	0.06	0.68
1983	73.36	25.47	0.12	0.78
1984	69.09	29.71	0.19	1.01
1985	64.86	32.08	1.85	1.21
1986	62.27	33.51	2.76	1.46
1987	59.73	34.62	3.64	2.02
1988	56.80	36.15	4.34	2.72
1989	54.06	35.69	4.80	3.44
1990	54.60	35.62	5.39	4.38
1991	56.16	33.00	4.83	6.01
1992	51.52	35.07	5.80	7.61
1993	46.95	34.02	7.98	11.05
1994	37.34	37.72	10.09	14.85
1995	33.97	36.59	12.86	16.58
1996	36.32	39.39	15.48	16.65
1997	31.62	38.11	17.92	18.45
1998	28.24	38.41	17.11	22.91
1999	28.21	35.37	18.18	26.14
2000	47.33	13.90		64.07
2001	44.41	10.53		71.46
2002	40.78	8.68		75.73
2003	37.54	6.65		80.36
2004	34.81	3.90		84.49
2005	33.28	3.42		85.67

*Continued*

TABLE 9 *Continued*

Year	State-owned and state-holding enterprises	Collective enterprises	Private enterprises	Others
2006	31.24	2.90		87.40
2007	29.54	2.51		88.51
2008	28.34	1.77		89.03
2009	26.74	1.75		89.93
2010	26.61	1.49		90.35
2011	26.81	1.31		90.79

SOURCE: National Bureau of Statistics of China, *China Industry Economy Statistical Yearbook* (Beijing: China Statistics Press, 2012), 19.

NOTE: The total percentage figures for several years exceeded 100 percent, which challenges the accuracy of the data. Yet the data provided by the National Bureau of Statistics of China can still convey useful information on the general trend of changes in the SOE sector.

firms, China chose to restructure its ailing state firms into national champions. This choice reflected Chinese decision makers' calculations of resources available from both international and domestic environments. In terms of international resources, during the reform era China received development assistance from international organizations such as the World Bank, yet the Chinese leadership had no confidence in the aid regimes that were dominated by major Western powers, mainly the United States and other major powers that had tense relations with China. For example, the Tiananmen incident in 1989 and the corresponding sanctions from the West made the creation of a strong SOE sector high on Chinese leaders' agenda.<sup>26</sup> In the decade following the incident, China's relationship with the United States, the only superpower by that time, was entangled with American domestic issues such as the bipartisan debate over extending most-favored-nation trade status to China.<sup>27</sup>

At the turn of the new century, China's entrance into the World Trade Organization put Chinese firms in direct competition with firms that had been cultivated in developed economies. Making all these pressures more severe was a persisting distrust regarding China's economic rise in the international community, manifested by the debate over whether the PRC was a revisionist or a status quo state.<sup>28</sup> Compared to Taiwan's state capitalism, which was fostered when the United States provided a stable alliance, China's state capitalism was engineered in the midst of a security dilemma in which only SOEs at the Chinese state's disposal provided reliable and effective support for national development.

Given that only state ownership provides the CCP regime with a source of legitimacy, its distrust of the growing class of private entrepreneurs also influences leaders' decisions about building the state capitalist system. In the early years of China's economic reform, the continued influence of ideological battles against

the exploitation of the class of workers made Chinese leaders limit the actors in the nonstate sector to individually owned enterprises with a maximum of only eight employees.<sup>29</sup> In the meantime, insecure property rights led to the widespread phenomenon of “wearing a red hat,” whereby private capitalists registered their enterprises as collective ones as a cover for their trade.<sup>30</sup> Although Deng’s 1992 Southern Tour of China to stress the importance of his agenda of economic reforms reinvigorated private capitalists’ confidence in running businesses, it was not until 2002, when Jiang Zemin asserted the “three represents” that the PRC stood for (advanced economic production, cultural development, and political consensus), that they were entitled to legal protection.

Official discrimination against the private sector in China still exists even as private entrepreneurs and their property rights have gained legal status. As a regime that resorts to socialist ideology for its legitimacy, China’s party-state continues to privilege state ownership at the expense of other types of property rights. A good example is China’s stimulus package of US \$586 billion in response to the global financial crisis in 2008. The investment plan mostly went to infrastructure projects in which state firms were the main operators. Private firms, in contrast, had difficulty securing stable funding sources such as bank loans and government subsidies. As a result, the saying that “the state advances, the private sector retreats” (*guo jin min tui*) became a reality.<sup>31</sup> Even today several industries that are critical for national development still shut the door to private firms and remain monopolized by the state.<sup>32</sup> Given that the class of private capitalists is the main agent of democratization in a number of countries, it is not surprising that the CCP’s leaders keep a vigilant eye on the private sector and adopt the preceding ownership discrimination strategy. On the basis of the above elaboration of China’s international and domestic concerns, it is obvious that leaders in Beijing, wary of the political implications of the private sector, can rely only on SOEs to play economic catch-up.

In sum, both Taiwan’s and China’s state capitalist regimes are characterized by strong states and have similar industrial policies; however, the effect of state intervention in the two political-economic systems is far from the same. Industrial policies under Taiwan’s state capitalism have emphasized social performance indicators such as social equality, whereas industrial policies under China’s state capitalism have focused on the resilience of the authoritarian political system.<sup>33</sup> These different concerns have led to divergent ownership structures in the domestic markets under the two varieties of state capitalism.

#### CONCLUSION: RETHINKING ECONOMIC INTEGRATION ACROSS THE TAIWAN STRAIT

An increasing body of research focuses on the development of state capitalism across different parts of the globe as a response to the new economic environment

brought about by the 2008 financial crisis. The scholarship has done an excellent job of presenting how states adopting the state capitalist system employ flexible strategies to interfere in markets and succeed in achieving growth. Although the literature has identified various forms of state capitalist regimes, it has yet to offer an explanation of why the variations exist. Using state capitalism in Taiwan and China, this chapter finds that resources available to leaders when they engage in the cultivation of state capitalist regimes condition the main agent of economic development and thus the ownership structures in the domestic markets. Assistance from the United States and the commitment to a liberal market explain the prevalence of small and medium-sized private firms under Taiwan's model of state capitalism, while tensions with major powers and the CCP's reliance on state ownership as one of its sources of legitimacy account for the dominance of the SOE sector under China's state capitalism.

This finding corresponds to the latest development of historical institutionalism, in which researchers are paying renewed attention to human agency in an effort to avoid determinism brought about by the analytical concept of path dependence.<sup>34</sup> In other words, even though both Taiwan and China had a history of using Leninist control models in their markets, their similar starting points did not mean they followed the same evolutionary path for domestic market structures. Their differences, however, cannot be explained away by the positive effects of increasing returns associated with the process of path dependence. Rather, as the cases of Taiwan and China demonstrate, the evolution of state capitalist regimes hinges on the choices of political leaders.

It is useful to close my argument by discussing how my research findings would affect the development of cross-Strait relations. As of this writing in the second half of 2016, relations between the two sides of the Taiwan Strait have been facing a downturn since Tsai Ing-wen of DPP was sworn in as the new president of Taiwan in May 2016. Tsai's rejection of the so-called 1992 Consensus (the previous agreement that there is only one Chinese nation but that the PRC and the ROC can differ as to which of them is its legitimate representative), which served as the foundation for détente between the two sides from 2008 to early 2016, was interpreted as a defiant assertion of Taiwanese separateness and independence. While it remains to be seen how both sides adapt to this new situation, it is fair to say that Tsai's stance toward China has generated distrust in China-Taiwan interactions. Below I focus only on the implications of these research findings for cross-Strait relations during the 2008–16 period.

Ma Ying-jeou of the KMT, Tsai's predecessor, adopted a policy of engagement with China and cultivated extensive economic ties with the Chinese market. Ma's approach totally reversed the hostile policy stance toward China under DPP president Chen Shui-bian from 2000 to 2008. Despite being charged with selling Taiwan out to China, Ma's effort has been fruitful. China and Taiwan signed the

Economic Cooperation Framework Agreement in 2010, and cross-Strait trade has risen by more than 50 percent, reaching US\$198 billion in 2014. At the same time, the Ma administration gradually relaxed restrictions on foreign direct investment from China.<sup>35</sup> This growing economic integration developed in tandem with more social exchanges between Taiwan and China. Ma's first term was the first time that Chinese students could register for and get degrees from Taiwanese universities. In the meantime, the opening of Taiwan to Chinese tourists, with a daily quota of five thousand visitor groups and four thousand individual travelers, is said to be an economic boon for Taiwan's domestic market. All of the preceding exchanges created the foundation for peaceful development across the Taiwan Strait and thus the prospect of *détente* between Taiwan and China.<sup>36</sup>

Without a doubt the argument for cross-Strait *détente* has its theoretical underpinnings, namely the commercial peace research agenda. Revised from the democratic peace research program, which emphasizes that democratic countries have the ability to promote peace among themselves, the commercial peace literature argues that economic institutions associated with these democracies and frequent commercial exchanges among them create the space for political stabilization among these countries.<sup>37</sup> If we apply the logic of commercial peace studies to cross-Strait relations under Ma's presidency, there are reasons for optimism. As noted above, cross-Strait exchanges with regard to trade, capital, and personnel have been boosted to an unprecedented level. At the same time, the economic system in China has been transformed into a capitalist economy and the market mechanism has been the major institution to coordinate domestic economic activities.<sup>38</sup> Together, these two trends have further integrated economic activities across the Taiwan Strait to the degree that neither side would escalate political tension in cross-Strait relations. Yet the findings of this chapter suggest that caution is warranted in interpreting the effect of economic integration on cross-Strait peaceful development during Ma's presidency.

While international trade is said to promote the welfare of the country as a whole, individuals within the country experience different impacts, depending on whether they work for sectors with comparative advantages. In other words, international trade generates a distributional issue that creates winners and losers within a country. As a result, political rivalry associated with the trade issue is heightened when both groups try to lobby and influence decision makers.<sup>39</sup> In this respect trade politics in Taiwan is no exception, especially when the Chinese political-economic system is dominated by a strong SOE sector, as mentioned in the previous section. As deepening economic ties with China were the hallmark of Ma's presidency, his party, the KMT, experienced a difficult situation during the Sunflower Movement protests and suffered an overwhelming election defeat in 2014 and again in January 2016.<sup>40</sup> Three key aspects derived from this study help us understand the public backlash against Ma's economic engagement with China.

First, the visible hand of the Chinese state causes concerns about fair market competition in Taiwan. As noted earlier, China's state capitalist regime favors the SOE sector at the expense of the private sector. State interference and state subsidies have facilitated the expansion of Chinese state firms not only in the domestic market but also in the global market.<sup>41</sup> The two trends in China's domestic market described by the saying "The state advances and the private sector retreats" and China's "going out policy" in the global market where SOEs have played the dominant role manifest such a discriminatory industrial policy. Certainly the Taiwanese government has also wielded power in the market and adopted industrial policy to pursue national development under state capitalism. Yet as noted above, the Taiwanese government interfered in the market without incurring ownership discrimination against private property rights. Rather, private ownership played an essential role in the course of economic development in Taiwan. As a result, whenever the Ma administration took actions to further open Taiwan's domestic market to Chinese capital, there were concerns that Chinese firms supported by state subsidies would drive out Taiwanese local private businesses.

Second, and relatedly, the distributional issue in Taiwan brought about by trade with China has worsened with the progress of economic integration across the Taiwan Strait. Although Ma's engagement policy is said to boost Taiwan's economy, the benefits of economic exchanges are not shared evenly within Taiwanese society. Income and wealth inequality has been one of the top issues in public discussions since Ma's second term started in 2012. While there is no evidence showing that widening domestic income inequality is a result of increasing cross-Strait economic integration, public sentiment toward the lack of transparency in China's political economic system is becoming even more complicated. This is largely because the new pattern of economic growth is different from what Taiwanese people ever experienced under Taiwan's state capitalism, which emphasized both high economic growth and low income inequality.

That is, the seemingly similar state capitalist regimes on both sides of the Taiwan Strait actually have divergent experiences in development. As the illustration of "the domestic version of commercial liberalism" argued by Patrick McDonald, international trade per se does not necessarily lead to peace between countries; only international trade among economies in which private ownership plays the predominant role can pacify potential military conflicts.<sup>42</sup> Seen in this light, although the Chinese government has engaged in economic liberalization for decades and although internationalist economic interests in China's domestic politics have had pacific effects on its foreign policy agenda, a preponderance of state ownership in its economy still makes economic actors in Taiwan skeptical about China's political goals in promoting cross-Strait economic exchanges. This leads us to the next point.

Last but not the least, extensive economic integration with China stimulates popular awareness of Taiwan's sovereign status. International trade leads to interdependence between/among economies and entails the issue of security externality.<sup>43</sup> Numerous studies show that in general trade among allies generates a positive security externality while trade among nonallies generates a negative security externality.<sup>44</sup> Given that China has the claim of sovereignty over Taiwan, according to a new national security law that China passed in July 2015, political rivalries between the two parties remain as intense as ever. Consequently, security concerns about growing economic dependence on China have never disappeared from Taiwan's trade politics, even under the presidencies of Lee Teng-hui and Chen Shui-bian.<sup>45</sup> Ma's engagement policy and China's increasingly active and aggressive stance on the world stage have deepened Taiwanese people's concerns about further integration. In particular, a certain percentage of Chinese investment in Taiwan comes from the state sector,<sup>46</sup> making the public in Taiwan suspect that their operations may have goals other than economic profits.

#### NOTES

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1. For works on the recent wave of state capitalism in policy-making circles, see Ian Bremmer, "The Return of State Capitalism," *Survival: Global Politics and Strategy* 50, no. 3 (2008): 55-64. See also Ian Bremmer, "State Capitalism Comes of Age: The End of the Free Market?" *Foreign Affairs* 88, no. 3 (2009): 40-55. For works on the recent wave of state capitalism in academia, see Usha C. V. Haley and George T. Haley, *Subsidies to Chinese Industry: State Capitalism, Business Strategy, and Trade Policy* (New York: Oxford University Press, 2013). See also Aldo Musacchio and Sergio G. Lazzarini, *Reinventing State Capitalism: Leviathan in Business, Brazil and Beyond* (Cambridge, MA: Harvard University Press, 2014); Kellee S. Tsai, "The Political Economy of State Capitalism and Shadow Banking in China," *Issues and Studies* 51, no. 1 (March 2015): 12-19; Barry Naughton and Kellee S. Tsai, eds., *State Capitalism, Institutional Adaptation, and the Chinese Miracle* (New York: Cambridge University Press, 2015); Benjamin L. Liebman and Curtis J. Milhaupt, eds., *Regulating the Visible Hand: The Institutional Implications of Chinese State Capitalism* (New York: Oxford University Press, 2016).

2. These four countries are known as BRIC, a term coined by the British economist Jim O'Neill.

3. Musacchio and Lazzarini, *Reinventing State Capitalism*, 1-20.

4. Yasheng Huang, *Capitalism with Chinese Characteristics: Entrepreneurship and the State* (New York: Cambridge University Press, 2008).

5. Alice H. Amsden, "Big Business and Urban Congestion in Taiwan: The Origins of Small and Regionally Decentralized Industry," *World Development* 19, no. 9 (1991): 1121-35; Wan-wen Chu, "Industrial Growth and Small and Medium-Sized Enterprises: The Case of Taiwan," paper presented at "Transitional Societies in Comparison: East Central Europe versus Taiwan," conference jointly held by the National Science Council, Republic of China, and the Academy of Sciences of the Czech Republic, in Prague, May 27-29, 1999.

6. Musacchio and Lazzarini, *Reinventing State Capitalism*, 2.
7. It is worth noting that while it is popular to label Taiwan's political economy as a developmental state, for two reasons I have adopted the label of "state capitalism" instead. The first is methodological: the core characteristic of both state capitalism and the developmental state is the prominent role of the state in the marketplace. Compared to the concept of state capitalism, the developmental state is a much narrower concept to capture the feature of state interference in economic activities, under which only a few East Asian economies are included. Using Collier and Mahon's words, both concepts have "family resemblances" and occupy different positions along the "ladder of generality." See David Collier and James E. Mahon Jr., "Conceptual 'Stretching' Revisited: Adapting Categories in Comparative Analysis," *American Political Science Review* 87, no. 4 (1993): 845–55. Second, and practically, whether or not China's political economy is development oriented, one of the main features of developmental state is still a matter of debate. Some scholars, such as Pei, argue that the Chinese state is predatory rather than developmental toward its economy. See Minxin Pei, *China's Trapped Transition: The Limits of Developmental Autocracy* (Cambridge, MA: Harvard University Press, 2006); Minxin Pei, *China's Crony Capitalism: The Dynamics of Regime Decay* (Cambridge, MA: Harvard University Press, 2016). In addition, there are academic precedents that place the developmental state in the broader category of state capitalism, as in Frieden's analysis of South Korea in the 1980s. See Jeffrey Frieden, "Third World Indebted Industrialization: International Finance and State Capitalism in Mexico, Brazil, Algeria, and South Korea," *International Organization* 35, no. 3 (1981): 407–31.
8. Edward S. Steinfeld, *Playing Our Game: Why China's Economic Rise Doesn't Threaten the West* (New York: Oxford University Press, 2010), 224–26.
9. For Leninist control in the working place in China, see Andrew G. Walder, *Communist Neotraditionalism: Work and Authority in Chinese Industry* (Berkeley: University of California Press, 1986).
10. Huang, *Capitalism with Chinese Characteristics*, 276; Sebastian Heilmann, "Regulatory Innovation by Leninist Means: Communist Party Supervision in China's Financial Industry," *China Quarterly* 181 (2005): 1–21.
11. For the details of Kuomintang's (KMT) Leninist control over Taiwan's industry during the authoritarian period, see Ming-sho Ho, "The Rise and Fall of Leninist Control in Taiwan's Industry," *China Quarterly* 189 (2007): 162–79.
12. Shelley Rigger, *Politics in Taiwan: Voting for Democracy* (London: Routledge, 1999), 64–65.
13. Musacchio and Lazzarini, *Reinventing State Capitalism*.
14. *Ibid.*
15. Yu-Shan Wu, "Taiwan's Developmental State: After the Economic and Political Turmoil," *Asian Survey* 47, no. 6 (2007): 977–1001.
16. On the domestic debate over the Taiwan issue, see Thomas J. Christensen, *Useful Adversaries: Grand Strategy, Domestic Mobilization, and Sino-American Conflict, 1947–1958* (Princeton, NJ: Princeton University Press, 1996).
17. On Sino-US rapprochement, see Warren I. Cohen, *America's Response to China: A History of Sino-American Relations*, 4th ed. (New York: Columbia University Press, 2000), 195–210.
18. Alice H. Amsden, "The State and Taiwan's Economic Development," in *Bringing the State Back In*, ed. Peter B. Evans, Dietrich Rueschemeyer, and Theda Skocpol (New York: Cambridge University Press, 1985), 90–94.
19. Cohen, *America's Response to China*, 183.
20. Stephan Haggard, *Pathways from the Periphery: The Politics of Growth in the Newly Industrializing Countries* (Ithaca, NY: Cornell University Press, 1990), 84.
21. *Ibid.*, 97. Peter Evans, *Embedded Autonomy: States and Industrial Transformation* (Princeton, NJ: Princeton University Press, 1995), 56–57.
22. Yun-han Chu, "Gua zhan jing ji yu wei quan ti zhi" [Oligopoly economy and authoritarian system], in *Long duan yu bo xiao: Wei quan ti zhi de zheng zhi jing ji fen xi* [Monopoly and exploitation:

The political economic analysis of authoritarian systems], ed. Zhong Gji Wu (Taipei: Taiwan Research Fund, 1989).

23. Haggard, *Pathways from the Periphery*.
24. Evans, *Embedded Autonomy*, 12–13.
25. According to Musacchio and Lazzarini, the type of “leviathan as a majority investor,” differing from the type of “leviathan as an entrepreneur” in that the state has full control over and ownership of the state sector, exemplifies a transformation in the relationship between the state and its firms. That is, “The government corporatizes or lists firms on stock exchanges . . . in which the state retains control while attracting minority private investors.” This is what the Chinese central government has done in the reform program of corporatization. See Musacchio and Lazzarini, *Reinventing State Capitalism*, 8.
26. Zhijun Ling, *Chen fu: Zhongguo jingji gaige beiwanglu (1989–1997)* [Ups and downs: The memorandum of China’s economic reform (1989–1997)] (Beijing: People Daily Press, 2011).
27. For the impact of the Tiananmen incident on the interactions between China and the West, especially Sino-US relations, see Cohen, *America’s Response to China*, 211–42.
28. On how this debate evolved, see John J. Mearsheimer, *The Tragedy of Great Power Politics* (New York: Norton, 2001). See also Aaron L. Friedberg, *A Contest for Supremacy: China, America, and the Struggle for Mastery in Asia* (New York: Norton, 2012); Adam P. Liff and G. John Ikenberry, “Racing toward Tragedy: China’s Rise, Military Competition in the Asia Pacific, and the Security Dilemma,” *International Security* 39, no. 2 (2014): 52–91.
29. Bruce J. Dickson, *Wealth into Power: The Communist Party’s Embrace of China’s Private Sector* (New York: Cambridge University Press, 2008), 34.
30. For various strategies of wearing a red hat, see Kellee S. Tsai, *Capitalism without Democracy: The Private Sector in Contemporary China* (Ithaca, NY: Cornell University Press, 2007).
31. For an in-depth analysis of “The state advances, the private sector retreats,” see Sheng Hong and Zhao Nong, *China’s State-Owned Enterprises: Nature Performance and Reform* (Singapore: World Scientific Press, 2013), 125–56.
32. Sarah Eaton, “Political Economy of the Advancing State: The Case of China’s Airlines Reform,” *China Journal* 69 (2013): 64–86.
33. Huang, *Capitalism with Chinese Characteristics*, 278–85.
34. See Kathleen Thelen, *Varieties of Liberalization and the New Politics of Social Solidarity* (New York: Cambridge University Press, 2014).
35. On the positive results of Ma’s cross-strait policies, see Office of the President, ROC, *Policy Standpoints*, January 21, 2016, <http://english.president.gov.tw/Default.aspx?tabid=491&itemid=36626&rmid=2355>.
36. See Richard Weixing Hu, “Taiwan Strait Détente and the Changing Role of the United States in Cross-Strait Relations,” *China Information* 27, no. 1 (2012): 31–50.
37. For a literature review on commercial peace in the international relations field, see Scott L. Kastner, *Political Conflict and Economic Interdependence across the Taiwan Strait and Beyond* (Stanford, CA: Stanford University Press, 2009). See also Patrick J. McDonald, *The Invisible Hand of Peace: Capitalism, The War Machine, and International Relations Theory* (New York: Cambridge University Press, 2009).
38. János Kornai, “What the Change of System from Socialism to Capitalism Does and Does Not Mean,” *Journal of Economic Perspectives* 14, no. 1 (2000): 27–42. See also Edward S. Steinfeld, “Moving beyond Transition in China: Financial Reform and the Political Economy of Declining Growth,” *Comparative Politics* 34, no. 4 (2002): 379–98.
39. For a detailed study of trade politics, see Michael J. Hiscox, *International Trade and Political Conflict: Commerce, Coalitions, and Mobility* (Princeton, NJ: Princeton University Press, 2002).
40. The Sunflower Movement was a student-led protest against the Cross-Strait Service Trade Agreement.

41. Haley and Haley, *Subsidies to Chinese Industry*.
42. McDonald, *Invisible Hand of Peace*, 263. However, McDonald argues that “economic liberalization has promoted peace in the Straits and helped to limit some of the conflict-heightening pressures unleashed by democratization.”
43. For security externality of free trade, see Joanne Gowa and Edward D. Mansfield, “Power Politics and International Trade,” *American Political Science Review* 87, no. 2 (1993): 408–20.
44. See Edward D. Mansfield and Jon C. Pevehouse, “Trade Blocs, Trade Flows, and International Conflict,” *International Organization* 54, no. 4 (2000): 775–808. See also Joanne Gowa and Edward D. Mansfield, “Alliances, Imperfect Markets, and Major-Power Trade,” *International Organization* 58, no. 4 (2004): 775–805.
45. For details on Taiwan’s security concerns for economic integration with China and its changing policy toward China, see Kastner, *Political Conflict*, 42–75.
46. There are no official statistical data on the ownership types of Chinese capital in Taiwan.