Governance Crisis and the Transformation of East Asian Capitalism*

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In 1997, the Asian economic crisis, initially spawned in Thailand, debilitated the miracle economies of East Asia. Even though East Asian countries bounced back with remarkable agility and quickly climbed up the other side of their V-shaped economic growth curve, their resilience is yet to be assured. This study argues that the state as the main governing mechanism lost its institutional capacity as a locus of governance in the face of globalization and financial liberalization. A governance crisis occurs when the state's monitoring and disciplinary capacities become weak and its credible commitment to ensure a secure economic development becomes severely challenged. Ultimately, the state as a governing mechanism needs to address its capacity problems in order to return to a path of sustainable growth and move towards liberal capitalism. However, because of a web of socio-political networks and contingent historical experiences, the extent to which the East Asian model of capitalism will transform into the Western model of liberal capitalism is limited.

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INTRODUCTION

The economic crisis, initially spawned in Thailand in 1997, spread to neighboring countries of Southeast Asia and eventually triggered serious turmoil for the miracle economies of East Asia. Even the resilient economies of Singapore, Taiwan and Hong Kong showed related problems, slowly being eroded by the persistent weaknesses of their neighboring Asian economies. Thus, economic growth in the so-called four East Asian tigers hit its lowest level since World War II at negative 1.4 percent in 1998. However, after a period of unprecedented economic turmoil, a few encouraging signs of recovery slowly emerged in Asia. The Asian Development Bank recently announced that the Asian economic growth rate will rise to an average of 6.9 percent this year, compared with 6.1 percent in 1999 (Financial Times, September 19, 2000).

Asian countries bounced back with remarkable agility and quickly climbed up the other side of their V-shaped economic growth curve. But, perhaps the optimistic v-shaped recovery of the past two years was a bit premature. The beginning of new economic troubles has emerged across the region, notably in Thailand, Indonesia, and to a lesser degree in the Philippines. Among the three East Asian countries, South Korea is not expected to have a severe recession, much like the one it experienced after the 1997 financial crisis, but an economic slowdown. The Japanese economy appears to be improving, but it is still far too early to assure that there is a strong recovery under way. Taiwan shows clear signs of an economic downturn, including a downturn in the semiconductor business cycle, depressing currency, and rising non-performing loans.

The signs of recovery were precarious from the start because they were based on expectations resulting from the government's macroeconomic expansionary policies and stimulation measures. East Asian countries such as Korea and Japan have not yet made much progress towards addressing both inherent and structural flaws that gave rise to the crisis in the first place. Taiwan initially escaped the worst aspects of the regional crisis, but faces new challenges due to the minority government and its limited capacity in governing the national economy. Furthermore, the three economies are still contingent on such external factors as the sustainability of the ongoing boom in the U. S. economy, the prospect of the European Union economy, the stability of oil prices, and the vulnerability of South American economies to external shocks. The timing and strength of the recovery certainly depend to some extent on developments in the Asia region as a whole as well as on global and structural economic conditions.

There have been numerous debates over the East Asian model of capitalism, as a quest to find reasons for the economic crisis and ways to return to a sustainable growth path (Chang et al. 1998; Haggard 2000; Jomo 1998; H. Kim et al. 2000; Mathews 1998; Pempel et al. 1999). The most contentious debate is on the root cause of the crisis. Some point to the institutional weaknesses of the so-called crony capitalism as a root cause. The institutional weaknesses include the collusive state-business alliance, an opaque and poorly regulated financial system, government-controlled mechanisms for the allocation of capital, and non-transparent corporate governance. Others argue

that market failures in over-liquidated and under-regulated financial markets resulted in an over-reliance on short-term foreign capital and speculative investments. This view emphasizes that the devastating force of international capital led to a series of economic crises in East Asia.

In searching for the cause of the crisis, this study attempts to address the following questions in relation to the future of East Asian capitalism. How vulnerable is the model of East Asian capitalism to external shocks? How resilient is the East Asian model as an economic governance system? Will the East Asian model of capitalism be transformed into the Western model of liberal capitalism? And finally, what role will the state play in the transformation of the East Asian model of capitalism?

This study attempts to answer these questions by suggesting that the state as the main governing mechanism lost its institutional capacity as a locus of economic governance in the face of globalization and financial liberalization (H. Kim 2000b). Furthermore, this study suggests that the diversity of capitalism will remain in the East Asian region although elements of liberal capitalism are evident in the reforming process. This is because inertia of historical and institutional contingencies over time in East Asia will not be changed in a short period of time even during the period of economic turmoil. This study finally argues that the state needs to have salience and should remain an important actor even in the structural reform of economic governance in East Asia. An analysis of economic governance should illuminate the unique nature of East Asian capitalism and assist us in understanding the origins of the economic crisis in this region.

EAST ASIAN ECONOMIC CRISES

In late 1997, the Korean economy suffered a currency crisis that was in part instigated by the broader Asian financial crises. However, well before the crisis, South Korea had various fundamental flaws in the national economy: debt financing and cross-shareholdings by major conglomerates, non-performing loans by financial institutions, and highly leveraged business groups and financial institutions (H. Kim 2000c). More importantly, financial liberalization and the movement of massive capital across national borders had shifted the South Korean government out of its dominant position as the center point of economic governance.

Consequently, the 1997 crisis in South Korea brought an end to the prosperous era of \$10,000 per capita income, as the nation's per capita GNP declined to 9.78 percent that year. More significantly, the nation's economic growth rate shrank from 5.0 percent in 1997 to negative 6.7 percent in 1998. The unemployment rate, which had fallen close to 2 percent prior to the crisis, increased to 8.6 percent at the beginning of 1999 and dropped to 3.4 percent in 2000.¹ In view of these apparent economic troubles,

¹ The employment rate could rise sharply again if more bankruptcies occur as a result of an expected slowdown in economic growth next year. For example, the collapse of Hyundai Engineering & Construction would cause more than a half million of job losses if we include subcontractors.

the Korean government can no longer avoid a comprehensive reform program in the financial sector, the corporate sector, and the public sector. After implementing reform programs, introduced in 1998 when Dae-jung Kim came to power, South Korea bounced back on track showing a 10.7 percent growth rate in 1999. But the Korean economy is already showing signs of slowing down, after the crisp v-shaped recovery of the past two years.

Japan maintained an average GDP growth rate of 9.7 percent between 1956 and 1973, and 4.1 percent between 1975 and 1991 even after the oil crisis (Katz 1998). But Japan's economy has shown trouble ever since the inflated "bubble" prices tumbled in the beginning of the 1990s. Since the collapse of the 1980s "bubble" in asset prices, economic growth in Japan slumped to 1 percent or less a year during the period of 1990s and has not yet created an economic structure adjustable to the rapidly changing modern economy in a competitive global market. Because of the lingering effect of asset price deflation, Japan is grappling with a banking crisis that has threatened to overwhelm the financial system and undermine its powerful industrial base. Furthermore, the corporate sector is still facing serious challenges to overcome the excess capacity and debt created during the 1980's "bubble". Because of the economic recession in Japan, unemployment was at a post-war record level of almost 5.0 percent and monthly corporate bankruptcies were at an all-time high in 1998. With both increasing unemployment and corporate bankruptcies, Japan experienced two consecutive years of negative growth not seen in two decades.

The Japanese government thus attempted to implement various structural reforms to stabilize the economy and financial markets, mainly through fiscal spending. For this, Japan has allocated massive stimulus packages worth 117 trillion yen since 1992. The government was set to use a supplementary spending package worth some 4 trillion yen this year. With these reforms, Japan's economy was assumed to reach a critical turning point in 1999. The Economic Planning Agency in Japan released the growth rate for the fiscal year of 1999 to March 2000 which had risen to 1.4 percent (Financial Times, November 25/6, 2000). But there is little sign of higher growth yet. It is also not yet clear whether a recovery will be sustainable. One certainty is that Japan needs to consistently commit to the regulatory reform in order to return to a sustainable long-term growth path.

In contrast, Taiwan's economy has escaped relatively unscathed and has performed well on most measures, even during the devastating earthquake that hit central Taiwan in 1999. Unlike Japan and South Korea, Taiwan's economy has been skillfully managed through a combination of tight exchange controls, low foreign debt, and conservative fiscal policies. Furthermore, the Taiwanese economy has continually adjusted itself to the production of higher value-added products produced by a large population of small-and medium-sized enterprises (H. Kim 1993).

Nonetheless, the Taiwanese economy was affected by the Asian crisis. Taiwan's GDP growth slowed to 4.7 percent in 1998 while Japan and South Korea recorded negative

growth. This growth may have been good by regional standards, but it was the slowest recorded in 16 years. In addition, Taiwan's volume of exports decreased and showed its first negative growth in the last decade. Despite all of these crisis-related problems, the Taiwanese economy has performed remarkably well on most measures. Thus it is expected to increase its GDP growth rate to the upper 6 percent this year. However, Taiwan is now forced to address new challenges, including the trade slump, the shortage of experienced labor in the electronics sector, sluggish traditional industries, rising non-performing loans, and weaknesses in the financial sector.

GOVERNANCE CRISIS AND THE TRANSFORMATION OF EAST ASIAN CAPITALISM

Governance as a user-friendly "umbrella" concept (Frischak 1994) generally refers to how institutional relations in society are organized. In relation to this paper, this term is being defined to refer to the capacity of governments to formulate and implement sound policies in the management of a country's economic resources and to credibly ensure a secure environment for economic transactions for development (Dhonte and Kapur 1996; Frischak 1994; Frischak and Atiyas 1996; Kauffmann et al., 1999; H. Kim 2000b,c; Kooiman et al. 1993; Williamson 1996; World Bank, 1992, 1). Although similarities among the three East Asian countries - South Korea, Taiwan, and Japan - might suggest a convergence toward a uniform East Asian capitalism, the three countries have actually shown different trajectories of development (H. Kim 1993, 1994). There have been considerable variations in the form of economic governance of the national economy: namely, *chaebol* capitalism in South Korea (Amsden 1989; E. Kim 1997; H. Kim 1998, 2000a), family capitalism in Taiwan (Greenhalgh 1988; Redding 1990; Wong 1985), and alliance capitalism in Japan (Fruin 1994; Gerlach 1992).

This paper will argue that divergence in the governance mode of the national economy is constituted and shaped by the embodiment of state capacity (H. Kim 1994, 2000b). This study will also argue that the economic crisis stems from the state's inability to adequately and successfully fulfill its capacity in response to the rapidly changing environment of globalization and financial liberalization. State capacity basically refers to the ability of the state and its bureaucracy, through a centralized chain of command, to formulate and implement economic policies and enforce monitoring and disciplinary actions on economic actors and activities. State capacity could also be enhanced to include governance over the activities of the private sector in an economy, derived from the institutional link between the state and the private sector. The institutional linkage between the state and the private sector can be understood as a form of economic governance through which both sides interact to address the market failures in various forms (Hollingsworth and Lindberg 1994; H. Kim 2000b).

Korean Economic Governance in Transition

In each decade since 1960, South Korea has tripled the size of its economy. South Korea successfully developed a distinctive economic governance structure during its period of economic growth.² The concentration of state bureaucratic power, the dominant position of the state in relation to the private sector, and its relative autonomy from societal pressures helped to explain the dirigist approach to industrial transformation (H. Kim 1994). During the period of economic growth, the South Korean government extensively employed a wide range of tactics to ensure the private industry's compliance with its plans. Among them, the most widely used strategy was the allocation of credit through the control of commercial and special banks (Cho 1997). Under these circumstances, access to a stable and low-cost source of credit was considered crucial for the private sector throughout the high economic growth period.

However, by mid-1997, various fundamental problems in the national economy, such as debt financing and cross-shareholdings by major business groups and the accumulation of non-performing loans by financial institutions, had surfaced. Under the umbrella of government protection, banks and other financial institutions indulged in questionable lending practices, while big businesses or *chaebol* pursued excessively leveraged expansion. As a result, South Korea faced austere measures prescribed by the IMF program in 1997. Also, the sustainability of rapid economic growth in South Korea has been widely challenged by rising inflation, bankruptcies, unemployment, and an unstable currency.

The economic governance constructed throughout the past several decades began to display its weaknesses.³ Korea's state capacity problems began when the state bureaucracy lost its centrality in maintaining a secure and consistent macro-economic environment. While making efforts to overcome the difficulties that arose following its admission into the OECD, the state failed to maintain its monitoring and disciplinary functions as a locus of economic management in the face of financial liberalization (Lee and Kim 2000). Furthermore, uncertainty and lack of coordination between ministries intensified intra-bureaucratic conflicts and led to inconsistency and unpredictability in government policy, thus the state lost credibility in sustaining a secure economic environment. The advancement of political liberalization in the early 1990s, as well as the deterioration of state capacity also coincided with growing weaknesses in state capacity to coordinate the private sector in the policy-making process.

This is in part due to the expansion of the private sector. The private sector of *chaebol*, in terms of both size and power, eroded the ability of the state to function in its past strong-armed fashion. The *chaebol* sector, in particular, succeeded in transforming a hierarchical relationship to a symbiotic one so that the articulation of big business interests grew stronger (E. Kim 1997). As manifested in the frequent changes in economic policies,

² I extensively examined the historical shaping and structuring of economic governance for the last half century in the paper (H. Kim 2000a).

³ I investigated in detail the fundamental flaws accumulated in the Korean economic governance in the paper (H. Kim 2000c).

the growth-oriented policy network was transformed into the rent-oriented policy network in which the private sector heavily penetrated the formulation and implementation of economic policies (H. Kim 2000b). This becomes evident when the government ordered to reduce their debt-equity ratios from the reckless heights of 500 percent to below 200 percent. But *chaebol* found ways to resist by engaging massive share issues to lower their debt-equity ratio, while achieving little in cutting its total debt. In consequence, the *chaebol* sector increased cross-shareholdings among group subsidiaries so that its internal shareholding increased on average from 27.2 percent at the end of 1998 to 34.6 percent in 1999.

The immediate fear is that the country's industrial giants, including the Daewoo and Hyundai groups, are on the verge of collapse due to debt burdens exacerbated by the failure of state-led reform. The collapse of the Daewoo group⁴, with record breaking debts of 80 trillion won, has placed further burdens on the financial markets. Banks also worry that weak balance sheets would make them the target of a state-led consolidation of the banking industry. In addition, the Hyundai group, with total debts of 5.2 trillion won, may retrace the demise of the Daewoo group. The government prefers not to deal with the unravelling of Hyundai Engineering & Construction at the same time it faces Daewoo Motor collapsing.⁵ The government fears that the failure to roll over maturing corporate debt would trigger a new series of bankruptcies that would further weaken the financial institutions.⁶ For this, the government is preparing to inject another 40 trillion won in public money into weak financial institutions this year on top of more than 100 trillion won already spent.⁷

The root of the economic turmoil in South Korea lies in the unique system of economic governance created throughout the past several decades (H. Kim 2000c). Signs that economic growth was regaining momentum became increasingly evident in 1999. This was partly due to the strong efforts of the Korean government to implement far-reaching macroeconomic measures and structural reforms in the financial and corporate sectors as well as in the labor market. However, resistance by the corporate and public sectors, labor unrest, and moral hazards in the financial institutions have remained major obstacles in the reforming process.

It is thus unclear whether both the government and the corporate sector will go far or fast enough in reforming Korean economic governance. Although major reforms

⁴ Even though the collapse of the Daewoo group negatively affected the national economy, it was seen as contributing to the economy in two positive ways: one is seen as an end to the myth that *chaebol* were too big to fail; the other as an encouraging sign for a reform drive.

⁵ The failure of state-led reform regarding Hyundai Engineering & Construction stands to have a series of repercussions. The apparent one is that it is likely to undermine investor confidence in the program of corporate reform.

⁶ It is generally estimated that Korea will be burdened with 80 trillion won of corporate bonds that must be financed by the end of next year. It is also speculated that the level of non-performing loans in the Korean banking sector could rise to 190 trillion won next year if the government keep forcing non-viable companies into liquidation.

⁷ An extra 40 trillion won in public money to recapitalize the finance industry would carry political risks for the government. However, it would not be excessive since public debt was just 40 percent of gross domestic product at the end of 1999. This figure is well below the average for OECD countries (Far Eastern Economic Review, vol. 165: 74).

are gearing toward the implementation of the global standards of liberal capitalism such as transparency, the removal of moral hazard, and a regulatory regime rather than an interventionist one, the basic institutional scheme remains largely in tact. In the process of reformation, the government might simply adopt a strategy of fiscal spending and stimulus packages, similar to the strategy being used by Japan. Instead, the government needs to deal with complacency engendered by the recovery, make a renewed push for corporate restructuring, and finally restore confidence in the financial markets. In the process, the government should enhance its institutional capacity by establishing a suitable and sound regulatory framework for comprehensive reform efforts. If successfully accomplished, state capacity will be properly reshaped in a way to credibly ensure a secure environment for economic transactions in a market economy without losing a locus of economic governance.

Japanese Economic Governance in Transition

Japan's economic growth has been based on a model of government-regulated capitalism. During this period, much emphasis was placed on the governing triad of interlocked private, political, and public institutions - large industrial and financial enterprises, the Liberal Democratic Party (LDP), and the economic ministries which shared a common regard for the importance of aggregate economic performance (Katz 1998; Stockwin 1988). This exclusive coalition had the ability to arrive at a shared consensus about basic macro-economic goals, and this Japanese bureaucratic system of "administrative guidance" was a hallmark of Japan's political economy. After several decades, however, the coherence and concentration of the bureaucracy in initiating and implementing a state development strategy became increasingly diffused. Moreover, with increased economic power, the corporate sector became less dependent on the state bureaucracy in making its own investment decisions. In addition, political parties and other sectors of society began chipping away at the dominance of bureaucracy over economic policy-making itself.

In particular, the institutional linkage between the state and the private sector, which was based on its structural interdependence through a stable long-term relationship (Dore 1986; Imai and Itami 1984; Okimoto 1989), exemplified the problem of structural rigidity in the face of globalization. State and business were informally bound together over a long period of time through interactive and consensual practices. In this policy network, business interests were both formally and informally integrated into bureaucratically sponsored negotiations by consultation and a consensus building process. Although this network worked in a way to provide the private sector ad hoc or informal advice from ministries, it became problematic particularly for international businesses lacking the established bureaucratic relationships, and for domestic businesses preferring a less opaque system. In other words, both domestic and international businesses wanted to establish predictability through a clear regulatory framework as well as deregulation to enhance flexibility in a competitive global market.

The Japanese bureaucracy was politically insulated from the legislature and other social forces, like those of South Korea and Taiwan. However, Japan differed from both South Korea and Taiwan in that emphasis was given to the equal relationship between the bureaucracy and special interest groups (Johnson 1982; Wade 1990). This produced institutional legitimacy for the creation of formal mechanisms of exchange between the government and social interest groups excluding labor (H. Kim 1994, 2000b; Pempel and Tsunekawa 1979; Pempel et al. 1999). Formal inclusion of interest groups in both policy formation and implementation became a distinctive characteristic of the Japanese system. The government did not act until there was enough agreement between the government and the concerned party. The process of policy-making on the basis of mutual consensus became so complex that a great deal of time was lost building up consensus, which in turn resulted in ill-timed policy implementation and subsequent policy failures.

Although the Japanese government has successfully kept its economy from reaching the stage of complete collapse, its policy tools have appeared increasingly ineffective since the early 1990s. Moreover, the state bureaucracy, which has effectively run the country for five decades since 1955, is in growing disarray due to recent failures in the expansionary macroeconomic management policy and successive corruption scandals. The Hashimoto, Obuchi, and Mori Cabinets undertook the long-delayed fiscal and financial reforms on non-performing loans by spending massive stimulus packages of 117 trillion yen since 1992. In particular, in the past two years, the government forced the financial institutions to deal with their mountain of bad loans by injecting a 70 trillion yen banking support package. As a result, the economy appears to be improving, but it is still unclear whether there is a strong recovery under way.

Considerable work remains to be done in order to make a sound transition in the economy. Bureaucratic mismanagement led many to believe that the state bureaucracy was incapable of responding quickly to the rapidly changing economic environment of globalization and financial liberalization. Since the bureaucrats lost the initiative in managing economic problems, responsibility was left to the politicians to devise policies. It was the LDP that presided over the "bubble" economy and led Japan into a recession. Motivated by electoral concerns, the LDP has fallen back on the traditional and conservative policy responses of bank bail-out programs and spending packages. The LDP was firmly enmeshed in a web of financial and political constituency of farmers, small retailers, and construction companies that were adversely affected by liberalization of their markets in the reform process. Although the LDP has produced reforms recently, these have usually arrived in response to a demand from traditional vested interests and were mostly based on high fiscal spending.

After many delays and false starts, Japan's plans for restructuring its economic system seem to be getting under way. Real progress in financial reforms and corporate restructuring, combined with a further loosening of fiscal policy, put Japan back onto a growth path.⁸ However, there are growing concerns over fiscal spending and its related debt problem, as well as over growing polarization across the economy. Debt to gross domestic

product is projected to be 130 percent by the end of this year.⁹ Also there is a growing concern about polarization across the economy: industrial production and corporate profits have been surging for large companies, while profits have been gloomy for small ones.

To tackle these growing concerns, Japan needs to move towards a more flexible and market-driven economy by developing credible policies as well as an efficient mode of implementation for the reform and liberalization of the financial sector.¹⁰ In addition, the factional politics in the LDP in favor of policy status quo, associated with slow reform and high fiscal spending, should be eliminated to implement comprehensive structural reforms of deregulation and financial liberalization for a vibrant Japanese economy. In the process, the policy patterns of protectionism and patronage to reflect the interests of the party's key political constituencies need to be changed to adopt the global standards of liberal capitalism. Finally, the government should resort not to the bureaucratic system of administrative guidance, but to clear and transparent regulatory schemes for business. In general, the Japanese government needs to have salience as a locus of economic governance in the reform process.

Taiwanese Economic Governance in Transition

The Taiwanese economy has maintained high growth for the last few decades and initially escaped the worst aspects of the regional crisis. This has been done through a less centralized bureaucracy, with power over industrial policy issues dispersed among more ministries and agencies than those of South Korea or Japan (H. Kim 1994, 2000b; Wade 1990). The state agencies have played mostly an advisory role in the policy process. While relying less on selective credit, the Taiwanese government has relied more on arms-length fiscal and trade instruments as well as infrastructure investments to steer private firms. The government has also used more state-owned enterprises to develop selected industries rather than create "national champions" of large private firms. Considering that state planning has usually been done in a loose, non-command style, there has been no rigorous enforcement of obligations via compulsion in state planning (Hamilton and Biggart 1988; H. Kim 1994). The state economic bureaucracy has less authoritatively and forcibly asserted substantial influence over the national economy, compared with the bureaucracies of Japan and South Korea.

Driven by an anti-big business capitalist stance and fear of the political potential of native Taiwanese economic power, the government has developed a weak policy network

⁹ The government has forced the large banking sector to merge. For example, there are now four main merged groups: a financial group of Sumitomo Bank and Sakura group, a group of Industrial Bank of Japan, Dai-ichi Kangyo and Fuji bank, a group of Sanwa, and Tokai; and the Bank of Tokyo Mitsubishi. The government has also encouraged the bank sector to open up its operations. In addition, entry barrier into the protected financial sector has now been cleared so that a host of foreign banks and brokers have purchased domestic rivals, increasing their market share in Japan.

¹⁰ Even though such a figure would be the highest in the industrialized world, Japan is confident that the government could easily fund the government's debt. This confidence is in part based on the level of assets that the government holds.

¹¹ Since the estimate of bad loans is still far too small, it is going to be a constant source of problems. Furthermore, the giant banking mergers have not yet removed much excess capacity.

(Cheng 1990; H. Kim 1994, 2000b; Wade 1990). The government has also discouraged the formation of large-scale organizations and the accumulation of economic power in private hands. Thus, the state and the private sector have remained apart. This lack of an extensive web of channels to the private sector has constrained state officials in initiating and implementing a state development strategy. Within this thin policy network with the private sector, the government only gets information about the production capability of individual firms through such means as the export quality control scheme, the loan guarantee scheme, and the external marketing agency (Wade 1990). On the basis of this information, the government undertakes administrative guidance over private investment decisions. State-private sector negotiations are, thus, event-based and take place with individual firms rather than with aggregations of firms.

Another feature distinct to Taiwanese society is that the separation between political power and wealth roughly parallels the ethnic cleavage between the Mainlanders and the Taiwanese (H. Kim 1994, 2000b). But this has dramatically changed after the March presidential election victory of Chen Shui-bian and his Democratic Progressive party, resulting in the end of more than half a century of rule by the Nationalist party. The transfer of power has in turn brought a new tension between Taipei and Beijing as well as between Taiwanese and mainlanders. Furthermore, the minority government searching for Taiwanese identity and independence has much to contend within a hostile legislature, which in turn forces the government to pay more attention to elections which are to be held late next year in 2001.

In the face of the current financial and economic crises of the Asian region, Taiwan has not yet developed serious symptoms of the crisis. The resilience of the Taiwanese economy has been based on its small and medium-scale businesses accounting for more than half of total production (H. Kim 1993). Unlike the rigidly controlled and vertically integrated *chaebol* in Korea, the Taiwanese economy has been characterized as having loosely coupled networks of small and medium-scale family businesses (Greenhalgh 1988; Wong 1985). But this form of family capitalism in Taiwan is fragile since it is quite sensitive to the frequently changing pattern of global demands. In addition, strategic industries have been governed by the public sector, composed of mostly upstream industries like energy, heavy machinery, shipbuilding, and steel, which have proven to be the most inefficient sectors in the economy. The use of state-owned enterprises as an instrument to develop strategic industries became an impediment for further development of the Taiwanese economy. Once accounting for more than half of the GNP, the state-owned enterprises have accounted for just over 10 percent in recent years. Unless this sector is decentralized and state involvement in these private sector industries is reduced, there is the threat of a future crisis.

Furthermore, the Taiwanese economy faces new challenges including a growing polarization across the economy and an emerging weakness in the financial sector. While the electronics sector is proving to be an engine of growth, the sluggish traditional industries are seen as a source of trouble. In addition to polarization, the dynamic electronics sector which accounts for more than 30 percent of Taiwanese exports, faces a slowing

global demand for exports, a shortage of skilled labor, and a narrowing profit margin. The traditional old economy has shown poor corporate governance and rising costs in a competitive market. In addition, the financial liberalization which began in the early 1990s has eventually caused a series of problems. For example, average non-performing loans hit a record 5.36 percent of total commercial bank lending (Financial Times November 30, 2000). The regional banking sector, which is small in terms of total assets, has been poorly managed and overcrowded. Recent failures of a few regional small banks have cut down confidence in the market.

Frictions between executives and lawmakers, as well as a lack of coordination within the framework of thin policy network, have had a chilling effect on investor confidence, with the stock market falling by 50 percent this year. Heavy reliance upon the export market and fluctuations in the regional economy are now creating unprecedented challenges. The minority government, together with the private sector, must immediately deal with the new challenges including a downturn in the semi-conductor cycle, rising bad loans, depressing currency, and weaknesses in the financial sector. Since the minority government has yet to find a coherent voice on economic policy, it urgently needs to enhance its bureaucratic capacity to formulate and implement sound policies. The government will also need to address the issue of uncertainty and lack of coordination with the legislature in order to set a clear sense of priorities in the reform process and eventually to ensure a secure and credible economic environment. In short, sources of flexibility and dynamism in Taiwanese economic governance need to be further evaluated in the face of the East Asian economic crisis.

CONCLUSION

The 1997 economic crisis in the region led to the belief that the state, as the main governing mechanism in the East Asian development model, lost its capacity as a locus of economic governance. Specifically, this study argues that the economic crisis exposed the problems of state capacity in the region of East Asia. These economies have experienced severe setbacks because of the weakening capacity of their states to credibly ensure a secure economic environment. The governance crisis of East Asian capitalism took place because the state's monitoring and disciplinary capacities became weak and failed to adjust to the rapidly changing environment. In general, crisis ensues when the state's economic policies become unpredictable and inconsistent due to intra-bureaucratic conflicts and mismanagement of proper regulatory systems, and when the state's coordination with the private sector is transformed into a rent-oriented network where the private sector heavily influences economic policies (H. Kim 2000b). In the face of crisis, East Asian states need to undertake real reform that requires much more political will and a clear sense of priorities in order to enhance their institutional capacities of economic governance.

We must carefully examine the present economic conditions, their modes of governance,

and their state capacities to determine whether or not the East Asian model of capitalism is coming to an end. Although major reforms shift toward global standards of liberal capitalism, the basic institutional structure of the East Asian states remains largely in tact. In the process of reformation, the state as a governing mechanism needs to address its capacity problems in the wake of the economic crisis and perhaps find a new path toward sustainable economic growth. Specifically, the state needs to enhance its monitoring and disciplinary capacity as a locus of economic governance, restore credible commitment in the process of policy implementation, and establish a system in which the state is not captive to vested interests.

At the current stage, one may not be able to conclude whether the East Asian form of capitalism will evolve into the Western model of liberal capitalism. As long as Confucian-authoritarian and familial values remain influential (H. Kim 1998, 2000c), the public demand for market democratization will remain unsolved and the diversity of capitalism will still remain (Lee and Kim 2000). What is certain is that the state needs to enhance its capacity as a locus of economic governance if it wants to successfully implement the structural economic reforms of liberal capitalism. Because of a web of socio-political networks and contingent historical experience, the extent to which the East Asian model of capitalism will transform into the Western model of liberal capitalism is limited.

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