Building the Diverse Community

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Can Taiwan's Pattern of Financial Deregulation be Instructive for Market Reforms in Mainland Chinese Financial Sector?

Ongoing debate in Mainland China on the need to free exchange and interest rates, the recent inauguration of the Shanghai Free Trade Zone as well as the plans of the fifth generation of Chinese leaders to introduce more market reforms in national finance proclaimed at the Third Plenum of 18th Chinese Communist Party (CCP) Congress in November 2013, made it relevant to turn to the lessons of the 1980s successful financial liberalization in Taiwan to see if these lessons may be instructive for the new stage of market transition in the People's Republic of China (PRC).

To casual eye it may seem that the situations in Taiwan at the turn of 1970–1980s and in Mainland China today are indeed structurally very much similar. Huge trade surplus and foreign currency reserves, international pressure to appreciate national currencies, an imperative to make the banking system and investment mechanisms less rigid and more diverse to meet the need to achieve more balanced and intensive economic growth – all this seem familiar to both cases across the Taiwan Strait.

Moreover, institutional arrangements in Taiwan in the late 1970s – early 1980s and in today's PRC also look comparable. In both cases political regimes were organized in the form of Leninist party-states penetrating and controlling society from above in a pretty dictatorial, autocratic way.

To say the least, there are undeniable cultural similarities between the political and social entities across the Taiwan Strait.

The following paper will examine the systemic relevance of these similarities and possible lessons – if any – of the Taiwan's successful financial liberalization for the planned financial liberalization in Mainland China.

The first part of the paper defines basic methodological points of departure for comparative analysis of Taiwan and Mainland China's financial reforms.

The second part is devoted to the analysis of structural socio-economic and institutional prerequisites for the successful financial liberalization in Taiwan.

The third part examines fundamental features of political economy of price reform and macroeconomic dynamics in Mainland China as structural and dynamic foundations for currently debated interest and exchange rates' deregulation. The last part of the paper contains concluding remarks.

Basic methodological framework: two types of "non-democracies"

A considerable portion of applied political science literature in the second half of the 20th century was devoted to the description and definitions of non-democratic developmental regimes. The crisis of the "totalitarian" approach in late 1950s was followed by almost two decades of triumph of "social science," modernization and convergence theories. After the collapse of the Soviet Union and of the East-Central European "socialist block" the "totalitarian" approach shortly lived through a kind of "renaissance" but it quickly turned out that its traditional explanatory potential is still rather limited (Mueller 1997, p. 27–28). A. Motyl argued with good reason that "totalitarianism" is nothing like the same everywhere but constitutes rather a continuum of political systems characterized by the degree and forms of the state penetrating and monopolizing societies (Motyl 1993, p. 117–118). But it is exactly this degree and forms of state monopoly over the social and economic life in different non-democratic political entities that caused profound debates among political scientists and made it so difficult to define and explain the differences between these entities.

This paper methodologically proceeds from the approaches adopted by S. Huntington, C. Moore, J. Linz and the Hungarian school of political economy of socialism whose leading figure is J. Kornai.

S. Huntington and C. Moore argued that one-party regimes can be divided into two types: strong revolutionary and week exclusionary. The main guideline for understanding the "strength" and "weakness" of a one-party regime is exactly the degree of its political, social, economic, cultural, etc., monopoly.

The first type annihilates the opposition (quite often physically) and proclaims the aim of monopolizing society as deep as possible in the name of its thorough qualitative transformation. Empirical history testifies that the absolute majority of such regimes (with the sole exception of Nazi Germany) practice Marxist-Leninist utopia. In the course of their development these political entities go consecutively through the stages of "revolutionary transformation," "regime consolidation" and "adaptation". The last stage means gradual retreat from terror and utopia, more technocracy in leadership nominations and possible introduction of market reforms.

Exclusionary regimes may be very well dictatorial too, but they tend to exclude the opposition from the process of political decision-making without totally annihilating it and without proclaiming the aims of utopia-based qualitative social transformations. Moreover they may eventually try to co-opt some parts of the opposition into the elite, however, controlling it and preventing from undermining the leading positions of the ruling group (Huntington & Moore 1970, p. 1–50).

J. Linz openly calls revolutionary regimes "totalitarian" and exclusionary regimes "authoritarian." He defines what S. Huntington and C. Moore called "adaptation" of revolutionary regimes as "post-totalitarianism" (Linz 2000, s. 72).

For us here methodologically most important is the fact that J. Linz understands the "post-totalitarian" period of revolutionary regime development as still an integral part of the "totalitarian" stage and not as "authoritarianism."

Indeed, in a number of revolutionary regimes the stage of adaptation brought such feasible social, economic, cultural and even ideological changes that a large portion of experts was at a loss to find principal differences between the adapting revolutionary and developing exclusionary non-democratic regimes. In fact, most of "social theory," "modernization" and "convergence" approaches to the former communist systems in the Soviet Union and Central and Eastern Europe, as well as to the PRC since the start of "reform and openness" argued and go on to argue that post-Stalinism and post-Maoism respectively are nothing but a goodbye to totalitarianism and transformation to authoritarianism.

J. Linz does not sign up to such arguments and we tend to agree with him. He points to the fact that in authoritarian regimes the degree of socio-economic and cultural pluralism is usually higher than that in post-totalitarian regimes but this is not perhaps the most important factor. The really crucial moment is that for both ruling party-state and opposition in post-totalitarianism the point of departure is the previous stage of revolutionary transformation and consolidation when the party-state annihilated all important forms of socio-economic and political pluralism by means of force in the name of proclaimed "bright future."

In other words, the systemic setting was given well before and thus – according to J. Linz – there is no direct and easy-going way between post-totalitarianism (which is still the concluding stage of totalitarianism) to a authoritarian political and socio-economic arrangement. He presumes that such transformation inevitably means a sort of rupture with totalitarian structures and practices of power monopoly.

J. Linz argues in conclusion that post-totalitarianism is also actually a continuum of political regimes which may well sway from "early" to "frozen" or "mature" forms. But such sways do not mean that there is an ingrained logic of consecutive transformation from "early" to "mature" post-totalitarianism and then to authoritarianism or democracy. Some socialist countries indeed may go through all these stages but others may be locked for decades at certain junctures of transition (Linz 2000, s. 75).

Another important methodological point for our analysis is the structure and dynamics of economic monopolies of totalitarian (post-totalitarian) and authoritarian systems. Empirical history tells that strong revolutionary one-party regimes led by Marxist-Leninist utopia tend to annihilate the market as a socio-economic institution and substitute it with central planning based on party-state distribution-redistribution practices operated by means of vertical bureaucratic coordination. Such an annihilation of the market means that first of all the abolition of market pricing and the whole amount of socio-economic institutions connected to it. This revolutionary transformation that happened in some countries in the 20th century was something really brand new in the history of humankind.

According to the works of the leading figure of the Hungarian school of political economy of socialism, J. Kornai, the systemic substitution of the market by party-state bureaucratic coordination done by force puts all principal socio-economic players in the socialist economy under specific conditions of soft-budget constraint. This means that they are non-sen-

sitive to price indicators and demand constraints while the party-state is always ready to bail out their economic inefficiency. With given hard resource constraint economic growth in such a system becomes inherently extensive and resource devouring, strangulating the party-state itself in infrastructural and resource bottlenecks (Kornai 1992, p. 250–300). From the political point it is important to mention that the conditions of soft-budget constraint are not enjoyed by everybody in socialism by definition. A party-state grants these conditions only to those socio-economic players who behave according to certain political rationality, i.e. to those who do not openly oppose or deny the party-state power monopoly. All other players are either obliterated or constantly face the danger of obliteration (Csanadi 1998; 2006).

J. Kornai claims that even when market reforms are introduced in socialist economies the principle of soft-budget constraint and politically rational behavior prevails. According to him the main systemic obstacle on the way to get over such state of affairs is the political and ideological power monopoly of the ruling communist party (Kornai 1992, p. 408).

Our own research in the field of market reform limits in socialist economies brought us to the conclusion that it is exactly the party-state non-market monopolistic control over national finance as a whole (banking system, stock market, exchange and interest rates, investment mechanism, monetary policy etc.) that makes soft-budget constraint and ideological political rationality a sort of incurable sickness of post-totalitarian "market reformed" socialism (Karpov 2011a, p. 21–39; 2011b, p. 34–57).

By contrast, ruling groups in authoritarian regimes do not aim at annihilation of the market as socio-economic institution. Their purpose is to control the amount and structure of the profit extracted by different players from the existing market economy. In order to do this, they use different direct and indirect leverages such as artificial containment of investment institutions diversity, manipulating exchange and interest rates, channeling credit for certain purposes etc.

Indeed, there is no free market in most of authoritarian regimes. But from the systemic point of view the lack of a free market is not at all equal to the lack of the market as an institution.

Thus financial liberalization in authoritarian regimes and in post-totalitarian regimes means essentially adifferent nature of the tasks facing the respective political structures.

In the case of authoritarian financial liberalization, the ruling elite and opposition have to agree on the terms of abolishing state control over

the structure and amount of the profit extracted from the already existing market economy.

In the case of post-totalitarian financial liberalization party-state and potential opposition face the double task to agree on the terms of how to introduce a market mechanism itself and how to abolish the party-state control over the extracted profit. Such a transition, in our view, presumes much deeper and painful socio-economic and political restructuring than in the case of authoritarian financial liberalization.

Bearing all this in mind, our methodological point of departure is following. What happened in Taiwan in the 1980s was essentially a case of financial liberalization in democratizing the authoritarian system. What is happening (going to happen) in Mainland China currently is an attempt to introduce financial liberalization in a comparatively "mature" post-totalitarian socialist one-party system. In these two cases we have to deal with a very different constellation of actors and – perhaps – with rather different outcomes.

The case of Taiwan: from the market with state-controlled profit to free capital allocation

There is unique concourse of necessary and incidental circumstances which eventually conduced to the successful financial deregulation in Taiwan in 1980. These circumstances go well back to 1949 and perhaps even earlier.

1. **Already since 1949 financial system in Taiwan was market based and diversified.** Although after coming to Taiwan the Kuomintang (KMT) government did not have to face mature local financial entrepreneurship it is worth noting that the first investment cooperatives on the island were created by Qing dynasty authorities in 1890, five years before the war with Japan. Japanese administration followed suit but at a bigger scale, especially after 1914. The cooperatives were supposed to be the centers of socio-economic life of rural localities. In the cities big Japanese banks were operating, thus leaving very limited space for local finance.

The KMT nationalized the branches of Japanese banks but decided to integrate rural financial structures. This decision might be a forced one because the KMT – especially after tragic events of of February 28, 1947 – felt the need to find the basis of cooperation with local society.

Thus almost from the beginning of KMT rule in Taiwan the island's financial system became double or perhaps even triple layered.

The first (highest) layer was represented by the KMT controlled state banks operating mainly with state-owned big enterprises and supporting large infrastructural projects. In the 1950s the Bank of Taiwan, which was de-facto the Central Bank, possessed one-third of all deposits and gave two-thirds of all credits received by the state sector. In 1961 the Central Bank, as well as four commercial banks which used to exist in Mainland China, was restored. In 1959 China Development Corporation – the first private investment institution with 75% of local capital and with only 10% of state capital – was established. In 1962 six foreign banks from the United States (US), Japan, Thailand and Philippines were invited. Two more private banks were introduced in 1961 – Huaqiao Bank and Shanghai Trade Bank – to accumulate the capital of Chinese diaspora abroad. By the middle of the 1970s Taiwan had rather multiple structures of big state- and foreign-owned banks but obviously an underdeveloped system of local private capital representation (Cheng Tun-jen 1993, p. 55–92).

The second layer of the island's financial system consisted of local credit cooperatives and credit departments of farmers' and fishermen's cooperatives. The number of credit cooperatives, although licensed, was not subject to limits and membership in such cooperatives was voluntary. The number of associations was limited (one township – one association) and membership was compulsory. Associations were ruled by the board of directors responsible for four departments: credit, distribution, selling and insurance. The department of credit was the backbone of the whole association. Politically speaking, there was a marriage of convenience between the local elites ruling cooperatives and associations and the KMT. The latter controlled the former politically, expecting consecutive victories at local elections. The former had to accept the latter's control having no other political option but expecting granted rights for local financial or other economic monopoly.

Local credit associations and departments could allocate deposits in Cooperative Bank and Land Bank, controlled by the KMT. At the same time, even in the 1950s there was no obligation to do so. Local credit associations and departments enjoyed a Central Bank-licensed corridor for their interest rate policy.

The third layer of Taiwan's financial system was represented by an export oriented medium and small private enterprises' funds and their investment activities. Existing literature on the subject sometimes alludes to them as to "shadow banking" but most of the experts whom I interviewed during my field research in Taiwan expressed the opinion that

there was basically no shadow banking on the island. Although this layer of financial system accounting for 25–30% of GDP was perhaps the least regulated, it nevertheless definitely was not "shadow banking" in the sense used to describe the current state of affairs in Mainland China's financial system. These enterprises in Taiwan were operating with their own money received as export income or investment from abroad and did not have an access to the state banks' national or foreign currency reserves. They were also the least inclined to take loans from KMT controlled state banks because of two reasons. First, state-owned banks themselves were not eager to deal with small and medium private local capital looking upon it as a irresponsible, unreliable and perhaps politically dangerous client. Second, local small and medium enterprises – being in most cases family- or clan-based economic structures – found it easier to make investments from their own savings or turning to credit cooperatives and private trust companies for extra capitalization. They operated independently from the state – politically, institutionally and financially (Szu-yin & Ho Jih-chu Lee 2001, p. 69–89).

But they indeed could undermine the country's macroeconomic stability. Perhaps the most vivid case is the accumulation of a big amount of foreign currency by them in 1985–1987 just on the eve of Taiwan's final acts of financial deregulation. At that time the third layer of the island's financial system was expecting huge profits in the wake of Taiwan's dollar appreciation, which looked inevitable. But restricting measures of the Central Bank on the amount of accumulated foreign currency in 1987 and 1988 basically ruined the Taiwanese "shadow banking" and at the same time softened appreciation pressure on TWD (Liu 1992, p. 207–208).

The national financial system as a whole withstood the interest rate liberalization without recession and big bank insolvency.

2. **The KMT's attempts to regulate prices on Taiwan's domestic market were absolutely marginal.** Unlike the CCP in Mainland China which attempted to annihilate the market in the name of Marxist-Leninist utopia and thus made almost all prices in the national economy subject to the state's direct setting, the KMT's price setting policy in Taiwan was actually pretty loose. Interestingly enough, even in the most politically harsh period of the 1950s there were basically no attempts to resort to direct price setting.

There were only two attempts to introduce price control procedures. From July 1, 1973, till January 1, 1974, in the wake of the oil shock consequences the KMT government decided to start regulating the prices of

clothing, staple foods, building materials etc. As a result, shortages ran wild while the black market flourished. Moreover, after the lifting of these regulations staple foods prices hiked well higher than the pre-regulation level.

The second attempt took place in January 1974 while the KMT government forbade the rise of domestic oil prices to the world market level in order to prevent imported inflation. The ban held on for less than a month. Eventually the overall index of oil prices in Taiwan in 1974–1975 grew higher than in developed countries in the same period. (Wan-an Yeh 2001, p. 38–40).

The KMT government learned useful lessons from these two conspicuous price regulation failures and never tried this path again. That is why by the beginning of the final stage of financial liberalization in Taiwan in the 1980s, there was basically no need for any "price reform" or introduction of "market price setting." Prices in the island's economy were well before adjusted to the dynamics of supply and demand.

As regards the price of capital, by the end of the 1970s deposit rates in the sate-owned commercial banks were defined by the Central Bank. Credit interest rates in state-owned commercial banks were defined by the banks themselves but within the corridor, the parameters of which were submitted by the Association of Taiwan Banks to the Central Bank for approval.

In 1988–1989 the "ceiling" of the corridor was abolished. In 1991 fifteen new private banks, investment and trust companies and cooperatives were established, marking the final stage of deposit and interest rate deregulation in Taiwan (Yun-peng Chu 2001, p. 89–119).

3. **Under the KMT government Taiwan's Central Bank enjoyed super independence and its credit and monetary policy invariably remained super conservative.** Describing Taiwan's credit and monetary policy in the decades of KMT dictatorship, Tun-Jen Cheng wrote that "the case of Taiwan poses the puzzle of the dog that did not bark" (Cheng Tunjen 1993, pp. 55).

By this he meant that between 1949 and 1989 all commanding heights in the island's financial system were under KMT monopoly, to which it may seem reasonable to stimulate economic growth by means of credit expansion. Especially in the wake of export oriented miracle when Taiwan's foreign currency reserves were only next to those of Japan. Still it never happened. The credit and monetary policy of Chiang Kai-shek's regime was so conservative and the island's Central Bank enjoyed such

a degree of real independence from both legislative and executive power branches that it can be claimed that long before monetarist theory upsurge and the formation of the Washington consensus, pretty dictatorial and statist KMT autocrats pursued exactly the financial policy that Milton Freedman and the Chicago school would have prescribed to them if existent in 1950 or 1960.

Some statistical data that can be given in this context is indeed amazing, especially in contrast with the financial developments in "reforming and opening" today's Mainland China.

Between 1951 and 1988 the deficit of Taiwan's central budget was either non-existent or never higher than 2% (Tun-jen Cheng 2001, p. 120).

The monetization of Taiwan's economy (M2 rate to GDP) according to different sources was less than 25% in 1950, around 34% between 1961 and 1971, around 57% in 1971–1981. On the eve of financial deregulation it was still well below 100% – around 85–90%. Only in the wake of final stage of liberalization in 1986–1988 with the central government deliberately increasing money supply to curb the possible rise of the state banks interest rates did M2 to GDP exceed 100% (Liu 1992, p. 198).

As far as the investment rate is concerned: in the decade of import substitution in 1950 investment stood 16% to GDP. By 1965 it increased to 23%. During the oil shocks at the beginning of 1970 investment was up to 26% to GDP. And on the eve of financial deregulation in the early 1980s it was slightly above 30% (Wan-an Ye 2001, p. 29).

Such a strict financial diet of the KMT-led socio-economic development model has, however, at least two feasible explanations.

First, the KMT leadership and Chiang Kai-shek in particular perceived hyperinflation of the 1940s as one of the main reasons for political and military defeat in the Civil War of 1946–1949. Closely connected with this perception was deep distrust towards private entrepreneurs and investors as corrupt clientele always ready to swindle economically and betray politically. This twofold distrustful fear to a great extent laid the foundation of the political economy of Taiwan's financial order between 1949 and 1988. Monetary and credit policy must be strict almost up to an extreme degree and the private sector is to be separated from the state finance by all possible means. Although with the passing away of Chiang Kai-shek and rise of Jiang Jingguo the attitude towards local private entrepreneurs became much friendlier but the idea of no-deficit and low-inflation financial policy absolutely prevailed until the end of the 1980s.

Second, the KMT regime in Taiwan faced a potential lack of accessible capital, at least through the first two decades of its rule on the island. US financial help delivered and distributed through the Agency of International Development (AID) between 1951 and 1965 made up to almost 40% of state investment in this period. Indeed, it was both economic and political leverage of considerable strength. In 1958, for example, Chiang Kai-shek had to yield to pressure from AID advisors on the subject of creating a friendlier environment for private investors. But it seems that the AID board of advisers and KMT leading autocrat were united on the point of the need for credit and monetary conservatism (Chen Hen-chin 1996, pp. 115–116).

The Republic of China on Taiwan indeed had to pay a big price for initial macroeconomic disorder. Between 1948 and 1949 the prices on the island soared thirty-five times. This was the overspill of hyperinflation from Mainland China torn at that time by the Civil War. Tragic events of February 18, 1947, can also be partly explained by growing economic misbalances.

In June 1949 the national gold and currency reserve was established and – as a firewall from Mainland China's inflation – the quantity of banks in Taiwan was reduced by cancelling the licenses of four banks existent during KMT rule in Mainland China. After currency reform was carried out, state banks started absorbing people's savings for an annual deposit interest rate of up to 125%. By the end of 1950 the monthly inflation rate went down from 12% to 2% (Wu Jiahua 2012, p. 18).

The new Central Bank Law promulgated in 1952 followed the example of the Central Bank Law of 1935 in the sense that it made the Director of the Central Bank accountable only to the President, i.e. Chiang Kai-shek. Indeed, two Central Bank Directors of the KMT's Taiwan period, Xu Boyuan and Yu Guohua, were closely associated with the Chiang Kai-shek family and served in this post for fifteen years each.

The Central Bank in Taiwan in a way was something more than a Central Bank. The leader of the KMT was the highest guarantor of financial stability and the Central Bank was the "bank of the banks" whose credo was proclaimed in 1958: "First thing which we must achieve is macroeconomic stability. This can be achieved only by means of fighting inflation. The main source of inflation is budget deficit and loose credit policy with low interest rates. If we can achieve balanced budget CB may use at least a portion of its reserves to help economic development" (Yan Jiajin 1958, p. 2–3).

There is another interesting piece of evidence of Chiang Kai-shek's personal concern about macroeconomic balance. In 1963 the KMT leader, in conversation with the Minister of Finance, stressed that the purchase of Taiwan's farming produce by the state companies must be financed by means of current export income and by no means through the spending of Central Bank reserves (Li Guoding 1963, p. 47).

The principle difference between the Taiwan financial policy and that of Chinese Communist government in Mainland China since the inauguration of "reform and openness" is that in Taiwan – even after the sky-rocketing export income since the 1960s – the state foreign currency reserves were never used as a source for stimulating economic growth. This fact also greatly conduced to healthy GDP growth, the overall macroeconomic stability of the island and positive sustainability of its financial system.

In fact, even in the period of import substitution the state banks' credit interest rates were never artificially set too low. In the 1960s, when the Taiwan export-oriented miracle began taking shape, state credits were almost never channeled for support of certain branches or enterprises but went to export-supporting infrastructural upgrading, for example, to the development of ports and near-port logistics.

Interestingly enough, by means of state credit policy, namely by stopping certain credit lines, the KMT government prevented accumulation of excessive industrial capacities.

All banking procedures in state-controlled banks were extremely bureaucratized but perhaps the most complicated and potentially punishable measure was the process of debt amortization. Accumulation of debt itself as well as its unaccounted amortization was looked upon as serious political delinquency which could lead to severe administrative and sometimes even criminal penalties. By the end of each day, on all levels of the state banking system, consumption must have equaled parish.

The system was indeed able to achieve an almost perfect macro-economic balance, but was rigid, closed, poorly institutionalized and badly prepared to supply the demand for capital from both state and private businesses. It became especially clear by the middle of 1970 after the oil shocks, with huge trade surplus and – hence – unprecedented amount of liquidity in the state banks.

Between 1979 and 1989 the Central Bank was gradually put under the control of Executive Yuan (Cabinet of Ministers) and the deregulation of interest rates on credits and deposits splendidly carried out against the

background of a more loose monetary policy in 1986–1989 finished the process of "normalization" of Taiwan's Central Bank's position with regard to political leadership and to other banks.

4. **After 1955 until the final stage of liberalization between 1986 and 1989 Taiwan's financial system was in an almost constant process of deregulation.** The first feasible steps towards financial deregulation in Taiwan can be traced back to July 1955 when the KMT administration abolished previous restrictions on security trading, proclaimed free stock-price setting and place of trade and diminished by half the transaction tax. This was followed by the inauguration of the first stock exchange in 1962. About 58% of its capital turnover belonged to private businesses, although the state intervened to support certain companies and to ensure an overall growth trend (Wade 1990, p. 110–115).

The money market was officially introduced in 1976, deregulating partly the capital account for export oriented private sector with the Central Bank-licensed Bank of Taiwan, Trade Bank and Transport Bank to supervise loan securities turnover.

In 1975–1981 state banks were granted more autonomy in defining credit interest rates within the corridor defined by the Central Bank. Subsequently credit interest rates of credit cooperatives and credit departments of farmers' and fishermen's cooperatives were actually freed while interest rates of state banks were more than dozen times adjusted to become closer to the real capital demand index.

In 1982–1984 the financial market in Taiwan facing double-digit inflation, fall in growth rate and excessive liquidity reacted accordingly by decreasing deposit interest rate from 13% to 9% and loan interest rates to less than 5%. In March 1985 loan interest rates were deregulated against the background of almost 9% GDP growth and less than 2% inflation. Spread between short-term and long-term loans was widened and in January 1986 the "ceiling" of deposit interest rates was finally abolished. 1989 witnessed the final stage of current account and capital account exchange rate deregulation (Chiu 1992, p. 121–193).

It can be said that by the end of 1991 with the beginning of state banks' privatization and establishment of fifteen new private banks, Taiwan's financial system transition from the market with state-controlled profit to the market of free capital allocation and turnover was basically completed. What followed was the maturation and development of the island's free capitalist finance. This process went on not without serious socio-economic and political pitfalls and continues until today. But these

pitfalls, their causes and consequences as well as the reasons as to why the process of financial market maturation in Taiwan is perhaps still not finished are well beyond the scope of this paper.

5. **The political economy of Taiwan's financial deregulation: basic constellation of actors and ideas.** The principle conceptual cleavages between the parties concerned with Taiwan's financial liberalization can be traced in the discourse on the role and place of the Central Bank which was held in the second half of 1970s.

According to the view of the "reformist party," "financial policy must correspond to economic policy and…Central Bank is to report to the government. In this country (Taiwan) … government embodied in the Ministry of finance, Ministry of economy under the leadership of a Prime Minister will … control the CB activities bringing them into correlation with imperatives of economic policy" (Bai Junnan 1975, p. 1).

The take of the "conservative party" was the following: "Central Bank is first and foremost the instrument of monetary policy carried out in the interests of society as a whole. Government represents different parties and political orientations. CB reporting to the government may end up in a situation when common interests will be sacrificed to some private and factional aspirations. Government will invariably choose growth to the detriment of stability. And Ministry of finance won't be able to avoid the policy of low loan interest rates to ease the debt burden. Low loan interest rates and high attention to economic growth create nutrient medium for inflation. Besides, in order to attain certain goals monetary policy must be of consistent and long-term character. If CB reports to the government the latter's policy changes may … make monetary policy chaotic and inconsistent" (Women dui 1979, p. 1).

The same cleavage is visible in big debates on economic policy which took place in the first half of 1980 when fundamental financial deregulation was already in the air. For example, in August 1982 round table discussion on loan interest rate policy held by the "Commercial Times" newspaper (Shangye Shibao) witnessed a sharp clash between the advocates of low interest rates ("reformers") and those who adhered to the principles of strict credit and monetary policy ("conservatives").

At the end of the day, however, leading figures of both parties (Wan Juyong and S.C. Tsiang) published a joint article urging further deregulation of Taiwan's financial system (Yun-peng Chu 2001, p. 115–116).

With the market economy existing and overall macroeconomic environment (debt, inflation rate, loan and monetary policy showing) healthy,

"reformers" backed by local private entrepreneurs, foreign investors and liberal intellectuals were eager to make the island's financial system better institutionalized, more competitive and open, ready to meet capital demand from the non-state sector, which made up more than 70% of GDP.

The so-called "conservatives" did not oppose deregulation in principle but were seriously concerned with possible inflation overspill, monetary policy chaos and factional strife in the government. They were certainly also preoccupied with saving their political and financial positions as "commanders of Taiwan's economic heights."

Technically speaking, the essence of the dispute was the degree of the loan and monetary policy softness. The "reformist" party was eager to increase this degree by means of more institutional pluralism in both financial and political systems. The "conservative" party, understanding pretty well the shortcomings of the existing financial arrangement, was still inclined to retain overall hard loan and monetary policy constraints with limited institutional pluralism and gradual political liberalization.

From the height of today it is impossible to deny that the following two fundamental structural factors of internal socio-economic development in Taiwan created favorable conditions for the success of final stage of financial deregulation. First, the overall healthy macroeconomic environment guaranteed by extremely conservative loan and monetary policy of the politically authoritarian KMT regime. Second, despite the political and economic patron-client relationship between the KMT party-state and local private credit and investment structures, the latter remained financially and institutionally independent from the former. Taiwan's financial system stayed diversified and plural. This plurality was guaranteed and enhanced by the fact of an existing market economy and by gradual but consistent financial deregulation which began as early as the mid-1950s.

The case of Mainland China: from "non-market" to the "market" of bureaucratic agreements

Price reform in China, being introduced as a priority step "from above" in 1979–80, forestalled many other measures aimed at market transformation, such as property, bank, tax or administrative reforms. The new mechanism of pricing, which took shape in China by the mid-1980s, was called "double-track" – meaning the parallel existence of "plan" and "market" prices in the national economy (Li Huizhong 1998, p. 81).

On the whole, the implementation of "double-track" price reform in China in 1980s essentially was the quantitative expansion of mechanisms familiar from the past, with which communist leadership effectively got over the shortages on the domestic market. Decentralized decision-making and resource allocation made radical price "liberalization" technically impossible. The "double-track" model was far from uniformed. Chinese experts usually allude to "sectional" and "proportional" variants of the "double-track" price model (Yang Shengming & Wang Lijun 1993, pp. 27–33).

In reality, however, the "double-track" price model was a queer and multi-dimensional combination of these two variants. Empirical facts testify that this border was always very mobile, moving periodically both into the directions of "plan" and "non-plan," depending on concrete political, administrative, economic and social conditions. Chinese experts claimed that "so far as currently market prices are considerably higher than planned prices, the produces want to sell their produce on market prices but to buy raw staff on planned prices. "Volume proportions of used planned and market prices for the most part are subject to bargain between enterprises and the government. Thus it is extremely difficult to say, what these proportions are" (Yang Shengming & Wang Lijun 1993, p. 81).

Party-state institutions had the final say in defining the design of the "plan-market frontier." It should be also remarked that the implementation of "double-track" price model went simultaneously with the decentralization in decision-making. Thus the role of local authorities in defining the parameters of this "frontier" was gradually but steadily growing.

Covert and at the same time harsh bargaining developed all along horizontal and vertical lines of party-state bureaucracy and enterprises' management. First, lower levels of party-state hierarchy lobbied for getting more powers in price-setting decision-making from the center. Second, corresponding economic organs fought for more powers on the horizontal levels. Third, enterprises of both central and local subordination lobbied party-state organs for more price-setting possibilities as well as for "optimal" (in the enterprises' own understanding) ratio of "plan" and "market" spaces.

The Chinese "double-track" pricing model was such a symbiosis of "plan" and "market," which badly yielded to central management and simply couldn't yield to any targeted dismantle, either in the name of "plan," or in the name of "market." In our judgment the "double-track" price model as an internally coherent system with a clear ratio of "plan" and "market" prices for each commodity, enterprise, sector or province,

probably never existed in the PRC. The volumes of "plan" and "non-plan" sections differed greatly from one sector and region to another, defined by more and more decentralized price-setting powers of party-state organs and productive units.

The next stage of deepening fragmentation and localization of price setting, which took place from 1990 on, was in most cases irregular and spontaneous. It further undermined the central government's ability to administer "plan-market frontier" in the bigger part of Mainland China's "economic space." By 1993–1994 this process led to **such a state of affairs when the central government retains the rights to set the prices of natural monopolies, capital and national currency, while local authorities retain the rights to design a "plan-market frontier," using a tremendous variety of bargained "tracks." We tend to call this structural environment the "multiple-track price setting model"** (Karpov 2011 № 4, p. 39).

The "multiple-track" model in different sectors of the Chinese economy

From the mid-1990s on, there appeared more and more signs that "market-oriented transformations" in all important socio-economic sectors – state own enterprise joint-stocking, interest and currency rates, taxation, real estate etc. – proceeded according to the logic of "multiple-tracking." It seems to be also true even for some parts of the political and administrative fields.

Each "track" is, in fact, a sum of conditions on which different units of the system participate in the Chinese domestic "market." This sum of conditions for the concrete unit is achieved through non-transparent bargaining between this unit and corresponding level of party-state authorities or between mutually depending units under the control and patronage of the corresponding party-state organs. Thus the "tracks" are bargained between party-state organs of different levels, between enterprises (social units) and party-state organs and between enterprises (social units) themselves but under the party-state's auspices.

The supporting frame of the "multiple-track" model is still the political monopoly of the Leninist party-state, which penetrates the whole society and guarantees the norms of politically "rational behavior," reproducing the principles of "soft-budget constraint" in both economic

and political fields. In order to be able to do so, the party-state firmly and monopolistically controls and regulates the whole complex of national finance – banking and monetary policy, interest and currency rates, taxation, stock market as well as price setting in key sectors. **Hence it is the party's power monopoly intertwined with the party's financial monopoly at the central level of the party-state which secures internal cohesion of the whole "multiple-track" edifice from the danger of different "tracks" tearing apart.**

The most important structural characteristic of the "multiple-track model" is non-transparent and indissoluble "symbiosis" of "plan" and "market." The described mechanism of non-transparent bargain under control and with mediation of the party's political and financial monopoly **in each concrete case designates to the "contracting parties" quite clear limits of the "market space."** "Market" here is not a "system" but a "practice" of a speculative nature which is used unevenly and – for the external observer - without clear regulations at different "floors" of the party-state which still constitutes the core of the "system."

The "multiple-track" model in Chinese financial system

It is very characteristic, that in financial sector and in macro-economic regulation (certainly, as well as in political and ideological fields) the Chinese party-state *is at least inclined to bargain* with its economic and social counterparts. Cyclical struggle with macro-economic "overheating," at least since the mid-1990s, each time begins with the implementation of the so-called "indirect" or "market" methods of regulation which means enhancing interest rates and increasing the flexibility of taxation.

But with given Chinese "multiple-track" credit and investment mechanisms, interest rates and taxation being subject to bargain, inflation "overheating" repeats. Thus central financial bodies of the party-state have to drop the bargain and go for inevitable administrative limitations of credit, price regulations and other prohibitive non-market practices (Fan Gang & Zhang Xiaojing 2005, p. 165).

In other words, each macro-economic cycle in China starts with bargain and ends up with administrative repression which is also an important mechanism of the system's self-reproduction. Such a model will come to an end only when this growth turns unsustainable (depriving

the "track" bargain parties of their rent share) or in the case when still technically sustainable growth – due to the increase in total costs on more aggregated levels – will lead to such structural damage, which would be lethal for the system. In our view such an "end" will, most likely, take a form of systemic collapse.

Other structural factors in Mainland China's economy which run contrary to Taiwan's developmental experience

The Chinese banking system as well as investment mechanism are still not structured along the market economy lines. Reforms initiated by former Premier Zhu Rongji indeed helped to recentralize four big central banks and separate the tax base of central and local governments but did not lead to long-awaited interest rate deregulation. The investment mechanism, although decentralized, remains "the last bastion of socialist planned economy." Chinese "shadow banking" which has become extremely active in recent five years is in many ways a replica of state-owned central and local banks capitalizing from their reserves but lending on even less transparent conditions conducing to overall precariousness of the macroeconomic environment (Zhang Joe 2014, p. 107–119).

Chinese economic growth was and, despite all undertaken reforms, still is predominantly investment-led, with an investment to GDP ratio up to 50% and even more.

Loan and monetary policy subject to "multiple-track" bargaining and politically motivated growth settings produce an avalanche of liquidity with monetization (M2 to GDP) running as high as 200% (Guilford 2013).

National hard-currency reserves constitute one of the main sources for GDP growth stimulation. The exchange rate mechanism is still fixed to meet the needs of growth stimulating money supply. (Qin Yi 2011, p. 5)

Domestic indebtedness runs high, standing, according to some recent estimation, at more than 200% to GDP. The problem, perhaps, is not that much with the actual amount of the debt but with the fact that the party-state still stands as the whole system's lender of last resort. This means that any substantial movement towards financial deregulation (loan interest rate liberalization, investment or exchange mechanism reform, further diversification of the banking system etc.) may activate so far latent claims of the creditors, thus dealing a powerful blow to the

whole political and economic edifice of the PRC. The "lack of liquidity" crisis which happened in Mainland China in May-June 2013 was provoked not by the actual shortage of liquidity. With M2 standing 200% to GDP the assumption of such a shortage sounds absolutely irrelevant. The true cause of the Chinese financial system coming almost to a standstill by mid-June was the limits imposed by the Central Bank on money supply to other state-owned banks in order to curtail subversive loan activities of quasi-state "shadow banking." However, universal debt and moderation of the creditors' claims demand a steady money supply. So the "lack of liquidity" crisis was in fact the crisis provoked by activated creditors' claims facing a sudden credit crunch.

Mainland China's financial reform: basic constellation of actors and ideas

Unlike in the case of Taiwan, the main actors of economic transition in Mainland China are still closely associated with the party-state both institutionally and financially. Relations between them and the communist party-state are characterized not only by political patron-client arrangement but also by "multiple-track" model bargaining based on vague and twisted price setting in the domestic goods and capital market.

To our mind, what actually emerged in China after three decades of "reform and openness" is not even the "authoritarian" market with the state-controlled profit rate but rather a "post-totalitarian" "market of bureaucratic agreements." The principle actors in this "market" including a big portion of what looks like the non-state sector are interested not that much in financial deregulation but in the perpetuation of middle-of-the-road conditions which provide nutrient medium for different sorts of "moral hazard." Neither of the parties concerned seem to crave for free capital market. It looks as if both "reformers" and "conservatives" clash for the upper hand in dealing with the state financial resources just to use them afterwards for the benefit of their respective clientele on the basis of "multiple-track" bargaining.

Unlike the Taiwanese case where the technical task of financial liberalization was the softening of loan and monetary policy, in Mainland China the technical task of market oriented deregulation should in principle be an opposite one, namely the hardening of budget constraints for the state-owned enterprises and other party-state clientele. Such hardening

indeed occasionally happens – in the cases of central government fighting inflationary "overheating" - but is carried out by administrative methods. It only conduces to the system's self-reproduction without either bringing in more market or curing universal indebtedness.

The above-mentioned "technical difference" between the cases of Taiwan and Mainland China testifies to the fact that when comparing these two entities we deal with systemic settings which are very much different in their structure and dynamics.

Financial liberalization outcomes might be also quite different. In the Taiwanese case there was successful deregulation which opened the way for free capital allocation accompanied by gradual introduction of political pluralism. In the case of Mainland China we still have to wait and see what may happen to the "market of bureaucratic agreements" and basically unreformed Communist party-state in the wake of ardently debated interest and exchange rate deregulation.

Conclusion

It looks like that the lack of a free market is indeed not equal to the lack of the market as a socio-economic institution. Authoritarian party-states create systemic settings which are essentially different from the settings of totalitarian party-states, even at their "post-totalitarian" stages.

The case of financial deregulation in Taiwan represents a successful abolishing of the authoritarian party-state profit rate control in a diversified and originally market based systemic setting. It is certainly true that some extremely important variables of this setting were either forced or incidental. The fact that the KMT accepted existing diversity of local financial institutions after arriving in Taiwan was a forced variable while the US aid to the island in the wake of the unfolding Cold War may be looked upon as an incidental one.

Anyway, the diversity of the island's financial institutions, existing market economy framework and conservative up-to-being-frenzy loan and monetary policy of the KMT between 1949 and 1988 laid solid foundations for the eventual financial liberalization.

The case of Mainland China looks structurally and dynamically very different. Initial lack of market economy as an all-nation socio-economic institution, annihilated during decades of Maoist utopia, made the terrain of "reform and openness" full of pitfalls unknown to Taiwan. **Almost**

all the important structural and dynamic variables with regard to the financial system of the PRC are in contradiction with those of Taiwan in the corresponding period. Bearing this in mind, it is indeed very difficult to point to the lessons which reformers in Mainland China may learn from the Taiwanese experience of financial deregulation. One might say that the overall systemic setting should turn out to be different. But this is obviously by no means a lesson.

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