Services and Economic Development in the Asia-Pacific

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and

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SERVICES AND ECONOMIC DEVELOPMENT IN THE ASIA-PACIFIC

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List of Contents

Chapter 10

Reluctant State, Decentralized Markets, and Under Developed Communities: The Construction of the Futures Trading Industry in Taiwan

Pin-Hsien Chen and Jinn-yuh Hsu

The emergence of the financial industry has become a dominant feature in the capitalist economic system since the breakdown of the Breton Woods agreement in the 1970s. Innovative financial commodities, in combination with the new information and communication technologies, have been stirring up the market structure and dramatically reshaping financial landscapes. There are three penetrating and cross-enhancing processes characterizing the current global financial system: deregulation, technological innovation and globalization (Martin, 1999). Deregulation or liberalization of financial markets opens up new geographical markets and encourages the development of new financial products. Under such circumstances, some key financial transactions occurred in a few global cities, while others dispersed to lower tier financial centers connected by electronic networks. Thanks to the development of information and communication technologies (ICT), it was argued that the majority of transactions have become virtualized and even blind to location (O'Brien, 1992). Among the innovations in ICT, a wide array of new financial instruments has appeared on the scene that facilitated greater spreading of risk (Boden, 2000). The most important product innovation since the mid-1980s has been the phenomenal growth of the derivatives markets.[1] The goals of these markets were to enable investors to manage risk by offsetting the effects of volatility, and to allow them to gain profits by arbitraging the gap in information. However, as argued by Tickell (2000), derivatives not only allow institutions to offset risk but have also been implicated in a series of high profile losses which have undermined the financial viability of companies, banks and government entities (see also Pryke and

1 Derivatives are 'financial tools derived from other financial products, such as equities and currencies. The most common of these are futures, swaps, and options…The derivatives market aims to enable participants to manage their exposure to the risk of movements in interest rates, equities, and currencies' (Kelly, 1995).

Allen, 2000). So, how to survive and even leverage futures markets has become the key issue for financial institutions seeking to grow in the turbulent world market.

However, even as abstract as derivatives products are, they are still regulated and affected, to some degree, by the embedded institutions (Agnes, 2000). Just as there are different national socio-institutional variants of capitalism, so there are divergent modes of financial development in various national systems, even though the basic monetary systems have tended towards convergence in the era of the neo-liberalist hegemony. Of critical importance are differences in regulatory environments, which are under attack from the forces of deregulation but still affect financial activities and monetary networks in/across divergent national systems in so far as financial systems are regulatory spaces (Martin, 1994). But why has the state been willing to deregulate financial control?

This issue is particularly relevant in the case of East Asian developmental states such as Korea and Taiwan. A number of researchers, such as Wade (1990), Amsden (1989, 2001) and Evans (1995), claim that the miraculous development of East Asia's Newly Industrializing Countries (NIC) should be understood as a process in which the state plays a strategic role in taming domestic and international market forces and harnessing them for national ends. Fundamental to these miracles is an insistence on industrialization, rather than on following current comparative advantage. In other words, market allocation rationality is subjected to the priority of industrialization, which usually means employing new technologies to increase capital accumulation (Storper and Walker, 1989). Key to the process of industrialization is that the state lends directional thrust to the operations of the market mechanism.

Among the protagonists of developmental state theory, Wade (1990) carefully distinguishes state-leadership from market leadership in order to allow theorization of the complexity of state-market interactions. Based on an empirical study of Taiwan's industrialization process before 1980, Wade concentrates on the synergistic relationships between state activities and market allocation in each industrial sector. He provides a vivid example of how state intervention, under certain historical conditions, can help to kick start industrialization and create economic spaces within which the market mechanism can function. In other words, the state in the Asian NIC is not a passive administration that takes price signals for granted and does not take charge of a sound regulatory environment only. Rather, the developmental state is interventionalist and actually performs a very active role in targeting industrial development (Pempel, 1997).

However, the key to the developmental state leveraging its capability for realizing its goals is the financial pocket.[2] As the leading figure promoting this concept, Johnson (1987) argued that state control of finance was the most important, if not the defining, aspect of the developmental state, followed by other aspects such

2 As argued by Skocpol et al. (1985), a state's means of raising and deploying financial resources tell us more than could any other single factor about its existing capacities to create or strengthen state organizations, to co-opt political support, to subsidize economic enterprises and to fund social programs.

as labor relations, autonomy of the economic bureaucracy, and the combination of incentives and command structures. In fact, the states still performs the key role of setting the principal parameters of national monetary activities and the modes for integrating them with the international system (Thrift and Leyshon, 1997). They can exploit their administrative powers to discriminate between financial institution by limiting the range of financial products and markets in which different types of institutions may trade. Finance is the tie that binds the state to the industrialists in the developmental state. The state takes advantage of the monopoly of financial resources, and maneuvers to allocate financial credits to promote those industrial sectors which it targets for some reason. By doing so, the state can exert influence over the economy's investment pattern and guide sectoral mobility, since in such a financial structure firms rely on bank credits, which are under the control of the state, for raising finance beyond retained earnings and to respond quickly to the state's policy, as expressed through interest rate and other financial policies (Zysman, 1983). As a result, finance itself is conceived of as the effective conduit of industrial policy. The top concern for the developmental bureaucracy in relation to financial development is therefore the stability of the system; anything but the competitiveness of the financial sector. The students of the developmental state believe that the model can work well for the newly industrializing countries, enabling them to catch up and helping to propel miraculous growth, as demonstrated by the East Asian case (Wade, 1990).

In contrast, the phenomena of financial repression, or the intervention in financial markets by the developmental state, have been targeted as the key area for deregulation, or back to basics, by neoclassic economists (McKinnon, 1989).[3] The neo-liberalist rhetoric argues that 'external' intervention will distort the optimal operation of the market mechanism, and lead to financial dualism; the co-existence of the legal and the underground financial systems. Meanwhile, the argument goes, financial resources will be misallocated and rent seekers will emerge in the market (McKinnon, 1989). According to the neo-liberalist prescription, the government would be better keeping away from resource allocation and loosening financial control to allow prices (?) back to the right track.[4]

3 The state usually intervenes in four areas of financial activities to promote economic development: interest rate control, credit allocation control, financial institution regulation, and foreign exchange rate control (McKinnon, 1989).

4 The antithesis proposed by these two poles leads to divergent positions toward the explanation about the cause, as well as the antidote, of the East Asian financial crisis. For the neo-liberalists such as Greenspan (1998), Asia's sudden straits are symptoms of chronicle diseases of 'crony capitalism'. They accuse the 'picking up the winner' industrial policy of distorting investment capital, and centering on political patronage and close personal connections between powerful politicians, bankers, regulators and business people. As a result, poor quality regulation exists within many Asian financial institutions, and leads to moral hazard, public guarantee for nominally private business transactions. Thus, the cure for the 'over-politicized' disease is to leave the market alone. Again, a starkly divergent diagnosis and prescription is proposed by the believers of the developmental state. They argue that the

The debate raises an interesting issue: why would the developmental state engage in deregulation policy if the control of finance has been the lifeblood for it to survival and even prosperity? Why would states dismantle the institutions that gave them the power to exert control over financial resources, surrendering much of that power to the market? As illustrated above, two explanations stand out. The first privileges the role of market forces and the second underscores the importance of policy decisions being influenced by the advocacy of domestic business groups and international hegemonic institutions, particularly the US government. The former tends to explain financial liberalization and deregulation as a relentless transformative process driven by the development of new technologies, particularly new information and communication technologies, and more sophisticated financial instruments. As a result, the state cannot but accept the market rule and losing its control as a result. By contrast, the latter focuses on the politics of the alliance between local and extra-local economic forces that exerts an effect on policy making. It leads to the erosion of state autonomy and the decline of state capacity in the political struggle and consequently the state is forced to withdraw from the policy of financial repression.

These two perspectives are usually mobilized to explain the respective cases (Loriaux, 1997). Even though they represent contradictory viewpoints on the causes and effects of financial liberalization, they ironically share an unpredictable consensus that market forces and state bureaucracy could work well together provided they do not interfere with each other. However, it is widely agreed that developmental states have to embed themselves in the market in order to devise effective policies (Evans, 1995) and, at the same time, the de-regulated market needs re-regulation from the state to operate smoothly at different geographical scales: from local, regional to global levels (Weiss, 1998, Martin and Sunley, 1997). To set the tone as 'either or' for the two institutions creates a deadlock for further theoretical development (Boyer and Drache, 1996). In fact, the wisdom of recent institutionalism demonstrates that both of them will encounter the issues of information incompleteness, coordination and governance, and as a result usually fail to function well. Moreover, the institutions have their own ways of doing things and constitute barriers to radical change (Amin, 1999, Scott, 1995, Nelson and Winter, 1982).

In light of the institutional analysis, a number of intermediary institutions could allow a richer historical study of industrial development in a particular locality (Piore and Sabel, 1984, Saxenian, 1994). Among these meso-level institutions, the community is usually referred as the alternative, but complementary, mode

model of developmental state works well if without the conspiracy of American hegemonic neo-liberalism and its puppets, IMF (International Monetary Foundation) and World Bank (Wade and Veneroso, 1998, Panitch, 2000). Under the pressure of the triple unholy alliance, the exemplars of developmental state such as Korea are forced to withdraw their interventional policies, and start to deregulate their financial control. Consequently, the system becomes vulnerable to the attack of hot money, and runs into a catastrophe. In other words, it make nonsense to engage a deep restructuring of financial system because of a temporary liquidity crisis struck them as inappropriate, given the model has proven its manifold developmental advantage (Pempel, 1999).

of organization and mediates between the seemingly polarized position of state regulation and market rule.[5] As argued by Storper (2004), the particular local and national forms of social organization in which social actors' daily lives are embedded underpin the supposedly transparent and anonymous forces of markets and state in modern society. In turn, these two forces shape the particularity of the social organization and interaction within the community.

In the case of financial services, the formation of the community will be heavily affected by state action and market shaping, and vice versa. In a late-developing country such as Taiwan the financial market is strictly regulated at an early stage and has been forced to loose control gradually. What are the forces behind the liberalization process? Furthermore, what kinds of institutions will work with the state and the market to govern the new system? Moreover, the technology transfer literature has demonstrated the particularity of the latecomer context in industrial development (cf. Amsden, 1989) and this leads to the question as to whether the late development situation applies to the financial industry in the construction of market. If so, are there any differences for the development of the professional community in the local context? All of these questions will be explored in the research reported here which is based on a case study of the creation of Taiwan's futures trading sector.

In the next section, the methodology is explained, followed with a brief discussion of the relationship between the developmental state and financial repression before the liberalization of policy in the late 1980s. Then, we will detail the development of the futures market in Taiwan. A number of particularities will be raised to illustrate the role of the state in the shaping of the market and the associated professional community. After the historical review, the social networks and product innovation of the community will be discussed. It will focus on the three domains of social networks in the decoding of financial information in the context of Taiwan's futures market.

Methodology

This chapter is based on the findings of a research project that commenced in May, 2004. The project examined the social and professional networks of the futures trading industry in Taiwan. In the research process, interviews were conducted with the general managers of 28 futures trading companies selected from the membership list for the Taiwan Futures Company Association, the major industrial association. Besides, representatives of key government agencies, business organizations and other social groups in the futures industry, related financial sectors such as securities and banking were also consulted. At the start of the research, a preliminary working hypothesis was adopted about the relationship between state policy and the evolution

5 'Community' is widely referred as the networks of social interaction among social agents with specific identities or collective emotion (Bauman, 2001). They are bound by relations of common interest, purpose, or passion, and held together by routines and varying degrees of mutuality.

of the futures trading community in Taiwan's newly emerging market. This was used a framework for formulating a semi-structured set of interview questions. The interim framework allowed us to focus on the research topic, and at the same time, to expose us to feedback on our original hypotheses from the real world. As more information was gathered, we sharpened our analysis and raised more critical issues in the interviews. In the corporate interviews, in particular, we were cautious to double-check the results from each interview with cross-references. These interviews typically lasted at least one hour. After each interview, the researchers discussed the findings, encoded the information, and challenged each other's assessment of the topics discussed.

In addition to the in-depth interviews, government publications, business surveys, and journal reports have provided valuable input to this research. However, in order to avoid turning the research into a collection of business anecdotes, we have been particularly careful when attempting to draw conclusions from these reports. We have double-checked with the relevant people or agencies before making any final judgments.

From Financial Depression to Financial Deregulation?

As a developmental state, the then ruling party, the KMT party (Kuomintang), manipulated financial resources as the key tool to leverage strategic industries. The financial policy was very conservative under KMT rule, perhaps because of its experience of failure in Mainland China before it was defeated by the Communist Party in 1949. Because of attributing the failure partly to the financial disorder, the KMT party tightly controlled the development of financial activities after it retreated to Taiwan (Cheng, 1990). Three points, particularly relevant to the futures trading industry, characterized the financial repression in Taiwan before the liberalization policy of the late 1980s.

Firstly, financial activities have played an ambivalent role in economic development since the state initiated industrialization in 1960s. On the one hand, the state used its financial resources to target key industrial sectors in line with developmental state theory. Finance played the supporting role for national industrial policy. On the other hand, the state had to tame the financial beast by controlling its full fluidity in order to weaken its subverting potential. Private companies were not allowed to obtain foreign loans directly and had to check with the state-owned banks. The penetration of foreign capital was strictly limited to certain financial areas and the foreign exchange rate was set and manipulated by the government (Wang, 1996). Taiwan's economic growth has been financed almost exclusively by domestic savings.

Secondly, a banking system that controlled credit allocation was the pillar for Taiwan's financial system before late 1980s.[6] State-owned banks selected their

6 Zysman (1983) makes two main types of national financial systems. The one is a capital market dominated system, in which securities and bond markets are the major channel

clients not on the basis of level of interest rate they could levy, but on the basis of their own 'policy discretion'. More importantly, as securities and foreign exchange markets were strictly manipulated so as not to disturb financial stability, most of the funding for the private sector came from banking loans, rather than from the capital markets (Chu, 1999, Wu, 1993).

Finally, the weakness of the capital market led households to choose bank savings as the most convenient channel for investment, even though the official interest rate was undervalued (Wu, 1993). As the banking system could not absorb the amount of capital accumulated as a byproduct of the process of national economic growth, a number of illegal financial mechanisms began to emerge to 'solve' the problem of over-accumulation.[7]

However, things changed gradually following the liberalization policy of the late 1980s. On the one hand, economic restructuring started to push the majority of Taiwanese labor-intensive sectors, such as plastics, footwear, and textile industries, into seeking cheap labor. Information Technology (IT) industries became the propelling sector, and started to take advantage of the booming domestic savings in the capital market to rise the funds that they needed. Prices on the stock market skyrocketed and the economy overheated in the 1990s. On the other hand, the pressure from the US to open the market in financial areas forced Taiwan to change its policies on foreign exchange and regulation. In fact, the pressure for deregulation also came from key national business groups, which were excluded from setting up commercial banks, but which began to penetrate the financial forbidden garden in late 1980s (Lin, T., 2001).

In 1994 the state proposed a major project (Project of Asian Pacific Operation Center) to take on the challenges from both the domestic and international sides. A financial center plan was included in the Project. It aimed to loosen the regulation of the banking system to allow the emergence of big private banks as well promoting the operation of a 'sound' capital market to channel capital into profitable investments. In particular, the core objective for the financial center project was to transform the old banking-dominated system into one that was capital market dominated with a focus on the development of derivatives, foreign exchange, and stock markets (Yeh, 1997). Financial deregulation in the early 1990s led to a boom in the capital market

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of capital raising. It's popular in the US and the UK. The other is a credit based system, in which the state or a small number of big banks control the interest rate and credit allocation, and other kinds of financial tools are difficult to be utilized for capital raising. It's prevalent in the East Asian developmental states such as Japan and Taiwan.

7 Most of the illegal investment companies collected capital from the community networks, with a name of *Mouse Association* to illustrate the prevalence of informal social networks. They offered a much higher interest rate (mostly double or even five times than those from the banks) to attract the household savings. They invested in the bubble economies such as land speculation. Once the economic condition encountered downturn, they went bankruptcy, and caused serious social problems (Lin, T., 2001). The underground futures trading companies, as shown below, is another case.

and around mid-1997 Taiwan's stock market ranked sixth in the world in average trading volume and fifteenth in terms of overall capitalization.

The change appears quite dramatic but why did the developmental state leave its major tool, credit allocation through the banking system, broken down without protection? In fact, in response to the neo-liberalism challenge, the state has chosen a sequence of financial liberalization steps that put priority on deregulating the domestic capital market over foreign participation. Despite the trend toward global financial integration, the state has still been cautious about the full internationalization of local currency, and controlled the volatility of cross-border movement of short-term capital (Chu, 1998). Even the QFIIs (Qualified Foreign Institutional Investors) were only allowed to enter the local capital market in an incremental rather than 'big bang' way. The state put a ceiling on the rate of stock held by the QFIIs in each local company's capital value at 5 per cent in 1991, rising to 15 per cent in 1998. Purchase of more than 50 per cent of any local company's value with local capital was not permitted until late 1999. In the adjustment process, small increments to the ceiling were usually increased by the state every two months. The process of financial deregulation in Taiwan was thus characterized by Chu (1998) as 'dragged and incremental'.

The reasons behind the conservative policy came from the contradiction between the need for financial stability *and* financial liberalization. The state tried to balance the two contradictory demands and created a catch-22 situation. Concerns for stability have become keen as Taiwan was diplomatically isolated from the international community and was in a situation of political and military confrontation with mainland China. The concerns caused the government to keep a wary eye on capital flows since:

> unlike Thailand, South Korea, Indonesia and the rest of the reckless tigers, Taiwan knew that it could not afford to go bust. As a diplomatic pariah, it was banished from virtually all important international organizations, including the IMF. If it got into trouble, it could not hope for a bail-out. Indeed, it worried that in the event of a domestic economic crisis the mainland China might just invade it' (*Economist*, Nov. 07, 1998).[8]

In other words, the state's longstanding policy guideline for financial management has been characterized by its overriding concern for financial stability since the KMT regime restored in Taiwan after 1949. However, the attitude towards the financial

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8 Such cautious tones were echoed by the government even the political change after the presidential election in 2000, which ended the 50 years long of KMT rule in Taiwan. The new minister of finance, Mr. Hsu Chia-dong, claimed that 'in the antagonistic situation between mainland China and Taiwan, we could not but worrying the free flow of capital would hurt Taiwan's financial stability. If we were to let capital flow without ceiling, one the one hand, the mainland China would absorb most of capital outflow, and would keep Taiwanese capital hostage and threaten us. On the other hand, the capital from mainland China would enter Taiwan, and could disturb our financial order to match the military actions' (Lin, Y., 2001).

sector has shifted from seeing it as a tool for the industrialization goal under the thumb of the developmental state before the 1980s, to liberalizing it to allow growth in response to the neo-liberalism hegemony. The contradiction between the institutional path dependency for stability and the institutional change for growth constituted the core issue in the emergence of the capital markets. Without doubt, the dilemma also appeared in the decision to establish a futures trading industry, a high risk and abstract capital market.

The Rise of the Futures Trade Industry in Taiwan: Reluctant State and Decentralized Market

A Short History of Taiwan's Futures Market: Offshore First, Then Inshore

The burgeoning of Taiwan's futures market can be tracked to the 'underground' futures trades undertaken by a number of business groups from Hong Kong in the early 1970s. It was not legalized at that time, as the government viewed such activity as gambling and did not want it to disturb financial stability. The accumulated household savings aggravated this money game and stimulated the growth of an underground market in the late 1980s.[9] The underground dealing companies were generally criticized as bucket shops, not sending clients' orders to foreign exchanges, parceling clients' money, and running away when they lost clients' money (Li, 1982).[10] The Taiwan government had twice (1983 and 1996) raided these futures companies but failed to wipe them out. Even though the legal FCM (Futures Commission Merchants) or IB (Introducing Broker) are widespread today, the underground futures companies have never perished (as reported in some newspapers, see Yang 2003). There were over 350 underground traders and a trading volume of more than NT$ 40 billion per day at the peak (Lin, 1988). It was not until the early 1990s that the government decided to legalize the futures trading industry (FTI).

The decision in the late 1980s to introduce legislation was made at a time when staple commodities price instability caused by international currency fluctuation was an important problem; futures trading was suggested by several key commodity exporters as a way of hedging the risk. Moreover, from then on, the Taiwan

9 Chu and Lee (1998) argued that a series of ominous economic signs, such as the mushrooming of underground financial institutions, bubbles in real estate and stock markets, and rapid deterioration of private sector investment, compelled the government to take decisive measures to overhaul the financial architecture in late 1980s.

10 According to Mr. L, the president of company H, a futures house with 120 employees, who has worked in the underground shops for more than five years, 'the underground dealers cheated their customers in most cases. When the customers deposited a margin, let's say NT$ one million, the dealers took more than half as their profit. If the customers lose, the money would stay in the dealers' pockets. Even if the customers won, the dealers would close the shop and run away to wait time to open another new shop. It caused serious issues in the public order' (interview with Mr. L, July 9, 2004).

economy has faced the pressure of industrial restructuring, and service industries, including financial services, have become critical for economic development. In addition, the trading volume on the stock market has continuously expanded and sometimes fluctuated fiercely, which also implies an increasing need for investment diversification and hedging. The relevant legislation finally passed into law in 1993 and the first futures brokerage company, Grand Cathay Futures Corporation, was established in 1994.

However, the legacy of the underground companies for the futures industry was unexpectedly significant in two perspectives. On the one hand, it served as a training school for many of the key managers of the 'legal' trading companies. Most of the 'underground' ex-employees accumulated their brokerage experiences and mastered the skills, as well as languages, of operation at that time. Once the industry was institutionalized, they were recruited as the foundation employees, and were soon promoted to the manager ranks. In a sense, the underground companies trained the generals and paved the way for the later legal 'troops'.

On the other hand, the fraud practices endemic during the underground period left a scar in the minds of the general public, and impinged on the government's policy making. In fact, underground traders still exist in Taiwan in order to take advantage of low brokerage fees and narrower margins than those in the legitimate businesses.[11] To avoid fueling the money game, the government adopts a gradualist approach to financial deregulation. Rather than pushing the market growth hard, the government loosened financial control step by step. It basically reacted to the issue of underground futures as a social problem, without a clear intention to take the futures market as a key element in the construction of a sound financial system. Under such circumstance, the futures markets were legalized in two steps: first, offshore futures contracts trading, such as those launched by the Chicago and Singapore markets, were permitted and this bypassed the 'Offshore Futures Transaction Law' of 1994. After three years, an inshore trading market, the Taiwan Futures Exchange Corp. (TAIFEX) was established in 1997, and eventually in July 1998 the first local futures contract designed by TAIFEX was launched.

The legislative process was not without controversy. Establishing the FTI was taken as part of the project for setting up the regional financial center in Taipei. A hot debate about the sequence of opening either offshore or domestic markets first occurred in the legislation process. The government finally opened the offshore transactions first because the underground traders had engaged in such business for a long time and it would be easier to legalize such transactions. If the policy was to prioritize the domestic market, which would be beneficial for the long-term objective for a sound financial system, it would take longer to pass the necessary

11 According to the law, each trader has to provide an initial margin for transaction to guarantee the later payment. In most cases, it only half or even none of the initial margin is required in the underground practice, which is usually based on mutual trust. It is obvious that the transaction cost is much lower for the underground brokers. As a result, it is expected that the underground brokers over-number their legal counterparts today.

legislation and might trigger speculation (Zan, 1993). Even in the permission for the offshore transactions, the capital requirement for establishing a brokerage house is NT$ 200 million (equivalent to US $ 7 million), quite high by comparison with their counterparts in USA, which requires only US$ 250 thousand.[12] This reflects again the logic behind the government's reluctant internationalization policy: to control the volatility of cross-border movement of short-term capital and hinder the full penetration of local financial activities by foreign capital.

However, these initiatives were challenged by the lawmakers who represented a number of key business groups. Among the disputes, the issue of whether to allow the same business group to engage in both stock dealing and futures dealing was raised. According to the government's plan, it was not permitted to merge together to create securities houses that would be beyond governmental control. But, as the securities business groups gathered together to fight, the government made slight adjustments to its initiatives that allowed securities houses to spin off another formally independent futures shops. 'By doing so, a firewall could be raised to prevent illegal dealings to occur for the financial business' argued by Mr. Lin Zong-Yong, the then vice-chair of the committee of securities management, who was in charge of the establishment of the FTI. The government was indeed cautious about the opening of seemingly speculative business and tried setting up barriers to the merger of financial businesses to avoid the prospect of disturbing the financial order.

In addition to the restrictions on market area and starting capital, the law also regulated closely the kinds of transaction and contracting procedure. Only those complying with the law will be allowed to engage, otherwise, a penalty will be imposed. In the words of Mr. W, the chair of the futures association:

> the aim of the government in the futures trade law is to prevent abuse, rather than to promote the industry. The bureaucrats do not take the industry as a necessary element for the capital market to grow healthy, but as a trap of speculation. Even they are forced to open market, they hesitate to comply with the liberalization doctrine'.[13]

Irrespective of the extent to which the policy objectives materialized, two positive effects were certain for the development of futures trading market in Taiwan. One was the change in the public image of futures products and activities. At least, it was no longer exclusively illegal and could be a normal channel of investment. More than 22 futures trading companies were established in March 1995, one year after the passing of the law. The other was the creation of a professional association, the Taipei Futures Trader Industrial Association, for the futures industry. In order to control the development of the sector it was stipulated that all of the futures houses had to join the association. It represents their collective interest and engages in the promotion of the industry.

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12 In fact, the high capital requirement of the legal trader hinders the legalization of most underground traders. As a result, it is reported that most of the underground traders remain untouched after the law passed, and even keep growing today (Gao, 1995).

13 Interview with Mr. W, July 21, 2004.

Nevertheless, the most significant development in the futures market has been the establishment and growth of the local exchange market. After permitting foreign futures transactions, the government started to draft the law to set up a local trade market. Meanwhile, two events pushed the government to speed up the legislation process. Firstly, a Taiwan Stock Index Futures planned to be launched by the CME and SIMEX in late 1996 caused concerns among the state if Taiwan would lose the supposedly advantageous local merchandize.[14] Secondly, an idea for a 'Pacific Asian Regional Operation Center' was proposed by the state to situate Taiwan in the global economic system. It argued that in order to attract foreign investment and to push the domestic financial market and institutions to be international, the government should head toward a journey of deregulation and liberation. A local futures market was taken as one of the symbols of a competitive financial system. Besides, the newly founded Futures Traders Association lobbied heavily with the opposition party legislators and forced the government hand to prompt the legislation process. Under the circumstance, the Futures Trade Law, which mainly covered the establishment of a local futures exchange market, was passed in 1998. Under the law, a locally launched index, the Taiwan Securities Exchange Capitalization Weighted Index (TAIEX) became a major target in the local market. A series of measures in Taiwan's futures market are shown in Table 10.1.

After the opening of the local market, the scale of Taiwan futures market has kept growing. Figure 10.1 shows the total trading volume of the Taiwan futures market from August 1998 to March 2004 and the following Table 10.2 shows the trading volume of each contract in TAIFEX. Figure 10.1 shows how the trading volume at the Taiwan Futures Exchange has skyrocketed, as the volume in the TAIEX options contracts repeatedly jumped higher. In addition, the TAIEX futures contract also fared well. As a result of such growth, the Taiwan Futures Exchange joined the top 20 derivatives exchanges by volume for the first time in the first quarter of 2004 (DeGrandis, 2004).

Such stock-based products reflect one of the major characteristics of Taiwan's economy: the turnover and volatility of the local stock market is extremely high in comparison with other countries. Since its takeoff in 1994, Taiwan's over-the-counter market has rapidly expanded into one of the most highly capitalized OTC markets in the world. An anticipation of the vigorous stock market influenced the planning and launching the sequence of derivatives; the government wanted to avoid fueling an overheating stock market by promoting the futures market too hard (Zou, 2002). The

14 In early 1996, SIMEX in Singapore has contacted with the Securities Management Commission (SMC) for their plan to launch the Taiwan Stock Index Futures in their market. The same year later, CME in Chicago also showed their intention to do the same commodity. As the law for the local transaction was yet passed, the government did not approve the actions taken by the SIMEX and CME. An urgent meeting was called by the SMC to coordinate and dissuade these 'unfriendly' actions. At the same time, the government decided to accelerate the passing of the law to legalize the local transactions, 'so that Taiwan could remain competitive in the establishment of the regional financial center', according to Lu Dong Ying, then the chair of SMC (Li, 1997).

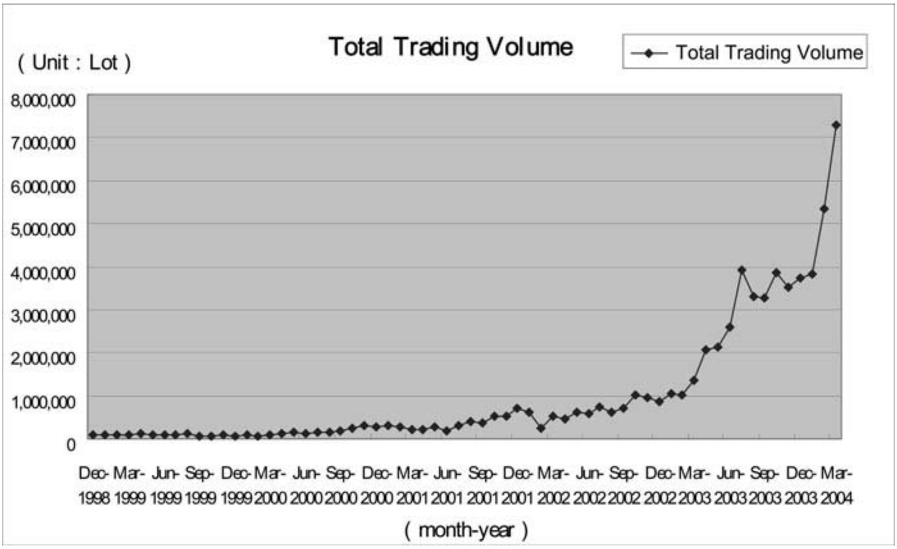

Figure 10.1 Total of trading volume at Taiwan Futures Exchange

Securities and Futures Commission was set up to manage the development of these two industries in 1997. The Commission vigilantly launched new commodities and little by little loosened the controls on the penetration of foreign capital into the local market. Mr. L1, the president of S Futures, the third largest house in Taiwan and a senior veteran in the industry complained that:

> the government never gave the futures industry an equal footing with the securities, and neither took these two industries as symbiotic. The key concern for the Securities and Futures Commission has always targeted on the development of stock market, and the futures market next. Every time while the Commission decided to launch new commodities in the latter, the first question would be if these would disturb the former.[15]

Market Facts

In line with the wisdom of institutionalism, the market was embedded in social and political structures. State policies would shape the market behavior in some ways. The reluctant liberalization enforced by the state resulted in the weakness of the financial service industries in Taiwan. As shown above, the state set up strict rules on the allowance of investment in the futures market by the institutional investors, so that the state could tame the organized investors safely. In combination with plenty of household savings without appropriate investment outlets, futures and options trading, similar to the structure of the stock market, was driven primarily by natural

15 Interview with Mr. L1, July 9, 2004.

Table 10.1 A series of measures in Taiwan's futures market after 1998

Date	Product	Relevant (de)regulations and rules
1998.7.21	TAIEX* futures (TX)	
1999.7.21	Taiwan Stock Exchange Electronic Sector Index Futures (TE) and Taiwan Stock Exchange Banking and Insurance Sector Index Futures (TF)	
1999.10.30		Allow QFII to short futures as the hedge.
2001.4.9	Mini- TAIEX Futures (MTX)	
2001.12.24	TAIEX Options (TXO)	
2003.1.7		Permit foreign investors the total position (including total futures contracts market value and the premium of put option) over the 30% of the purchased stock.
2003.1.20	Equity Options (STO)	
2003.6.30	Taiwan 50 futures (T5F)	
2004.1.2	10-year Government Bond Futures (GBF)	
2004.5.21		Allow foreign investors to long futures as the hedge to the position of securities to be purchased.
2004.5.31	30-Day Commercial Paper Interest Rate Futures (CPF)	
2004.6.15		Allow foreign investors to long futures as the hedge, regardless of whether they have already invested in spot market.
2004.6.30		Stipulate foreign investor for the long and short position separately. (The decree induced serious reaction from futures association and those institutional investors influenced.)
2004.7.15		In the newsletter issued by the Securities and Futures Bureau (SFB), the SFB approved of some opinions of the futures association, and hence promised to use net position to regulate foreign investors. But the details of calculation were still left to consult.

*'TAIEX': Taiwan Stock Exchange Capitalization Weighted Stock Index.
Source: http://www.sfb.gov.tw/ensfcindex.htm.

Table 10.2 Trading volume of each contract in TAIFEX

Futures Contracts \ Total Trading Volume(Lot)	2004, Jan-Mar.	2003	2002	2001	2000	1999
TAIEX Futures (TX)		6,514,691	4,132,040	2,844,709	1,339,908	971,578
Taiwan Stock Exchange Electronic Sector Index Futures (TE)		990,752	834,920	684,862	409,706	87,156
Taiwan Stock Exchange Banking and Insurance Sector Index Futures (TF)		1,126,895	366,790	389,538	177,175	18,938
Mini-TAIEX Futures (MTX)		1,316,712	1,044,058	427,144	NA	NA
Taiwan 50 Futures (T5F)		4,068	NA	NA	NA	NA
TAIEX Options (TXO)		21,720,083	1,566,446	5,137	NA	NA
Equity Options (STO)		201,733	NA	NA	NA	NA
10G bonds		NA	NA	NA	NA	NA
Total	16,433,992	31,874,934	7,944,254	4,351,390	1,926,789	1,077,672

Source: TAIFEX, http://www.taifex.com.tw/taifex0302.asp
*NA:No data, because which contract was not launched yet in that year.
**The underlying index of both TX and MTX is Taiwan Stock Exchange Capitalization Weighted Stock Index (TAIEX). The TX is 4 times the contract size of the MTX.

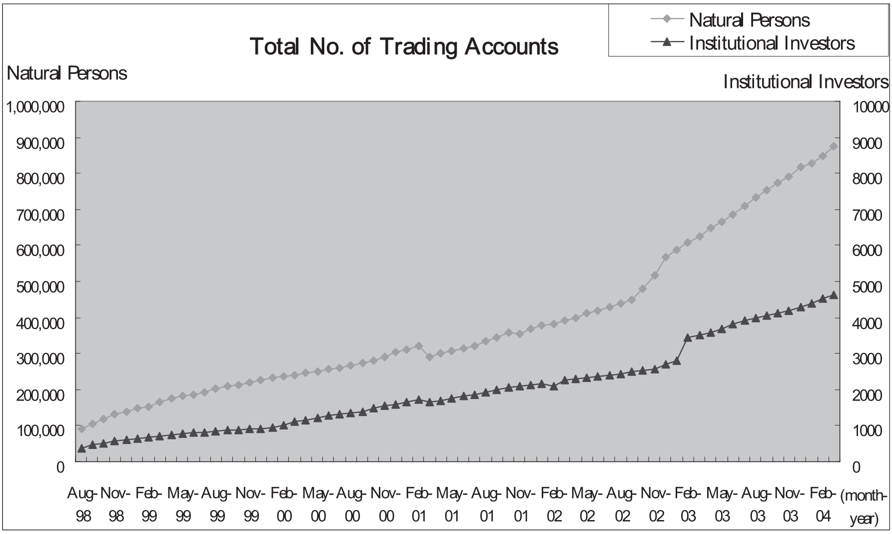

Figure 10.2 Trading account number of natural persons and institutional investors

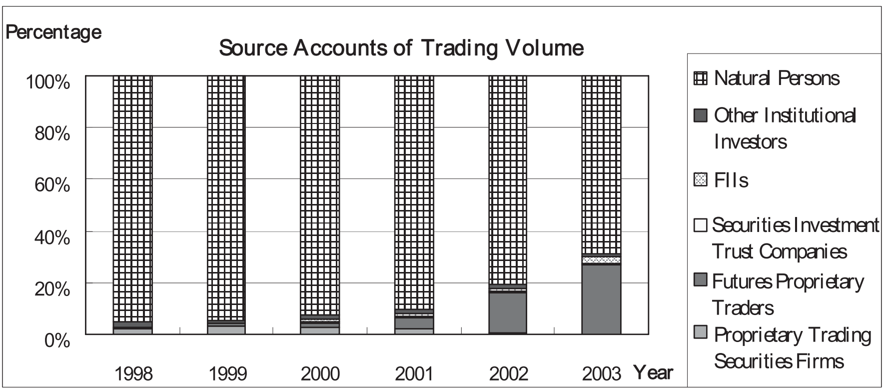

Figure 10.3 Source account of trading

persons (retail investors). In total trading volume, retail investors always accounted for over 50 per cent (Figures 10.2 and 10.3).

A market dominated by retail investors influenced heavily the activities and strategies of the futures dealers. Most of the individual investors carried less analytic capability and decision-making power in the market, and usually relied overwhelmingly on the judgments of the experts. As argued by Leyshon, Thrift and Pratt (1998), the perennial problem which faces all producers of financial services is information asymmetry, that is, providers and consumers of financial products have unequal amounts of information (and knowledge) about whether or not customers have the wherewithal to make them 'capable' purchasers. Natural persons are usually conceived as seriously information-handicapped investors, by comparison with institutional investors who usually employ researcher and analyst teams to help decision-making in an increasingly complex financial world. In addition, the natural persons are also quite sensitive to price, they care most about the cost of brokerage fees and transaction tax. Price competition rules over the futures market in Taiwan.[16] In other words, the major group of customers in the market is typically short of expertise/knowledge and susceptible to making decisions on the basis mainly of price. Therefore, two effects are produced in this market dominated by retail investors. Firstly, it leads the futures traders to exploit the ICT (information and communication technology) which is often claimed to render the financial texts readable and empower individual investors in decision making, to cost down their business operation. As a result, the digitalization of financial services is in vogue in Taiwan. Designing a humanlike trade platform becomes one of the major advantages in Taiwan's futures market. Secondly, even though ICT is widely utilized in the market, 'traditional' interpersonal relations and networks still matter in this natural person dominated market. The trust engendered in the process of other financial transactions, particularly securities and banking, can be helpful for the futures traders to expand their customer bases.[17] Consequently, the IBs (introducing brokers) who work in the branches of securities houses but are engaged in futures dealings for their frequent customers still play a key, if declining role, in the operation of Taiwan's futures industry.

The other characteristic of Taiwan's futures market is that foreign capital plays a relatively insignificant role (Figure 10.3). The government still hesitates to remove the restrictions on the entry of foreign capital in the decision making process. It adopted a series of gradual and adjustable measures on the deregulation of foreign penetration (see Table 10.1). The attitude of xenophobia illustrates the concern of the government to buffer the local financial market from the incursion of skillful 'players' who might jeopardize the stability of the stock and futures markets. Not until very recently did the Taiwan government approve of the newly amended regulations on foreign investors in futures trading.[18]

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16 Almost of all general managers complained the deteriorating price war in the business from our interviews. For example, the president of P Futures, the largest futures house, Mr. H described the severity of the price war, 'We introduced a humane interface technique which rendered the transaction easy from Korea to the market and set the brokerage fee at NT$ 100 per each transaction six months ago. Two months later, another company transferred the similar technology, and reduced the price to NT$ 80 per unit. This move forced me to follow suit and reduced the fee to NT$ 69. But, taking account of the cost of the technology transfer, the reasonable price should be around NT$70. The cut-throat competition would lead to an internecine situation' (interview with Mr. H, July 23, 2004).

17 Most of Taiwan's futures trading companies belong to the financial holding groups after 2003. Therefore, the former can get access to the customer bases of the latter which usually include banking and securities services.

18 Take the disputing order issued on June 30 2004 for example. The Premier Yu announced 4 liberalization measures on May 2004 to 'accelerate Taiwan's capital market

The ambivalent policies on foreign capital dissuade, to some extent, foreign investors from embracing Taiwan's market. Even though foreign capital takes a great deal of interest in the booming market, few of them set up offices in Taiwan. Most of the transactions are conducted from Hong Kong, with ordering contracts made through the channels of some specific traders, such as Capital and Grand Cathay. It is generally conceived that foreign capital, based on its long term accumulated experience, possess better trading skills than the local ones. The expatriate communities formed by the managers and professionals employed in the foreign companies could constitute a key channel of technology transfer to the host society in the financial centers, as shown by Beaverstock and Bostock (2000). As most foreign dealings are conducted 'at a distance', the story basically does not apply to the case of Taipei, with the exception that foreign capital has to dispatch its traders to Taipei for the 'market feel'. Nevertheless, the skilled transient international migrants still only constitutes a small group in the futures trading communities in Taiwan.

The Formation of the Under-developing Community of Professionals

Another key feature shaped by state policy was the communities of the futures dealers. So far, three major groups have been identified in the managing cohorts in Taiwan's futures trading industry. The first group is composed of those managers who worked in the underground shops at the early stage and were recruited to the newly established futures houses. Most of them accumulated the trading skills from nothing via the bucket shops; few have degrees in the relevant disciplines. Learning by doing was the key channel of mastering trading skills.

> In the beginning, I, as a graduate from agriculture studies, knew nothing about futures. As an underground company, it could not offer the formal course to train new employees. My then boss, who was from Hong Kong and has been in the business for more than 10 years,

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internationalization, and to render Taiwan's market development more in line with advanced securities markets around the world' (SFC, 2004). However, the practical orders and actions showed the ambivalent attitudes and being unfamiliar with practices of trading/market. The origin was that on June 15, in furtherance of the Yu's speaking, the SFC amended relevant articles to relax varied limitations on foreign investors, which allowed foreign institutional investors to long futures as the hedge to the position of securities to be purchased, regardless of whether they have already invested in spot market. It was expected to increase the flexibility of foreign fund's investment strategy and operation. But on June 30, following the afore-mentioned relaxation, an auxiliary order required the long and short position counting respectively. Moreover, the total amount of long position, which meant futures contracts market value plus options premium, can't exceed the cash and approximate cash position. In addition, the short position can't be over the total market value of securities possessed (i.e. stock and bonds). Such order upset local FCM and foreign institutional investors a lot, not only because it separately counts long and short position, but also the high requirement for buying hedging. The futures association and some investment institutions (including Merrill Lynch and others) immediately tried to exchange views with officials.

> took me directly to the trading place just after a short course. I spent time accumulating trading experiences and interacted closely with my customers and supervisor. It took me two years to master the variety of skills in handling different positions (Mr. L, the president of H Futures, recalled his early experience).[19]

As first movers, they were mostly promoted to high ranking positions in the newly legalized futures trading companies.

The second group came from those who participated in other financial service industries, particularly securities, before transferring to the futures sector. These experienced financial operators usually took advantage of the combination of varieties of financial tools in running the futures business. Most of them were employed by the newly established financial holding companies, and could utilize their social relations to persuade customers from other financial fields to join the futures market. They built up their competitive edge in the business by exploiting their widespread social networks within the futures industry and extending to other financial business at the entry stage. Accumulating knowledge about the stock market, they were usually quick to get particularly familiar with the trading skills in option futures. Based on their existing skills, they had to be sensitive about the difference between these two seemingly overlapping businesses. As stressed by Mr. C, the president of W Futures:

> The requirement of professionalism is higher in the futures industry than that in securities. While I was in the latter, what I needed to do is to establish relations with my customers, but in the futures business, I have to do research in trade model building and strategy setting, otherwise, I will be eliminated through competition.[20]

Besides the top managers, the makeup of the operating group was mainly the salespersons in the front counter, or the IBs (introducing brokers), in the securities houses. The securities sector has been better developed in Taiwan, and penetrated each household economy. It served as the capillary attraction of capital flow, and constituted one of the major channels for managing household finance. Most of the key financial groups had securities branches over the island. For the futures sector in the same group, these amounted to the could-not-be-better sales points. Take the case of company F, the currently number four market sharer, as an example. The F Securities possessed 64 branches, in contrast to only one for the F Futures. Thus, the latter provided a series of on-the-job training, and incentive mechanisms to mobilize the salespersons of the former to expand its market share. According to Mr. J, the president of F Futures, 'The interpersonal trust fabricated between the IBs and their customers from the securities business could be transferred to the futures business'.[21]

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19 Interview with Mr. L, July 9, 2004.

20 Interview with Mr. C, July 14, 2004.

21 Interview with Mr. J, July 15, 2004.

The third group, which is relatively small, comprises the ex-employees of the foreign companies in Taiwan or abroad. Among them, Chair W of the futures Industry Association and Mr. L1 of S Futures are exemplars. Mr. L1 worked in Merrill Lynch (Taiwan) before hopping to local companies, and Mr. W was a long-time futures brokerage manager in Chicago before being recruited back to run the local company, and become the Chair of the Futures Association. Since the activities of foreign capital were constrained, these veterans of foreign companies were the key channels for transferring new products and operation techniques, such as hedging skills, back to Taiwan.

The institutionalization of the communities was achieved by the formation of the Taiwan Futures Company Association. As the membership was obligatory by the law, the association became the key agent of collective interest and identity. Through the participation of the social and professional activities sponsored by the association, these three groups of managers maintained and enhanced dense social networks. More important, their monthly meetings provided a forum for the members to settle disputes and to reach consensus. The association could play the role of collective agent to lobby for favorable policies in the legislation process (Liu 1996).

Overall, the communities of professionals in Taiwan's futures industry were dominated by the locally trained groups spun off from other financial businesses, mainly securities, with a few returnees equipped with foreign experiences and skills. As most of the transactions were based on cost consideration, the expertise for the futures dealers was to master the borrowed technique from other countries such as Korea, and to exploit the advantage of networking extending from other financial business. Under the circumstance, it was the extent of social networks, rather than the sophistication of trading skill that was critical in the business. In other words, the reluctant state policies led to a decentralized market structure which further shaped an under-developed professional community in Taiwan's futures trading industry.

Conclusion

While financial liberalization was praised by neo-liberalists and criticized by political economists, its process has not been thoroughly examined in most studies. The establishment of Taiwan's futures market provides a case example to show how a developmental state adopted policies to meet the liberalization challenge, and at the same time, maneuvered to maintain the stability. Against the neo-liberalist argument that liberalization policy demonstrated the death of the state in managing financial flow, Taiwan's case suggests that the state can contrive a sequence of liberalization to balance the deregulation mandate and financial order. The case also refutes the discourse of the developmental state which identified the bureaucratic plan as the key driver behind financial transformation, since dragged and reactive responses characterized the main theme of state policy. In the process of forced liberalization, a market dominated by natural persons and little foreign capital participation was created. The market was characterized as decentralized and price sensitive to the service charge, and at the same time, required the brokers to stitch the knowledge gap for individual investors, rather than the institutional ones, in the complex financial transactions. Under such circumstance, it was the extent of social networks, rather than the sophistication of trading skill that was critical in the business. In other words, the reluctant state policies led to a decentralized market structure, which further shaped an under-developed professional community in Taiwan's futures trading industry.

As Storper (1997) argued, institutions consist of a persistent and connected set of rules, formal and informal, that prescribe behavioral roles, constrain activities and shape expectations. Institutions provide a cognitive structure to legitimize collective action, and tend to evolve incrementally in a self-reproducing and continuity-preserving way (North, 1990). At the same time, institutions are the products of historically-situated interactions, conflicts, and negotiations among different socio-economic actors and groups (Martin, 2000). Thus, institutional breakthrough could occur in the course of political struggle among the asymmetrically powerful agents.

The dialectics of path dependency and path breakthrough can shed light on the disentangling of the deadlock of state-market antitheses. Following the theoretical thread, the liberalization of the financial system in the developmental state can be understood as a process of the state's will to adjust in the new historical conjuncture set by the neo-liberalist hegemony, and simultaneously, it wants to keep policy priority over the control of the financial resources to avoid the damage drawn from the abrupt de-regulation process. It's a process of institutional learning, as well as institutional resistance.

Moreover, institutional evolution unfolds in different ways at various geographical scales, and constitutes the pillar of the particularity of each locality (MacLeod, 2001). Martin (2000) added that the evolution of particular institutional architectures would give rise to distinctive local, regional and nationally instituted 'configurations of capitalism'.[22] Hayter (2004), furthermore, argued that path dependent sectoral, regional or corporate trajectories were neither predetermined nor 'random walks'. Institutional evolution matters in different ways in different places. To claim financial liberalization as universalism is, in a sense, misplaced. In contrast, identifying and scrutinizing the social agents that interact with each other and their situated institutional endowments in the process of the financial deregulation in specific cases could be stimulating in the study of financial geography (Clark, Tracey and Smith 2002).

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