Policy Design and Implementation of Taiwan's Privatization

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ABSTRACT

In the face of the changing economic and political environments faced by SOEs, Taiwan's government revamped its blueprint for privatization in 1989. Although the policy was designed and implemented on a trial-and error basis, it has produced substantial results in the past decade. Thus far, 27 privatizations have been carried out across a wide range of industrial sectors, yielding considerable proceeds for government and injecting competition into various market sectors. The purpose of this paper is to explore the policy framework of Taiwan's privatization in the past decade and the rationale behind it. The paper has four main points of focus: First, it outlines the key features of Taiwan's SOEs. Second, it reviews the major elements of the current policy framework. Third, it examines the strategies for privatizing SOEs of different types and their outcomes. And fourth, an attempt is made to quantify the costs and benefits of implementing privatization since 1989. The paper concludes with a look at Taiwan's privatization prospects.

I. Introduction

Taiwan's achievements in economic development, built largely on a series of successful industrial strategies in the 1950s and 1960s,[1] have long been recognized world-wide and have earned Taiwan's inclusion as one of Asia's four 'little dragons'. In the 1970s, the government started to pursue a new strategy of structural adjustment, aimed not only at fostering high-tech industries to replace the capital-intensive industries which became mature in the life cycle but also at reducing the role of the public sector in economic activities.

In the early-1980s, to help it emerge from the 2nd energy crisis and the resulting global stagflation, Taiwan launched a domestic demand stimulus program including a series of capital-intensive

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[1] In the 1950s, the government promoted domestic industries by its "import substitution" policy; and in the 1960s the policy shifted to "export expansion", which spurred the prosperous development of manufacturing industries.

projects. Under the changed circumstances of the global economic environment, the industrialized countries understood that only by reducing the role of the public sector could economic growth be sustained. This realization spawned the trend toward privatization, which soon caught on around the world.

The privatization of state-owned enterprises (SOEs) in Taiwan had its genesis in a conference of social elites held in 1984, which concluded in favor of promoting “internationalization, liberalization and institutionalization” in pursuit of continued economic growth. Though this was soon followed by Taiwan’s first ever bankruptcies of SOEs, two of which occurred in the mid-1980s, the concept was not adopted as official government policy until the late 1980s.

In the face of the changing economic and political environments faced by SOEs, Taiwan’s government revamped its blueprint for privatization in 1989[2]. Although the policy was designed and implemented on a trial-and error basis, it has produced substantial results in the past decade. Thus far, 27 privatizations have been carried out across a wide range of industrial sectors, yielding proceeds of US$11.36 billion, and injecting competition into various market sectors.

The purpose of this paper is to explore the policy framework of Taiwan’s privatization in the past decade and the rationale behind it. The paper has four main points of focus: First, it outlines the key features of Taiwan's SOEs. Second, it reviews the major elements of the current policy framework. Third, it examines the strategies for privatizing SOEs of different types and their outcomes. And fourth, an attempt is made to quantify the costs and benefits of implementing privatization since 1989. The paper concludes with a look at Taiwan's privatization prospects.

II. Key Features of the SOEs in Taiwan

After World War Two, the Taiwan economy went through a long period of rehabilitation, and was then launched on the process of modern economic development around 1952. Industries that had been built up by the Japanese during their colonial rule were handed over to the ROC government and served as the foundations for industrialization. The SOEs played a key role during Taiwan’s early stages of economic development, but their importance has gradually been replaced by the private sector in the latter stages of economic development.

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[2] The first round of privatization in Taiwan was embarked on as a supportive measure for the land reform program in the early 1950s, under which the government gave landowners shares in SOEs in exchange for the surrender of tracts of their land. Though some partial privatizations were subsequently conducted for certain policy purposes in the following decades, none of these touched on the goals of improvement of efficiency and social welfare.

(1) The Contribution of SOEs in Taiwan

Taiwan is a free economy with some elements of central planning in the development of its economy. Accordingly, SOEs played an important role in Taiwan's industrialisation both directly and through encouraging the growth of the private sector. The contribution of SOEs in Taiwan's economic structure can be observed from their percentage shares of gross domestic production, capital formation and government finance shown as Table 1. The figures peak in the 1970s[3] and start to decline in the 1980s.

For example, state firms accounted for 14.7% of GDP in 1951, rising to 16.7% in 1971. By 1996 the figure had declined to 10.8%, and stood at just 9.5% in 2000. A similar trend is also evident in the contribution of state industries to gross domestic capital formation and government finance. For example, state enterprises accounted for 35.2% of capital formation in 1961, 32.7% in 1971, and only 9.8% in 2000. This decline in the relative importance of SOEs in the economy was not caused by any run-down in state enterprises but rather by the rapid rise of the private sector.

In addition, SOEs have made a significant contribution to social stability, particularly in terms of providing job opportunities, even to the detriment of their managerial efficiency and profits.

Table 1. The contribution of SOEs to the Taiwanese economy

Year	1951	1961	1971	1981	1991	1996	2001
% share of GDP	14.7	15.9	16.7	16.0	13.4	10.8	9.2
% share of domestic capital formation	29.1	32.7	35.2	31.6	24.1	13.3	11.6
% share of government net revenues	3.7	9.4	10.5	9.4	6.6	9.0	8.2

Source: DGBAS and CEPD, Executive Yuan, Taiwan.

(2) The Status Quo of SOEs in Taiwan

In 2001, there were still 31 SOEs operating in Taiwan. Their combined work force numbered 188,357, equivalent to about 2.3% of total employment. Although SOEs have been declining in

[3] In the early 1970s, the Taiwan government launched the '*Ten Major Projects*', which included the setting up of China Steel Corporation and China Ship Building Corporation as well as other capital-intensive investments in infrastructure.

number and importance due to the continuous promotion of privatization, they still dominate several sectors, including telecommunications, electricity, petroleum, railway transportation, tobacco & wines, and shipbuilding. Table 2 shows the status quo of SOEs in Taiwan in 2001.

Table 2. Taiwan's SOEs in 2001

Number	31	
Sectors	Manufacturing	10
	Utilities	2
	Construction	1
	Retailing	1
	Telecom & transportation	7
	Financial	10
Total assets	US$593.8 billion	
Total owners' equity	US$119.6 billion	
Annual sales	US$80.8 billion	
Profits before tax	US$7.9 billion	
Employees	188,357	

Source: DGBAS, Executive Yuan, Taiwan.

III. The Policy Framework of Taiwan's Privatization

The motivation of government decision-makers is of utmost importance in shaping the outcome of a policy. Since SOEs were once the main policy vehicles for promoting economic growth in Taiwan, they were broadly exploited by government to carry out a variety of policy missions. In the 1980s, as the state's retreat from economic activities became a global trend, Taiwan chose to follow the same course and the mid-1980s saw its SOEs facing bankruptcy for the first time. After the concept of market liberalization had been incorporated into the government's decision-making process, a privatization policy was gradually formulated and adopted as a major plank of economic policy.

This section will introduce the eight main elements of the policy framework of Taiwan's privatization, including the legal basis of policy, the organizational framework for policy

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These projects helped the economy ride out the recession following the first oil crisis.

implementation, the scope of privatization, the pacing of privatization in concert with market liberalization, the methods of privatization adopted, the consideration of employee rights and interests, the fast-track mechanism for financially troubled SOEs, and the management of residual state holdings.

(1) The legal basis of policy

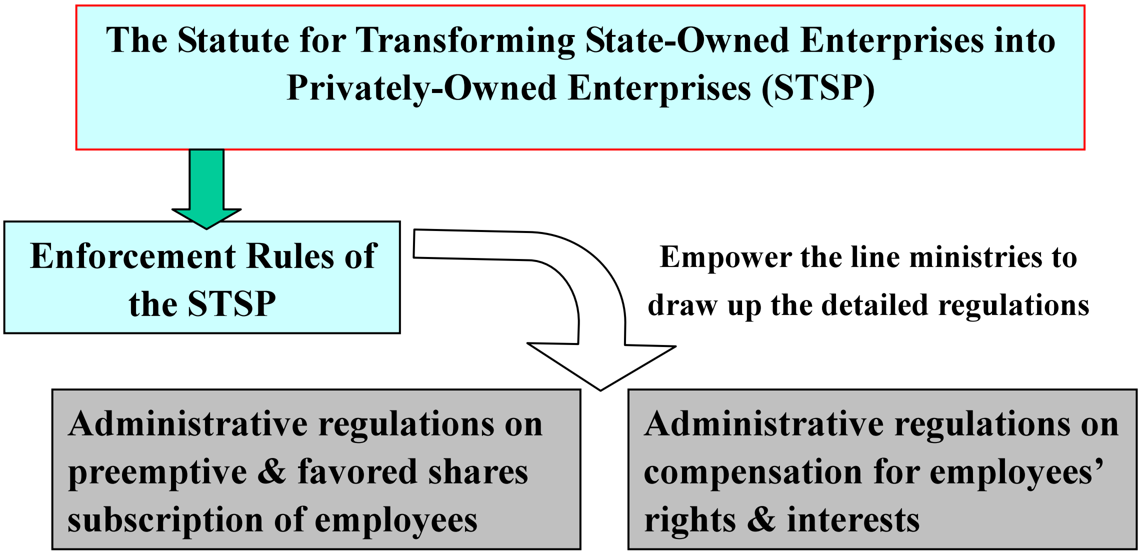
In a democracy, a legal basis is always required for a policy that might affect people's rights and interests. Whether or not a country needs to enact a privatization law depends on its legal and political situation and the specific characteristics of the enterprises to be privatized. In some countries the government does not need any special enabling legislation to privatize, either because constitutional principles do not require a law or because SOE legislation or other laws provide the necessary legal framework.

The legal basis for Taiwan's privatization policy is the ***Statute for Transforming SOEs into Privately Owned enterprises*** **(STSP)**[4]. The basic approach of the STSP is to set general rules for the privatization process of all chosen SOEs[5]. This approach, which contrasts with that of many countries that legislate specifically for each case of privatization, has advantages as well as disadvantages. For example, the general rules set out in the STSP are efficient in regard to the law-making process but sometimes fail to properly address the specific situations of SOEs and thus create problems for the authorities charged with carrying out the privatization.

Graph 1 illustrates the legal framework of Taiwan's privatization policy. The STSP provides the platform for all policy measures. The Statute and its Enforcement Rules regulate the basic obligations and rights of all related parties, including the government, the SOEs and their employees, in the process of privatization. They also empower the competent authorities to draw up detailed provisions on specific matters such as the allocation of priority shares to employees, redundancy payments, and so on.

Graph 1. The Legal Framework of Taiwan's Privatization Policy

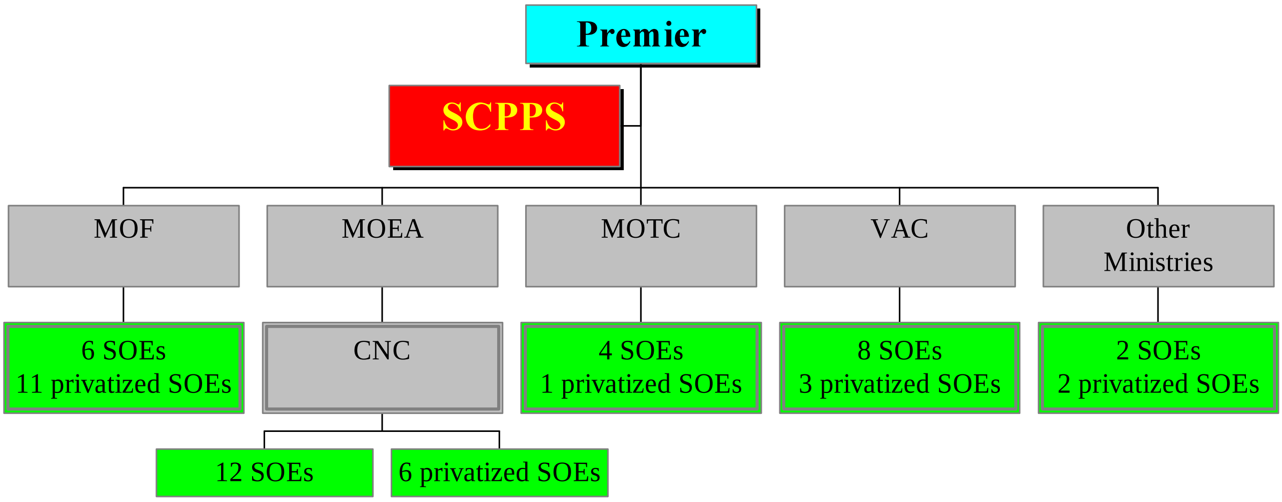
[4] The STSP was first promulgated in 1953 in support of the land reform program at that time. The law covered only the basic concept of privatization. There was a major revision of the STSP in 1991 to provide for consideration and protection of employees' interests and rights at the time of privatization.
[5] According to Article 5 of the STSP, when the authority in charge of an SOE considers that there is no more necessity for that SOE to be operated by the government, it may make a proposal for the SOE to be privatized, and privatization will be carried out upon receipt of the Premier's approval.



(2) The organizational framework for privatization

Although owned by the central or local government in Taiwan, SOEs are supervised by the line ministries which are also responsible for carrying out privatization of the affiliated SOEs. When the government revamped its privatization efforts, an ad hoc committee (the Steering Committee for Promoting Privatization of SOEs, SCPPS) composed of the line ministries and relevant agencies concerned was established in 1989 to oversee the planning and implementation of privatization policy. While the experience of other countries has demonstrated that a holding company is likely to perform more efficiently than a bureaucratic agency, the institutional framework for managing SOEs or promoting privatization in Taiwan is at present substantially restricted by law. A more flexible approach can only be expected after a package of government reform laws are passed by the legislature in the near future.

Graph 2. Institutional framework for Taiwan's SOEs



Notes:

1. MOF: Ministry of Finance; MOEA: Ministry of Economic Affairs; CNC: Commission of National Corporations; MOTC: Ministry of Transportation & Communications; VAC: Veteran Affairs Council.

2. The Steering Committee for Promoting Privatization of SOEs (SCPPS) oversees the whole privatization process on behalf of the Premier. Relevant cabinet members also participate in the decision-making of the SCPPS. As the SCPPS is an *ad hoc* organization, the CEPD serves as the core of its operations. The chairman of the CEPD convenes the SCPPS and the Sectoral Planning Department of the CEPD acts as the main policy-support staff for the working party of the SCPPS.

(3) The scope of Taiwan's privatization

When privatization was first promoted in Taiwan in the 1950s, a negative list was established in law to exclude certain SOEs from privatization on grounds of public interest or national security. However, when the government reconsidered the scope of privatization in its first revision of the STSP in the late 1980s, the statute was revised to provide for the privatization of any SOE in the circumstances that the competent authority, having given consideration to the market situation and industrial or technological changes bearing upon the need to keep the SOE in existence, proposes the privatization of the SOE, and the Premier gives his approval to the proposal. This revision of the STSP to broaden the scope of privatization gives the authorities more flexibility to promote the privatization of all kinds of SOEs.

(4) Privatization in concert with market deregulation

If the introduction of competition is sufficient to solve the efficiency problem of SOEs, then there is little need to consider the nature of ownership. However, if competition is not the only factor influencing SOE operations, then the focus must be not solely on the market but also on the ownership change.

Since numerous studies acknowledge that ownership per se cannot determine the performance outcome of an SOE, one of the critical components of Taiwan's privatization program is its alignment with market liberalization, particularly for the utility industries. For example, in the case of state-owned Chung-Hwa Telecommunication Corporation (CHT), which had exercised a legal monopoly in Taiwan's telecom market for nearly half a century, the authorities decided that both market structure and ownership issues should be addressed in concert in order to improve the efficiency of the telecom market. Table 3 details the sequence of telecom market liberalization and the scheduled privatization of CHT.

Likewise, the schedule for privatization of another state-owned monopoly, China Petroleum Corporation (CPC), was also set in concert with market deregulation. The schedule provided for Taiwan's petroleum market to be opened up in steps well before CPC's scheduled privatization in 2003. The first private naphtha cracker was approved for construction in 1997 and was already in operation at full capacity in 2000. Market deregulation was fully implemented at the end of 2001 when the *Petroleum Administration Law* came into effect. Although CPC will face unparalleled challenges in the market, its market dominance still prevails in the short term despite the authority's approach of asymmetric regulation. In the long term, CPC can survive the market competition only by its privatization slated for the end of 2003.

Table 3. Time line for state-owned Chung-Hwa Telecom's privatization and market liberalization

Time	Sequence for liberalization	Sequence for privatization of Chung-Hwa Telecom (CHT)
1987	User-end terminal devices	
1989	Value-added telecom services	
1996		Separated from Directorate General of Telecommunications
1997	2G mobile phone licenses	
1998	Satellite telecom services	
2000	Fixed-line telecom services	CHT's IPO
2001		Share auction of CHT

2002	3G mobile phone licenses	Scheduled issuing of CHT's ADR
2003		**Scheduled privatization of state-owned Chung-Hwa Telecom.**

(5) The methods of privatization

Privatization in the broadest sense means giving private actors a greater role in decisions about what, where, and how to produce goods and services. A great deal of experience has now accumulated regarding this process. Some of it shows the great potential that privatization has for increasing productivity, income and welfare. However, it also reveals the complexity and difficulty of effective privatization as no privatization glove fits all hands. Privatization even in the narrower sense of divestiture - the sale of state-owned enterprises - has presented greater challenges than its early advocates envisaged.

In the early stage of Taiwan's privatization drive, privatization was carried out only by the sale of shares or assets. However, the 2nd revision of the STSP in 2000 broadened the methods of privatization into five alternatives as follows:

1. Sale of shares.
2. Sale of assets through bidding.
3. Formation of a private-owned enterprise by joint venture with private individuals by way of contribution in kind.
4. Merger of companies with the surviving enterprise being a private-owned enterprise.
5. Dilution of state-owned capital by new issue.

In adopting any of these five methods for privatizing an SOE, the authorities in charge may effect the privatization by negotiating with a specific counter-party selected through public invitation.

(6) Employees' rights and interests (ERI)

In pursuit of a balance of the government's economic and political aims, provisions for the legal protection of ERI were included in the first revision of the STSP in 1991 and again in the second revision in 2000. Since then, ERI has become the most critical issue of policy design and implementation. Various compensation measures composed of seniority settlement, insurance compensation, redundancy payment and priority shares subscription (plus favored offering for long-term shareholding) were designed and implemented to reduce the opposition of employees toward privatization. However, it has proved all but impossible to fully satisfy employee demands, and confrontations between SOE labour unions and the government still arise from time to time. Consequently, ERI remains and a key issue and often a stumbling block in most SOE privatizations. Graph 3 illustrates Taiwan's policy design for ERI. Employees of the SOE chosen for privatization are offered a variety of legal rights in the run-up to privatization as follows:

(a) First comes priority share subscription, to encourage employees to participate in corporate governance through their shareholdings. Taiwan learnt the value of this method from the experiences of advanced countries and incorporated it into its policy design in the first revision of the STSP in 1991. The employees are entitled to preemptively subscribe to a specific amount of shares, with the ceiling either that each employee is allowed to buy shares equal in value up to 48 months' salary, or that total priority shares for employees shall not exceed in total 35% of outstanding shares of that company.

(b) At the time of privatization, all full-time employees are entitled to settle the length of their service years, a provision specially tailored for Taiwan's privatization to protect employees' seniority. They may then choose to stay or leave at their own discretion unless there is an agreement with the new employer (a situation that rarely occurs).

(c) Those who are unwilling to stay with the privatized enterprise are eligible for severance pay and insurance compensation[6]. Severance pay includes one month's salary for notice and 6 months' salary to cover a reasonable job-seeking period. Anyone who chooses to stay on after the enterprise is privatized remains eligible to receive compensation on the same basis if he is laid off within five years after privatization.

(d) In the early days, only profitable SOEs were chosen for privatization. Therefore, there was generally not any problem of large-scale employee redundancies before and at the time of privatization. However, with the changing situation faced by SOEs, some financially troubled SOEs were forced to be closed down or privatized in parts. Then the issue of employees' job transfer training or employment assistance in the run up to privatization became much more crucial and therefore was covered by the second revision of the STSP in 2000[7].

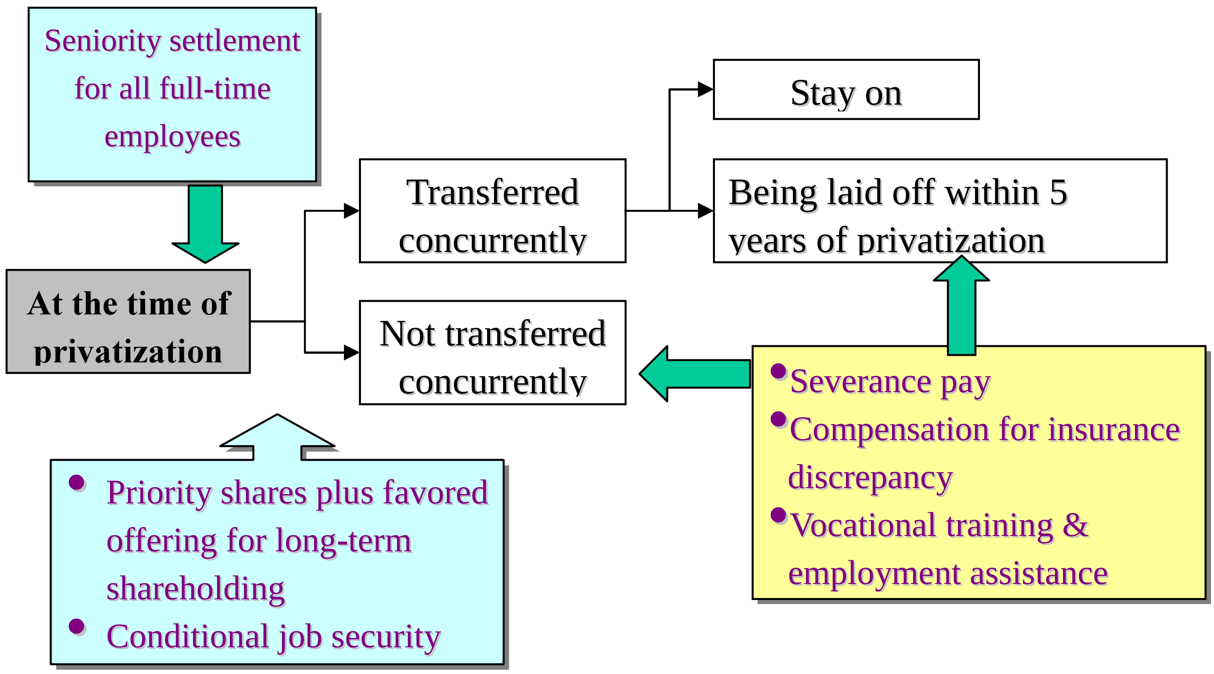
Studies on self-interested behavior in the public sector have pointed out the "capturing power" of organized groups of SOE employees (Borcherding, Bush, and Spann, 1977; Borcherding et al, 1982). The argument goes that SOE employees trade votes for laws or regulations that either protect the status quo of their working conditions or maximize the compensation if the working conditions must change. This relationship is similar to the private-sector capture scenario in which

[6] According to Article 8 of the STSP, where employees suffer the loss of pensions payable to them because of the original insurance scheme's interruption by privatization, their loss of such benefits shall be duly compensated. The scope of all other compensation, if any, shall be limited to the losses incurred at the time of privatization.

[7] According to Article 11 of the STSP, a government-owned enterprise shall conduct services of this kind when necessary. The authority in charge of the enterprise or the competent authority for labor administration shall assist therein.

interest groups exert pressure not through votes but with bribes and campaign contributions to regulators. Another point of emerging wisdom from many countries is that privatization is most likely to succeed if employees are "bribed" to ensure minimum opposition (Burton, 1987). Since 1991, SOE employees in Taiwan have gained increasingly favorable legal protection through the continuous lobbying of their labor unions. This has contributed to the gradually increasing distortion of the original ideology of policy design.

Graph 3. The policy design for employees' rights and interests during privatization



(7) The fast-track mechanism for financially troubled SOEs (FTS)

Originally, the policy was designed to have SOEs (or the employers) assume the main responsibility of taking care of their employees in the run up to privatization. Accordingly, employers (the SOE) are legally required to be responsible for most compensation, including seniority settlement and severance. Nonetheless, when financially troubled SOEs are privatized, they cannot afford the compensation legally required by the STSP.

A special Privatization Fund was established under the second revision of the STSP in 2000 and has been used to subsidize FTS payment of ERI expenditures. So far, at least four FTSs have been successfully privatized with financial assistance from the Privatization Fund. However, when an SOE experiences financial difficulties, budgetary constraints and parliamentary interference frequently still prevent the authorities from dealing with the problem in a decisive way.

(8) The management of residual state holdings

In many instances governments retain residual assets to address political or strategic concerns. The purpose of retaining such assets often determines whether they will remain in state hands for the longer term or will be privatized following the market deregulation. The difference among policy practices in the world has also raised the question as to whether state asset management can be a substitute to entire privatisation when there is a lack of public support for privatization.

After promoting 27 successful privatizations, the Taiwanese government still owns residual state holdings in 19 companies, with a total market value of US$9 billion in early 2002. Although the state shareholdings in those companies have fallen below 50% (the threshold for being legally privatized), the percentage of state-controlled seats on their boards of directors has remained at 60% on average. In other words, the executive branch of the government still exercises substantial control over those privatized SOEs.

In the early stage of Taiwan's privatization, the most commonly quoted reasons for the government to retain shareholdings in privatized SOEs include reducing the impact of abundant state shares selling on the stock market, implementing government policy (including introducing new regulatory regime in stages) in the early post-privatization period, maintaining market discipline through state-controlled enterprises, adapting the management level to competitive market for corporate control which prevent privatized SOEs from hostile take-over. However, many of these reasons exist no longer with evolution of time but the authorities are reluctant to release their shareholdings due probably to self-interested behavior.

Worse of all, scandals have occasionally happened because private investors have been able to take advantage of the inactivity of the state representatives on the board. Several administrative orders[8] have been therefore issued as guidelines for the authorities' handling of residual state holdings in privatized SOEs. The 2nd revision of the STSP also empowers the authorities to retain a "golden share", as an alternative of direct share holdings, issued by the privatized utility or national defense related companies in order to veto the corporate decisions damaging national security or public interests.

Nonetheless, the prevailing bear equity market and lack of clarity in policy missions assigned to those privatized SOEs have made it difficult to proceed with the early release of all residual state holdings.

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[8] The Article 10 of the "Guideline for Managing Residual State Holdings" came into effect in Oct. 1999 regulates that government can retain share holdings for utility and national defense related companies to exert substantial veto power on the management of these companies, otherwise, the state-owned shares of the privatized SOEs in competitive industries shall be successively and completely sold or transferred in view of the capacity of capital market;

IV. The Benefits & Costs of the Policy

Political, administrative, legal, economic, financial, technical, social, and other dimensions of privatization are equally important and directly affect the design of the privatization program, the content of the privatization legislation, and the way the program and law are implemented. Policy is not an end in itself; it is a reflection of social and political values and priorities. Table 4 illustrates a conceptual framework of policy impact.

Table 4. Dimensions of policy impacts

Dimensions of Impact	**Macro-view (industry-level)**	**Micro-view (firm-level)**
Economic	✓ Economic freedom ✓ Aggregate efficiency ✓ Market development ✓ Government revenue ✓ Public sector borrowing …	✓ Operational efficiency ✓ Profitability ✓ Business expansion ✓ Share price…
Social	✓ National or regional unemployment ✓ Service qualities ✓ Income inequity…	✓ Redundancy ✓ Salary and wage level ✓ Utility charges…

(1) Accomplishments of Taiwan's Privatization

In addition to substantially improving the efficiency and profitability of SOEs, privatization has made significant contribution in terms of raising revenue for government and supporting the development of Taiwan's securities market. Up to October 2002, 27 of the chosen SOEs in various industrial sectors have already been privatized through more than 50 offerings and several sales of assets. The sales of government ownership have yielded total proceeds of close to NT$400 billion, equivalent to nearly US$11.36 billion.

(2) Performance changes in the post-privatization period

Empirical study of SOE efficiency began in earnest after Alchain (1965) predicted that publicly-owned firms would be inherently less efficient than private firms. The wave of privatization in developed nations during the 1980s, particularly in Britain, opened a new avenue of empirical investigation on the performance changes before and after privatization (Martin and Parker, 1995; D'Souza and Megginson, 1999).

Voluminous body of empirical literature indicates that private or privatized ownership is superior to public ownership in a variety of situation despite of the argument by many SOE proponents that market failures in developing nations make SOEs more viable relative to private firms (Shirley and Walsh, 2001). Table 5 outlines the results of a CEPD's research comparing three-year average post-privatization financial and operating performance measures with the same three-year pre-privatization performance measures for 18 companies in Taiwan. The outcomes reveal the significant improvements in most of performance indicators across sectos.

Table 5. The average performance changes after privatization: the 18 cases in Taiwan

Sector	**No. of samples**	**Returns on assets** %	**Profitability** %	**EPS** (NT$ dollar)	**Leverage** %(debt/assets)	**Turnover rate** sales/assets
Manufacturing	4	1.93	7.76	-0.23	-2.97	0.02
Marine Transportation	2	5.21	8.84	1.13	-14.02	0.02
Banks	8	0.30	4.56	0.13	-0.34	0.01
Insurance & trust	4	-0.98	-1.54	0.31	5.02	0.25

Notes: the figures are computed by pre-and post-privatization 3-year means (relative to the industry average).

Source: CEPD, 2002

(3) Costs and Revenues of Taiwan's Privatization

A well-designed and implemented policy should consider its costs and benefits. Though one policy goal of Taiwan's privatization was set for relieving budgetary constraints and the proceeds of privatization proceeds since 1989 have indeed made a significant contribution in this respect, the compensation to employees at the time of privatization has become a black hole for government revenues due to increasing distortions in the legislation exacted by lobbying from SOE labor unions. Tables 5 and 6 show the costs and revenues of Taiwan's privatization. Though lack of international data for comparison, the percentage of the privatization receipts in Taiwan utilized for employee compensation reaches as high as 36%, implying the consistence with John Moore's (a senior member of the Thatcher Government in the mid-1980s) observation "*public sector trade unions have been extraordinarily successful in gaining advantages for themselves in the pay hierarchy* (or compensation) *by exploiting their unique bargaining position*" (Moore, 1986).

Table 5. The direct costs of privatization policy

Cost (US$ million)	4,085.3
Employees' rights & interests	**3,975.6**
Seniority settlement	2,921.5

Insurance compensation	821.1
Redundancy payment	143.5
Others	89.5
Operational Expenses	**109.7**

Source: CEPD, 2002

Table 6. The privatization proceeds and the contribution of different methods and sectors

Revenues (US$ million)	**11,356.9**			
Methods / Sector	**Share sale**	**Asset sale**	**Assets as equity contribution**	**Employee buy-out**
Manufacturing	4,160.6(4)	345.8(3)	2.4(1)	0.05(1)
Financial services	6,536.4(13)			
Transportation	294.6(2)			3.5(1)
Others		0.69(2)		

Note: the figures in parentheses represent the number of privatized enterprise(s).

Source: CEPD, 2002

V. The strategic priority for privatization of SOEs

The effectiveness of a privatization program may be a function of the pace of its implementation. Speed is of the essence: windows of opportunities often do not stay open very long. An attempt to go too fast may backfire, however, as a result of inadequate preparation and design, lack of response from investors, or lack of support from key constituencies. A drawn-out process, on the other hand, may lead to the deterioration of the SOEs slated for privatization, the loss of momentum and support for sometimes painful reforms, and the scuttling of the overall program.

When Taiwan’s government revamped its privatization agenda at the end of the 1980s, there were over 80 SOEs which might all or partly become candidates for privatization. In the first revision of the STSP in 1991, the “negative list” of SOEs ineligible for privatization was replaced by a more flexible regime for discretionary selection of SOEs to be privatized. Under this new regime, the line ministries started to review the situation and consider which of their SOEs did not need to remain in state hands.

Though reviews by the SCPPS furnished a list of 47 SOEs to be privatized (21 after the first review in 1989, increased to 33 in 1993 and 47 in 1996), the priority for their privatization still had to be set. That primarily entailed consideration of the government's limited resources and the urgent time frame for overcoming the likely technical and political impediments in the run up to privatization. Based on the competitiveness and assigned policy missions of these SOEs, they were divided into four different categories of priority as follows:

Priority 1: Industrial firms in the competitive industries (privatized mainly in 1989~96)

Several SOEs in manufacturing industries had long faced competition from the growing private sector. Their adaptability to the competition and gradually diminishing policy mission meant that they were still attractive to private investors in the early 1990s but would not be so for long if they remained under public ownership. Six such SOEs were privatized in the first half of the 1990s. They not only became the first successful cases of privatization in Taiwan but also enabled bureaucrats to accumulate precious hands-on experience in handling privatizations.

Priority 2: Financial institutions in the increasingly liberalized market (privatized mainly in 1998~99)

Financial institutions, including banks, insurance firms and building societies, were once targeted as the first wave of privatization due to their high profitability in this closely regulated industry. However, the legislature hesitated to approve the related budgets until the constitutional reform in 1997 resulting in the disentanglement of vested interests. In the following two years, nine state-owned financial institutions were transferred to private hands. A main reason why these SOEs could be privatized so quickly and smoothly was the relatively small gap between their employees' work conditions and those of the private sector.

Priority 3: Financially troubled SOEs (privatized mainly in 1999~2001)

As mentioned above, FTSs are unattractive to private investors unless they first undergo some degree of restructuring. That can take the form of downsizing, changing management, issuing new shares to introduce private capital as well as new management, and so on. Several medium-sized SOEs were listed as candidates for privatization in the early 1990s but failed to find appropriate investors. The financial condition of these firms worsened in the economic slowdown at the end of the 1990s. Unfortunately, the government lacked the budgetary means for making injections of capital as required. As described earlier in this paper, a fast-track mechanism for assisting FTSs was established in the 2nd revision of the STSP in 2000. With their privatization thus speeded up, four FTSs were privatized in 1999~2001. The government provided assistance for these privatizations mainly in the form of finance for ERI payments. Two of the privatizations were undertaken through employee buy-out.

Priority 4: Utility companies (yet to be privatized)

Utility companies, ranging from electricity and water to telecommunications and railways, are traditionally highly regulated industries due to the demands of public interest. Privatization for such utility companies needs to be pursued in tandem with competition-enhancing policy and the design of an adequate post-privatization regulatory framework. Some utilities do not even have a corporate structure and need to be corporatized prior to their privatization. Accordingly, enterprises in this category are accorded the lowest level of priority for privatization. The state-owned Chung-Hwa Telecom was originally chosen as the first candidate in this category and slated for privatization by the end of 2001 in concert with the telecom market liberalization. Now, due to parliamentary interference and the capital-market downturn, the schedules for this category have all been delayed.

VI. Prospects

Privatizing does not in any way imply putting a country's entire economy in the hands of the private sector and abdicating the role of the state. On the contrary, privatization offers governments a unique opportunity to refocus their action by shifting the emphasis from activities perceived to be strategic to core governmental responsibilities.

The real challenge of privatization is not just to sell an enterprise or shares. Much more, it is to seize the opportunity to refocus the role of government, increase economic efficiency, and adapt an enterprise, a sector, or the economy as a whole to the fast-changing requirements of the international economy. This challenge is inherent in all privatization programs, though its magnitude and intensity differ from case to case.

Despite its early successes, the progress of privatization in Taiwan has not proceeded as rapidly and smoothly as the government had originally expected. Its path has been littered with obstacles, thrown in the way by legislative and administrative institutions, the financial market, labor unions, and vested interests. Nevertheless, with the trend towards liberalization now clearly irreversible, the government has set privatization as one essential part of the current deregulation drive, and there is no doubt that the government will fulfill its privatization commitment for the rest 17 chosen SOEs and introduce competition into all markets.

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