

**AN EVOLUTIONARY PERSPECTIVE OF POLICY CHANGE BEHIND THE
ECONOMIC SUCCESS OF TAIWAN**



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Abstract

The role of the government in the economic development of Taiwan is well documented. This paper provides an evolutionary perspective on the economic management of the government behind the economic success of Taiwan. It develops a 'learning government' model which portrays the Taiwan government as an actor who makes decision under uncertainty. Public agents, like private enterprises, formulate expectations and plans based on their experiences. Assimilating new incoming events, decision makers in the public sector revise their plans, learn to implement projects, experiment new ideas, resulting in policy changes. This perspective is applied to understand the economic management of the Taiwan government since 1950. The upthrust of this argument is that the emergence of a government policy is, to a large extent, biographically determined. This evolutionary approach in understanding a policy change is an alternative to the cost and benefit analysis adopted by orthodox neo-classical public economists.

Keywords: evolutionary economics, learning, government policy, Taiwan, economic development

INTRODUCTION

The role of the government in the economic development of Taiwan is well documented (for example, see Johnsons 1985; Wade 1990; Castells 1992; Lee 1994). These literatures are able to explain and identify different kinds of development policies that steered the Taiwan's economy into an economic success. However, these literatures fail to explain why a policy is set in such a way that has led Taiwan to evolve into a wealthy economy. Policy formulation, to be sure, is shaped by historical factors. This paper uses an evolutionary approach to examine the economic management of the government in Taiwan. In particular, this paper portrays the government as an organization who has a history. Policy making in the public section is biographically determined. Thus, knowledge, experience, learning are important elements in decision making. In the next section, we shall develop a theory of learning government which will be used to explain the economic management in Taiwan.

GOVERNMENT ACTION IN THE WORLD OF UNCERTAINTY

The neoclassical analysis of economic problems in general and of the government¹ in particular is largely in terms of perfect competition, static uncertainty and Pareto Optimality. Some neoclassical public choice theorists (for example, see Auster and Silver 1979) treat the state as a super firm supplying public goods and legislation, and argue that state agents, given the right to regulate the economy, attempt to maximise budgets. In their view, rent-seeking behaviour gives rise to government failures. Another important development in the theory of state intervention is the recognition of information problem in decision making (Chang 1994:34-37). This theme, which had been neglected in the heyday of traditional neoclassical economics,

¹In this paper, the terms 'government' and 'state' are used interchangeably. Though there is a difference between the state and the government, when we discuss the extent of state control in economic sphere, we can simply refer to the role of government since in both cases we are interested in the relative merits of public or private control of economic matters (see Barry 1981:53-54; World Bank 1997:20).

has rapidly becoming prominent in recent economic literature (for example see Leijonhufvud 1981; Chang 1994; Chang and Rowthorn 1995; Rodrik 1996; Hardin 1997; Yu 2000). Using Henry Simon's bounded rationality concept, Chang (1994:34) argues that the government can be understood as the machinery for coping with the limits of human comprehension and computation in the face of complexity and uncertainty. Despite these contributions, in mainstream public economics, analysis of government learning is virtually absent. The creative, pro-active and dynamic aspects of state leadership have largely been ignored.² Without uncertainty, learning, trial and error spirit, one cannot fully understand the underlying reasons for policy changes and, more importantly, institutional changes. Neglecting government learning, one can easily draw a conclusion that government intervention yields negative impacts, i.e., distortions in the price mechanism and the encouragement of inefficient production (Yu 1997).

This paper puts forward a concept of the learning government in the evolutionary perspective. The major components of the 'learning government' model consist of human action, opportunity discovery, learning, experimentation, revision of plans and error elimination. Utilising the theory of human action developed largely in Sociology (Weber 1947/1964:87-118; Mises 1949:1-71), the nature of the government action are postulated as below: (1) The government, like a private corporation, has purposes. For example, the government may seek to promote growth (Johnson 1982), alleviate poverty (World Bank 1997:27) or maintain a stable environment for exchange (World Bank 1997:4, 12; Yu 2000). (2) Public sector agents engage in conscious actions toward chosen goals. To reach the goals, means must be employed. The agents have consciously chosen certain means to reach their goals. Since efforts have been made to reach the goals, the goals must have value to the agents. (3) Given uncertainty and imperfect knowledge, public agents believe that they employ the technologically correct method of reaching the goals, though those chosen policies may be found incorrect with hindsight. (4) All government actions must take place through time. In other

²Dollery and Wallis (1997) argue that it is necessary to incorporate leadership in the economic analysis of the government.

words, all government actions take place in the present and are directed toward the future attainment of an end. The emphasis of the role of time implies that government policies make a difference. It also implies that the agents do not possess omniscient knowledge of the future for if they had such knowledge, no action would have been taken. In sum, policymakers in the public sector, like those in the private sector, live in a world of an uncertain future and choose to employ means according to a technological plan in the present they expect to arrive at the goals at some future time.

THE LEARNING GOVERNMENT: REVISION OF PLANS AND POLICY CHANGE

When a public project fails, neoclassical public choice scholars often interpret this as a result of rent-seeking activities. While this may be true in some cases, their analysis generally overlooks one important element, namely structural uncertainty. Given such uncertainty, public agents initiating a new public project would encounter similar difficulties to private entrepreneurs in their decision-making. Therefore, supplying and implementing a new public programme also involve learning, trial and error, and revisions of plans. In this perspective, Lachmann's contribution (1956) to the entrepreneurial process can be well applied to the public sector. Government action, like private agent action, exists in the form of plans which ultimately link with the stock of knowledge possessed by public policymakers (Lachmann 1970:36). The subjective interpretation of problematic situation by government officials yields provisional judgements to be confirmed by subsequent experience, imperfect knowledge capable of being perfected. The formation of plans is therefore nothing but a phase in the continuous process of exchange and transmission of knowledge which effectively integrates an economy. Each plan does not stand by itself, but is the cumulative result of a series of expectations which have been revised in the light of later experience, and these past revisions are the source of present knowledge. On the other hand, the current plans to be revised later as experience accrues are not only the basis of the action plans but also a source of improved future knowledge. A new problem situation requires the public planner to invent new trial

solutions which are then subjected to further testing in the real world. The process continues indefinitely, so that a series of new problems and new plans gradually brings about progress in the public officials' knowledge. The formation of plans is thus a continuous process, an element of the larger process of the transmission of knowledge (Lachmann 1956).

AN EVOLUTIONARY VIEW OF POLICY-MAKING

Human agency approach to government action discussed above can be viewed in the evolutionary perspective. Fei (1995:34-35) argues that there are two types of forces governing policy evolution: objective and subjective. Objective forces are predetermined conditions such as physical environments, external economic conditions, etc. Subjective forces include belief, economic knowledge, memories, experiences and common sense of the policymakers.

During the process of policy formulation, though technical economic knowledge helps in selecting economic policies, policymakers are guided largely by their political beliefs. They seek policies that are to be consistent with their ideology. Policy making thus is *a process of ongoing undertaking*. The effect of a set of policies can only be known with hindsight (though in many cases, agreement on the effect of a policy may not be reached). Policymakers must then anticipate and respond to the problems if their previous decisions have been successful, and they must sell the public on their decisions. Accumulated successes, as well as the problems, account for the move from one phase to another. In short, "the economy evolves, priorities change, and so does the focus of policy. As the focus changes, policies or combinations of policies adopted during a particular phase are abandoned and replaced by a new combination during the successive phase. Policy changes follow the contour of economic evolution with some rationality, but with somewhat less predictability" (Fei 1995:34-35).

Assume that a policy package is adopted and the economy moves to the next stage where new problems arise. Given creativity of human agent, new issues emerge often that cannot be solved by the old policy package. The economy shows a sign of slowing down. Awareness of these new situations, policymakers would try to find a solution and debate on what to do. Hence,

new ideas emerge, modifying the old policies. Policy evolution must ultimately accommodate the objective forces. A wrong policy, which effectively delays economic development, will be abandoned sooner or later. In other words, policies are evaluated eventually by whether they can accommodate the requirements of development at the time (Fei 1995:35-36). In this sense, change in government policy should take on a small step approach because ideas are seldom abandoned overnight. As Keynes argues, individuals who are over 35 years old do not give up their belief readily (see Li 1988b:20). Taiwan's economic development will be interpreted in Austrian evolutionary perspective in the following sections. This paper focuses on one major theme of government policy making in Taiwan, namely the rise of the government control at its early stage of industrialization and its subsequent liberalization process at later days.

A SHAKY BEGINNING: RESTORATION AFTER THE WAR

After the Nationalist government³ recovered the island from the Japanese control in 1945, Chiang Kai Shek appointed Chen Yi (1883-1950) as the first administrator. The governing groups were largely newcomers to the island (Kuznets 1979:15-131). Under the administration of Governor-General Chen Yi, the economy was in devastating conditions. The economic management of Chen Yi and living conditions of Taiwan at that time is described by Wou (1992:54) as below:

production suffered. Unemployment was high. Inflation rampant. The Taiwan Provincial Administrative Office adopted a trade control policy that result in inflation. All trade was controlled by the government trading office and the private sector had no opportunity to make money. There was little capital investment and materials were in short supply. The government had to import materials to meet economic requirements. Foreign reserve shortages contributed to social disorder and social instability. Rationing programs led people to stockpile food and consumer goods. With little food on the markets, supply did not

³ The term 'Nationalist party' is pronounced as Kuomintang (KMT) in Mandarin. In this paper, two terms are interchangeably used.

meet demand and prices increased. Conditions were exacerbated by corrupt government officials and speculative merchants who controlled prices for their own benefit.

There can be at least three explanations for such economic disasters. First, right after the war with Japan when Kuomintang took over the Taiwan's administration from the Japanese, everything was in chaos. In economic terms, this is coordination failure.⁴ Therefore, it is not surprised that the economy was in chaotic condition. Second, the first nationalist government administration in Taiwan was an 'outsider' and suffered from inexperience.⁵ Some experienced and skillful Japanese remained in Taiwan after the war but did not participate in the Chen Yi's administration (Wou 1992:54). Thirdly, fleeing from the mainland, Chiang's followers in the Taiwan's administration remained the same corrupted behaviour. The first two reasons are the direct consequence of knowledge and learning problems and therefore, understandable. However, the third reason reveals that the Kuomintang officials at that time had not yet been aware why they lost the mainland to the communist party despite the Republic of China enjoyed relatively advantages in superior weapons and arms. In other words, they had not yet learned their lesson right after moving to Taiwan. It is impossible to envisage that the Chiang Kai Shek's government can survive if they continue the same corrupted policies as it did in the mainland. Our theory of government action predicts that the Chiang's administration will be alert to the situation and correct its corrupted policies, if they still want to compete and bargain with the Communist China. History confirms our insight. As a matter of fact, under Chen Yi's administration, people in Taiwan complained about the difficult living conditions and worse, they considered the government as their enemy,

⁴ In Hayek's perspective, coordination failure is defined as incompatibility of individuals' plans. (see Yu 2004:175-191).

⁵ Wade (1990:75) writes: "between one and two million soldiers and civilians poured onto the island of 6 million people in 1949. They had virtually no knowledge of or ties to Taiwan."

paving the way for the 228 incident of 1947.⁶ The nationalist government eventually learned its lesson and turned out to be a competent government.

The Birth of a Competent Government

Learning does not necessarily mean that learning “good” things. It is quite possible that a government may learn “wrong” things and become a ‘vampire state’⁷ (Wade 1990:350). History confirms that the government of Taiwan is a competent one (Johnsons 1985; Wade 1990; Castells 1992). Before the direct presidential election in May 1996, Taiwan was governed under an authoritarian one-party regime by Kuomintang. There was no organised opposition as all non-Kuomintang political activity was severely restricted under the martial law (Cheng 1994:61). In transaction costs perspective, Cheung (1984) argues that an ideal economic regime is the one that has a dictatorial government with benevolent and competent leadership. An authoritarian one-party regime has the advantage of avoiding huge costs incurred in democratic system. However, a competent government is not easy to be maintained. Public choice theories depict that government officials tend to pursue rent seeking, particularly in a one-party political system. Hence, it is

⁶ According the official website of the government of Republic of China (access on April 10, 2005), the tension finally exploded on February 28, 1947, following an incident in Taipei where an elderly woman was beaten while resisting arrest for selling untaxed cigarettes in Taipei, and a passer-by was shot in the riot. Crowds uproared across the island, seizing police stations, arms, and radio stations and killing a number of mainlanders. In the following months, Chen Yi proceeded to arrest and execute thousands of people who had demanded government reforms. Chen Yi was discharged from his governor post and later was executed in 1950 for conspiring with the Communists to overthrow the Republic of China government while serving as the governor of Zhejiang Province (<http://english.www.gov.tw/index.jsp?recid=40&id=28&viewdate=0&relflag=true>).

⁷ Their ruler in a vampire state is predatory in the sense that “their efforts to maximise the resource flow under their control erode the ability of the resource base to deliver future flows” (Wade 1990:350).

not surprised to find that corruption is phenomenal in a socialist regime. Accordingly, why had Kuomintang which monopolised ruling powers in Taiwan emerged as a competent government?

There are several environmental and historical factors that compel Chiang's administrative officials to learn to be a good government.

1. Kuomintang leaders experienced profound humiliation in being beaten by what they considered to be only a peasant army. They learned the lesson that a corrupted government will lose public support. To survive, they are willing to correct these defects.⁸ It is possible that the leaders had been locked in by their previous learning and therefore resisted to change. However, the experience of losing the mainland to the Communist during the civil war was so devastating that made unlearning possible. Thus, it is not surprised to find that the party members had little resistance to reform and were more vigorous than before in supporting development (Pye 1988:89).

2. In the public choice perspective, Mo (1995) argues that imperial China, though had once been a strong empire in history, eventually became a weak nation because its political system lacked opposition parties and hence lacked effective competition. On the contrary, after retreating to Taiwan, the Kuomintang needed to compete with its 'twin brother', the Communist. The separation of the Chinese economy, each led by an independent party, formed an effective, though reluctantly, a competitive environment. The Taiwan's government had to be competent in order to survive. Kuomintang could not afford to lose its last bastion of Taiwan.

3. The humiliation of military defeat also means that the Kuomintang had to search for something additional to justify its continued ruling. This issue is particularly important when Taiwanese considered the mainlanders as immigrants or even outsiders like the Japanese. One way of gaining continued legitimacy of ruling in Taiwan was to promote the island's economic growth and raise its living standard. Hence, political legitimacy in Taiwan had become inordinately dependent upon continued national economic progress.

⁸ In particular, Chan and Clark (1992:79) write: "Chiang Kai-shek and many KMT leaders realized the need for reform in the wake of their humiliation on the mainland (China)".

This aim is the origin of its 'development state' (Johnson 1982) in Taiwan. Subsequently, economic achievements in the island brought political stability and thus a degree of legitimacy. Economic growth reduced tensions between 2 million mainlanders who arrived with Chiang's defeated armies and 16 million Taiwanese (Pye 1988:95).

A NEED FOR TIGHT ECONOMIC CONTROLS

When Chiang Kai Shek recovered Taiwan from the Japanese, tight economic controls were conducted on the island economy. As Hsiao and Hsiao (1999:5) describe:

“In the 1950s, the KMT government control of Taiwanese economy and politics was omnipresent and omnipotent. In production, it even monopolized daily items like liquor, beer, tobacco, sugar, salt, and about 90 percent of petroleum and its products. It had a majority of shares in the production of food, chemicals and chemical products, metal and metal products, and others, which included from bagasse board to shipbuilding. In the distribution and financial sectors, the government monopolized railroads, all the communication facilities, commercial and development banks, and external trade”.

Controls on economic activities extend till the later stage of Taiwan's industrialization, though in a less strict way. For this reason, Wade (1990) refers Taiwan to as a "governed economy". We then come to the question of why Kuomintang conducted tight regulatory controls on economic affairs. The answer has something to do with the backgrounds and history of the Kuomintang and its leaders because their experiences and knowledge partially determined the choice of the policies:

1. A heritage from the past: Taiwan was a society without any democratic experience. Instead, it inherited a history of imperial control (Klintworth 1994:2). In the Chinese tradition, the emperor is sent by the greater god to take care of its people. The emperor thus possesses absolute authority. Chinese people generally expect their emperor to behave paternalistically and take care of people's welfare. Though the last emperor of Ch'ing Dynasty, Po Yi, abdicated in 1911, the 'mandate of heaven' mentality still lingered strongly

in people's mind. For the Kuomintang members, the term democracy was a very new concept though they claimed to follow Sun Yat-Sen's "Three Principles of People". During the Kuomintang's early settlement in Taiwan, many people still believed that Chiang Kai-Shek was the emperor sent from the heaven. Given this mentality, it is not surprised that the Chiang's government had the obligation to take care of the people's welfare and act paternalistically in economic affairs. This implies economic controls in the everyday life of ordinary people.

2. The Kuomintang, with huge backing from the United States and superior weapon, lost the mainland to the Communist. One reason for this failure was its poor strategic management in dealing with the Communist, notably in propaganda and negotiation skills. Hence, after retreated to Taiwan, the Kuomintang government kept itself in full alert to the Communist attack. To seal off from the Communist propaganda, the government imposed a tight control in economic activities.

3. A need for stability and coordination: Right after the war with Japan when the Kuomintang took over the Taiwan's administration from the Japanese, economic activities were in chaos. Stability was urgently needed to restore coordination and normal life. A way to achieve stability and coordination was through government control. This argument is consistent with the widely accepted view that the more rapid the economic change, the greater the need for coordination by a central agent (Yu 2000).⁹ Put it in differently, the more chaotic the economy is, the larger degree of government control is needed in order to achieve stability for coordination of economic activities.

⁹ Likewise, heavy government intervention is observed in emerging economies where rapid economic changes occur in their early stages of industrialisation. Stiglitz (1996:160) points out that in developing economies, the widespread absence of markets means that prices cannot perform their coordinating role. Similarly, World Bank (1997:6) argues that when markets are underdeveloped, the state can help reduce coordination problems and gaps in information. This implies that the more rapid the economic change, the greater the need for coordination.

CURBING INFLATION AND LAND REFORM

The Chiang government considered that the loss of the mainland to the Communist is largely due to ineffectiveness in reducing rural poverty and controlling runaway inflation. After retreating to Taiwan at the end of 1949, the government thus quickly took a series of actions to regain the people's confidence and win international support (Li 1988b:59). Hence, during 1950s, curbing inflation and land reforms were given priority in policy making.¹⁰

Controlling Inflation and Stabilize the Economy

Inflation is a major issue when Chiang took over Taiwan. Between June 1949 and the end of 1952, prices rose at an average annual rate of about 60 per cent (Li 1988b:51). The Republic of China lost the mainland because of inadequate monetary policies. As a result of hyperinflation in the mainland, Chinese suffered severely and eventually lost confidence in the Chiang government. Chiang and his followers experienced such event.¹¹ They learnt that if inflation was not adequately handled, it would lead to national disaster, and more importantly, experience the same fatal result as they were in the mainland. Therefore, once they landed Taiwan, they took curbing inflation and stabilized the economy as priority. In the early 1950s, Taiwan was still a small undeveloped economy with small industrial base and low-income level. The government thought that if curbing inflation by contractionary measures as those industrialized nations did, then the reduction in effective aggregate demand brought about by contractionary economic policies would lower Taiwan's economic growth. Government officials took that economic growth could not be sacrificed. Instead, the government fought hyperinflation of the early 1950s by simultaneous restraining demand and increase supply. The

¹⁰ When weighted stability against growth, the government always put more emphasis on stability (Li 1988a:31). This policy remains in the latter period of Taiwan's economic development.

¹¹ For instance, one of the Chiang followers is Li Kuo Ting, a major architect of Taiwan economic policies. About 10 of 40 years of Li's government official were spent on the mainland.

former measure centred on tightening government expenditure so to reduce budget deficits and inflationary pressure. The latter relied on promoting small-scale investments to increase agricultural and industrial production without adding inflationary pressure. In agricultural sector, land reform was conducted (see below). In industrial sector, emphasis was placed mainly on the promotion of labour intensive industries which required little capital and short setting up time. In this way, industrial production can be expanded quickly. As a result of trial and error, inflation was brought under control and the economy grew rapidly. From 1953-1960, prices rose at the wild average of 9 per cent a year. From 1961-1972, it was a period of price stability. Taiwan's wholesale prices rose in that period by an average of 2 per cent a year while consumer prices by only a 3.3 per cent a year, with economic growth rate registered as high as 10.2 per cent (Li 1988b:45).

LAND REFORMS (1949-1953)

To some degree, the loss of the mainland because of peasant unrest made the Kuomintang realise the importance of a more equal distribution of rural wealth (Chu 1994:49). Furthermore, the government perceived that something needed to be done to win support from islander population (Wade 1990:341-246). During the 1950s, the government undertook land reform programs which destroyed the land owning class and created a large population of small farmers that dramatically increased agricultural productivity. More importantly, the land reform policy won tremendous support from Taiwanese peasants. As they comprised the bulk of the subordinate class on Taiwan, their support greatly consolidated the legitimacy of Kuomintang's ruling.

With American assistance, land reforms were conducted between 1949-1953. Land reform was aimed at making tenants into landowners. However, the government felt that it was a goal that could not be reached in a single step (Li 1988b:61). Instead it was done in three planned stages:

1. The reduction of farm rents in 1949: It legally limited the amount of farm rent on private tenanted land to 37.5 per cent of the harvest. Before the implementation of the program, tenant farmers in Taiwan had to pay a land

rent amounting to more than 50 per cent of the total harvest. The new rental rate reduced the land rent paid by tenants by more than 15 per cent. The program also provided farmers with more security on lease contracts.

2. Sale of public land (taken over from the Japanese) in 1951: involving the transfer of land owned by government and public corporation to private tenants.

3. Implementation of the Land-to-the-Tiller Program in 1953: it involves the government first buying land owned by a landlord and tilled by tenants, and then selling it to the tenants. The program limited the landlords' holdings to no more than 3 hectares of paddy field and compensated the owners 70 per cent in kind and 30 per cent with shares of four government corporations. In this way forcing landlords to sell most of their land to the government in exchange for stocks and bonds valued at 2.5 times the land's annual expected harvest (Li 1988a:27).

The area transferred from landlords to tenants through the public land sale program, and the area bought by the tenants through the "Land-to-the-Tiller" program, amounted to 71 per cent of the total area of public and private tenanted land.

Although the program did not entirely attribute to the rent reduction, the production of major crops substantially increased. The combined results of higher production and lower rent improved farmer's income by 81 per cent between 1949-1952. With their new prospects, farmers even referred to newly acquired oxen as "37.5% cattle" and new wives as "37.5% brides". It is estimated that the wealth transferred by land reform was equivalent of 13 per cent of Taiwan's gross national product in 1952. The government purchased 140 thousand hectares in 1953, which was 58 per cent of all tenanted land and resold it to 195 thousand farm families (representing 64 per cent of tenant population on private land (Li 1988b: 63).

The land reform program had raised agricultural productivity through the incentive effect, released both tangible capital and human capital from agriculture, improved the distribution of income, provided the basis for an increase in aggregate demand (both consumption and savings) and enhanced investment in human capital (Lau 2002).

Apart from the above two important policies, other major policies were also implemented in the late 1950s: (1) Unification of foreign exchange rates, where NT dollar was fixed at a unitary rate of NT\$40 to US\$1, providing a very important basis for export promotion. (2) The Organization of Industrial Development and Investment Centre was established to study and identify all the factors affecting the investment climate, and to propose the revision of taxation and land laws which retarded capital formation and export promotion (3) The approval of the 19 point economic reform program as a guideline for accelerated growth. (4) The approval of legislature of the Statute for the Encouragement of Investment in September 1960 (see below), which provided the legal basis for further economic growth and expansion (Li 1988b: 51).

Since the first economic plan was launched in 1953, the economy of Taiwan started to progress rapidly in the 1960s. Industrial growth registered 18.5 per cent in the period. Exports grew even faster. Between 1963 and 1972, exports grew at 28 per cent annually. Real gross national product (GNP) grows at average of 9 per cent a year between 1952 and 1980. While per capita GNP was less than US\$100 in 1952, by 1980, it had risen to US\$2269 (Li 1988a: 51).

LIBERALIZATION AND ECONOMIC REFORMS

In the early post-war period, the economy of Taiwan was in tight control by Kuomintang military people. The reconquest of the mainland was given top priority. However, by late 1950s, it became obvious that the Communist regime on the mainland was firmly consolidated. Hence, making an assault from Taiwan was unlikely to be realized. As time passed, the Kuomintang people realized that they would have to stay in Taiwan. They began to understand that a sound economic management on the island economy could be a better quarantine of the Kuomintang party's survival. The military cabinets gradually lost their influence in the government policy making, while the economic technocrats began to gain ground¹² (Amsden 1985:78-106;

¹² For information regarding major policymakers and members of the economic technocrats, see Wou (1992:162-173).

Wade 1990:246). As noted, when Chiang Kai Shek took over Taiwan, tight economic control was imposed on the economy in the view to quickly restore the economy back to stability and production. Such regulations and controls were carried out as urgent means to handle the wartime situation.

In the 1950s, the Taiwan's government embarked on an import substitution strategies. Protection policies were pursued in the two Four-Year Economic Development Plans which intended to increase monetary incentives and boosted domestic investment. High tariffs were adopted to encourage domestic investment and produce fiscal revenues. Import controls and other policies were deployed to direct investments towards the products Taiwan needed. Strict government guidance was laid to prevent ineffective competition and oversupplies. With limited foreign reserves, the government used rationing to ensure right materials are imported. Interest rates were maintained at artificially low levels by the monetary authorities so to help infant entrepreneurs (Wou 1992: 60; Li 1995:44).

By the end of 1950s, the economy achieved some growth and stability. Business and industry expanded rapidly. Taiwan's annual economic growth from 1950 to 1961 averaged 8.2 per cent, while per capita gross national product increased 4 to 5 per cent (Wou 1992:61). Given the improvement in overall economic conditions, previous tight controls which choked off normal daily life had to be relaxed. Furthermore, a low interest rate policy contributed to inflationary pressure. The government's desire to achieve economic growth had to be weighted against the vicious effect of inflation. Moreover, the painful memory of the hyperinflation in mainland China during the 1940s still haunted over the minds of the Kuomintang people. Under the influence of S.C. Tsiang¹³ in the 1950s, the Taiwan's monetary authorities were aware of the inflationary impact of the low interest rate policy. They understood that economic reforms needed to be carried out sooner or later.

In 1959, the U.S. Agency of International Development (AID) formulated 'an accelerated economic development program' for Taiwan, based upon a

¹³ S.C. Tsiang completed a doctorate at the London School of Economics in 1944 and had incorporated some of the anti-Keynesian backlash associated with F.A. Hayek.

belief that the rapid economic progress already was in existence. Therefore, a stronger effort should be made by the Chiang government to create in Taiwan a 'showcase' of the achievement by a free market economy. The director of the U.S. AID's mission originally proposed an 8-Point Program of economic reform, including noninflationary fiscal and monetary policies, tax reform, unification of foreign exchange rates, liberalized exchange controls, establishment of utility commission and of investment banking machinery, and the sale of government enterprises to private owners (Hsiao and Hsiao 1999:5). Chung-Jung Yin,¹⁴ who was the Minister of Economic Affairs at that time, endorsed the economic reforms despite oppositions from other party members. In the early 1960s, the Kuomintang government, using U.S. aid as leverage, proposed the 19-Point Program of Economic and Financial Reform. The program aimed to encourage saving and private investment, remove subsidies, raise public utility rates, liberate trade regulations and controlled the military expenditures to the 1960 level. The Program was later implemented in the Third Four-Year Economic Plan, 1961-1964. A Statute for Encouragement of Investment was also enacted in that year to execute the Program. The Statute was revised more than ten times during the three decades, and expanded from 35 to 80 items. The major contents consisted of tax reduction, procurement of industrial land, and coordinated development of public enterprises. Thus, the wartime controlled economy in Taiwan started to change in the 1960s (Hsiao and Hsiao 1999:6). Economic liberalization proceeded gradually. The economic and financial reform programs paved the way for export expansion. Export processing zones were started in 1966. In the 1970s, import controls were relaxed in 1970. The bond market was established and rice-fertilizer barter program was abolished in 1974, and floating exchange rate system was introduced in 1978. In the 1980s, tariffs and import controls were further reduced and the capital market was

¹⁴ Chung Jung Yin came to Taiwan when mainland China was taken over by the Communists. In 1954, he became the Minister of Economic Affairs and the director of Central Trust of China. Yin's economic policy was heavily influenced by S.C. Tsiang. Yin's work is said to lay the foundation for Taiwan's recovery in the 1950s (Wou 1992:164).

liberalized.¹⁵ Economic reforms accelerated in the mid-1980s. Bank interest rates were deregulated and the labor standard law was implemented in 1985. In July 1987, the government eased foreign exchange controls, which had lasted 38 years. In 1988, import tariffs were reduced on the average of 50% for 3,500 items, including automobiles, color television sets and videocassette recorders. A new banking law was adopted in 1989. Commercial banks' interest rates were completely deregulated and private banks were allowed to establish and invest in stock market. A new foreign trade law was passed in 1993 to liberalize trade as a requirement for Taiwan to join the World Trade Organization (WTO) as well as enhancing Taiwan as an Asia-Pacific Regional Operation Center (APROC). In 1994, Taiwan allowed the foreign banks to open offices and branches (Hsiao and Hsiao 1999:5-9).

In summary, liberalization, as an economic reform, was a long gradual process rather than following the international wave of free market ideology appearing in the 1960s and the 1970s.¹⁶ It is important to note that the liberalization movement in Taiwan gained momentum through time in small cumulative steps rather than by large leaps and bounds (Li 1988b:19).¹⁷

CONCLUSION

An evolutionary perspective has been used to understand the economic management of the learning government in Taiwan. We argue that policy

¹⁵ For a comprehensive chronology of liberalization of Taiwan financial sector, see Li (1995:125-139).

¹⁶ On this, Kuo-Ting Li's (Minister of Economic Affairs in 1965-69 and Minister of Finance in 1969-76 in Taiwan) comment is worth noting: "During the 1950s, 1960s and 1970s, we did not always think of what we were doing as a liberalization process. The main point is that there has been a long-term momentum toward liberalization" (see Li 1995:215).

¹⁷ Specifically, in the external sector, Li (1988b:19) remarks that the liberalization of import controls via several small steps by 1971 subsequently gained momentum so that by 1983, it could take on an entirely new and unprecedentedly ideological appeal by accepting the principle of the survival of the fittest and discipline of international competition in the domestic market.

change is a matter of learning, experiment and trial and error process, involving subjective aspects such as policymaker's perception, vision and experiences and objective factors such as environmental, geographical or international constraints. Hence, in understanding why a particular economic strategy is adopted, historical, social and cultural factors should be taken into consideration (Yu 1995:11).

Taiwan is able to succeed because its policymakers are willing to learn and unlearn. Taiwan's economic success may give us the impression that appropriate policies are deployed. This is true. However, it is true that the spirit of pragmatism and experimentationism among Taiwan's policymakers is strong to replace policies that are not working (Fei 1995:43). Though the right policy is not always adopted, the policymakers are willing to experiment with a pragmatic mind. Policies that do not work are abandoned. Policies that do work are adopted. A natural selection force is at work (Fei 1995:36).

At the beginning, tight economic control was conducted when Kuomintang took over Taiwan. As the island economy was stabilized, the government gradually removed some controls and regulations. Subject to the economic conditions, a gradual process of depoliticalization was under way. Li (1995:258) rightly claims that "this evolution was not itself an explicit, ex ante policy; there was not timetable for reforms and liberalization". From the Taiwan's case, we can classify, in evolutionary perspective, the role of government in economic development as follows (Li 1995:258):

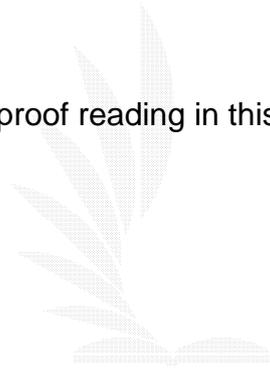
- (1) When the economy has only limited experience and capability, direct government involvement may be the most effective way to achieve results. In a similar analogy, Yu (1995:9) refers to the role of the government in this stage as a conductor while Yu (1997), as "entrepreneurial state".
- (2) When a sector of the economy gains experience and confidence, the emphasis shifts to government support or promotion; too much supervision and involvement can be counterproductive. Here the government acts as, in Yu's (1995:9) terms, an advisor.
- (3) As the economy continues to advance, the government will have only minimal involvement in day-to-day activities. Instead of monitoring and setting

overall objectives, the government can serve as a referee (Yu 1995:9) to ensure the competitive system works smoothly.

One important lesson from Taiwan's experience is that policy innovation "should be based on the anticipation of impending problems and conflicts, rather than be purely ideologically motivated... The very notion of an evolution of policy suggests that the timing (or timely appearance) of a particular policy is important, and a good policy innovation is one that does not arrive prematurely. Ideological considerations often get in the way of appropriate timing as, for example, with so called welfare state legislation that the economy simply cannot support. What can almost be called a rejection of Ideology lies at the heart of a healthy pragmatism that has guided policymakers in Taiwan and has supported a social consensus for growth and economic liberalization" (Li 1995:251).

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