

The Dynastic Impulse: An Hypothesis
Regarding Taiwan's Rapid Post-War Growth

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Abstract

This paper advances the hypothesis that Taiwan's successful post-war economic development stems mainly from a combination of (1) a cultural trait that was more common among the Chinese of the era of high growth than of other cultures (2) the special conditions that existed on Taiwan when Chiang Kai Shek and his Nationalist Party took command in 1949, and (3) of the policies subsequently followed by the Taiwan government. The paper discusses the role of private property and free enterprise under the special cultural circumstance where, roughly speaking, each head of household aims to build a dynasty for his or her temporarily extended family. The dynastic impulse drives the heads of household to work hard, to save, and, under the special conditions that exist in Taiwan, to produce human capital. The combination makes for an environment in which entrepreneurship can thrive. However, for this to occur, the government must promote private property and free enterprise, among other things. The paper presents hypotheses about how the particular policies that were adopted facilitated the household production of wealth and therefore provided a catalyst for the dynastic impulse. Besides discussing the creation and maintenance of a private property system and free enterprise, the paper also discusses monetary stability, infrastructure building, privatization, international trade liberalization, taxes, and human capital promotion.

The Dynastic Impulse

One of the most remarkable post-World War II contrasts is that between the Chinese in Communist China up until the early 1980s, and the Chinese in other parts of the world. During this period of persistently growing economic freedom both domestically and in international trade, the Chinese outside China flourished. They worked, saved, and built large estates to hand down to their descendants. The most obvious examples are the Chinese in Singapore, Hong Kong, and Taiwan. In these countries, many Chinese achieved success as international entrepreneurs. This occurred in some cases despite harsh anti-Chinese sentiment and envious expropriation, as in Malaysia and Indonesia.

The success story of Chinese outside China contrasts sharply with mainland China itself. The mainland Chinese kin of the successful emigrants faced persistent poverty and occasional famine due to unwise and often fatal central planning. The situation began to change markedly after 1979, when the Communist government initiated what, in retrospect, was a long-term shift to a market economy.

The main difference between the conditions outside China and inside pre-1980s China is the presence of conditions that are closer to those of a pure market economy. These conditions are a private property system, freedom of enterprise and a money that is not subject to periodic unexpected decreases in purchasing power. A private property system is never complete, enterprise is never completely free, and most monetary regimes are not ideal. However, those outside China were far closer to the ideal of a market economy than those inside. The result was an environment in which entrepreneurship could thrive.

The market economy gives rise to entrepreneurship everywhere. However, there is a special character of Chinese entrepreneurship that distinguishes it from what we can roughly call Western entrepreneurship. In this paper, we call this the “dynastic impulse. It stems from the the Chinese sense of the temporally extended family. It amounts to a desire not only to satisfy one’s own wants and to promote the interests of the immediate family but also to provide for expected unborn descendants. Broadly speaking, this paper argues that the Chinese who lived under market economy regimes were contributed even more to the economic growth of themselves and their nations than non-Chinese would have done under similar circumstances due to the dynastic impulse.

The argument proceeds in three steps. The first is to present the theory that entrepreneurship is the engine of economic growth under all circumstances. In part two, the paper clarifies the idea of the Chinese sense of the temporally extended family and the dynastic impulse. It also describes the likely effects of that impulse in the nations to which many of the Chinese emigrated. Part 3 shows how many of the policies followed by the Taiwan government, beginning in 1949 fostered and catalyzed the dynastic impulse by promoting a private property system and free enterprise. In addition, it discusses the policies of monetary stability, infrastructure building, privatization, international trade liberalization, taxes, and human capital promotion.

1. ENTREPRENEURSHIP AS THE ENGINE OF GROWTH

That entrepreneurship promotes growth and wealth is nowadays taken for granted, although we shall spend some time in this paper explaining just how entrepreneurship promotes growth and the conditions of private property under which it is likely to occur. The starting point is Adam Smith, the oft-proclaimed father of economics (1776). Smith believed that economic growth is mainly due to the increase in *human capital* which self-interested individuals have an incentive to produce under the conditions of the market economy. Human capital refers to specialized knowledge about peoples' demands for goods and about how to cause those goods to be produced. The conditions of the market economy that Smith had in mind were private property rights and free enterprise.

Private Property and Free Enterprise

A private property system contains two fundamental legal rights: (1) the legal right to consume or otherwise use a good or resource that one causes to be produced and (2) the legal right to exchange. The legal right to consume or otherwise use is sometimes called the legal right

of first possession.¹ The legal right to exchange implies a regime in which a person has a legal right to own a good or resource that he acquires by means of exchange.²

In a market economy, the person who first causes a good to be produce does not ordinarily plan to keep it for herself. She plans to sell it. In other words, she plans to give up her ownership right in exchange for money. She is an entrepreneur. Thus, the incentive to produce in a market economy is the prospective money profit from production and sales.

When a person buys a good from a producer, he gains the legal right to stop others from taking the good away. If he did not obtain this, he would have no incentive to buy. If no one had an incentive to buy, then no one would have an incentive to produce for the purpose of future exchange. It follows that the incentive to produce is greater than otherwise because a non-producer can acquire the legal right to use the good.

Free enterprise means that, with some exceptions, individuals are free from coercion to enter into any kind of business they wish, to apply for any kind of job, to buy and sell, and to make binding contracts. Free enterprise has never existed in complete form. Governments have always restricted it in some ways.

¹We could imagine a private property system in which someone else besides the producer owns the right to the produced good. But the world does not seem to contain any systems of this type.

²Exactly what rights accompany “ownership” is a complex subject that is beyond the concern of this paper. Suffice it to say that when the use of a good or resource in a particular way or for a particular purpose causes substantial harm or benefit to others, a “good” private property system ordinarily contains institutions that mediate conflict. Such institutions may consist of laws that limit the owner’s rights of use or, in some cases, prevent specific goods or resource from being owned at all. These situations are exceptions, however, and do not affect the general idea that a private property system can be roughly defined in terms of ownership.

Because a market economy has free enterprise, it contains competition. Competition refers to a continuing process of innovation and copying in which a large proportion of individuals, acting in the role of the entrepreneur, must continually produce new human capital in order to maintain their standards of living. Innovation refers to the act of introducing new consumers goods, new resources, or new methods of production. Copying refers to the act of duplicating the new goods, resources or methods.

Economic Growth

A logical theory of economic growth can be built on two simple assumptions: (1) that individuals aim to maintain their standard of living and (2) that they are self interested. To understand this theory, assume for simplicity that there is no change in consumer wants and no decrease in the means of satisfying them (i.e., in the resources) in the economy as a whole. Consumer wants and the environment are stationary. If an isolated actor – Robinson Crusoe – faced this situation, he may not try to improve his standard of living. In the market economy, however, there is competition.

Suppose that someone discovers a new product or method of production – through deliberate action, luck, or whatever. When this occurs, she will be able to profit by using that new product or method. However, as she begins to use it, *her competitors will face the prospect of a decreasing standard of living*. Even though the material environment of the market economy does not change significantly, innovation by one individual, acting as an entrepreneur, causes the personal environments of others to get worse. It is reasonable to assume that, under these

circumstances, the individuals in the worsening environments would have an incentive to use their imagination, creativity, and inventiveness to try to avoid a decrease in their standard of living. They can either copy the innovation, possibly improving on it; or they can try to make an innovation of their own.

Consider the position of the discoverer of the new product or method of production. At first, the discoverer earns higher profit and is content with her actions. Assume that she hires specialized employees by paying them more than they could otherwise earn. Her standard of living and that of her specialized employees improves. However, after others copy the innovation, her income decreases. She responds by reducing the incomes of her specialized employees, who have come to rely on her for employment at higher wages. Ultimately, to avoid a fall in her standard of living, she would have an incentive to either copy someone else's new product or method of production or to discover new ones. Her employees also would be concerned. They may help her with her efforts to innovate. Or they may invest in new human capital to prepare them for other jobs or to go into business for themselves. Their human capital investment may be designed to copy the human capital of others or to innovate by producing a different kind of human capital.

We can state the theory of economic growth based on self interest and competition as follows. Innovation or copying by each actor under free enterprise reduces the capacity of competitors to maintain their previous standards of living. To avoid a decline in these standards, they proceed to innovate and copy. This, in turn, threatens the capacity of still others, including

the original innovators and copiers. The result is a continuing concatenation of innovating and copying that causes economic growth.

Is this image of innovation and copying realistic? Consider the global market economy that exists in everyday life. This is an economy in which there is relatively free trade among the citizens of the different nations. In addition, it is an economy in which each employer and worker faces global competition. Since the global system has existed, there has been a continuing stream of new participants from all over the world. Most of these seem to aspire to the higher standards of living that they observe both in their own regions and in other regions. They aim to copy the methods of production used by market participants who enjoy higher standards. In this circumstance, if a person is complacent – if she fails to recognize that the means she uses to earn profit today are destined to become the relics of tomorrow – her standard of living is likely to fall. As Hayek wrote, "[m]an learns by the disappointment of expectations" (Hayek 1958: 193). One should add: The ordinary actions of some people under market economy conditions cause others' expectations to be disappointed and, therefore, provide important incentives for the others to learn.

2. THE DYNASTIC IMPULSE

A large proportion of people of Chinese descent share a culture that is based on reverence for that we might call the temporally-extended family. Such reverence is manifest in the belief

that a person's worth depends on his contribution to the family through time. A person who is strongly bound to the culture takes account in his or her daily life of the projected retrospective assessments of unborn descendants.

A good way to understand this idea is to consider the case of suicide. A common cause of suicide is depression caused by a head of household's failure in business or in gambling. In deciding on his self worth, the person contemplating suicide considers the approval or disapproval of his previous actions by his ancestors and descendants. Of course, no one can know how his actions would have or will be regarded by people who are not now alive. However, the person contemplating suicide builds images of such approvals and disapprovals in his mind. And these imagined reactions influence his actions. The members of many Western families also take account of their images of the approvals and disapprovals of their parents, grandparents, and children. But their cultural beliefs lead them do so to a much lesser extent and to consider those who are nearer to the present.

Limitations of Cultural Assumptions

In writing about culture, one must avoid overgeneralizing in two ways. A feudal society, which was characteristic of China before the massive change in the aftermath of World War 2, contains a set of peasant farmers, elite landowners, artisans, government bureaucrats, and soldiers. Only the landowner, artisan, and bureaucrat "classes" adopt the culture to the degree that warrants attention. Farmers and soldiers often do not. This partly corresponds to the higher level of literacy attained by the former classes. One might say that the culture of the temporally-

extended family is mainly a culture of the more educated classes. Thus, to speak about the common features of a culture does not imply that all members of a given society share the features.

Second, the idea of culture itself is far more distinct for societies that have undergone only minor changes over centuries of existence. Thus it is most appropriate for characterizing traditional societies. It is less relevant as successive generations confront the exigencies of a modern capitalist economy. Life in a modern capitalist economy requires continuous adjustment. Each person's innovation threatens the livelihoods of hundreds of others. And each person's copying of the others threatens the livelihood of the innovators.

When the leaders of a traditional society develop a private property system and freedom of enterprise, as occurred in Taiwan, the children of the landowners, artisans, and government officials lose their economic security. As the walls of enforced protectionism engendered under feudalism crumble, these people find that adherence to the old cultural values are no longer sufficient to assure their status. They must shift from the rigid rules of tradition to the ever-changing "rules of the marketplace." As a family that is steeped in the culture of the temporally-extended family comes to confront capitalism, its cultural roots are bound to fade into the background after only a couple of generations. Thus, when this paper uses the term "Chinese sense of family" and related terms, it is referring to a transient phenomenon – a phenomenon of only passing importance in the long march of history.

The Dynastic Impulse Under Capitalism

For simplicity, this paper uses the term “*dynastic impulse*” to refer to an individual’s internalization of the culture of the temporally-extended family. One can think of this impulse in relatively simple terms. Just as one can imagine an emperor of China who wants to continue the dynasty of his family and to be remembered in his descendants’ eyes as a great emperor, so also we can image the head of the Chinese household evaluating his actions partly on the basis of the projected approval and disapproval of his descendants.

There are many ways in which the dynastic impulse might manifest itself. A family member could achieve greatness in the arts, for example in painting or calligraphy. In a market economy, however, greatness is measured by the accumulation of wealth. A person who possess the dynastic impulse can achieve his goal best by earning income and saving it – by building an estate and by contributing to his expected further expansion of the estate by his descendants.

Of course, wealth must be gained honorably. A family member who steals, extorts, or embezzles could bring great shame. A successful gambler may be remembered as a black sheep not as a good emperor. Since business is not dishonorable, wealth acquired through successful entrepreneurship is both worthy of note and valuable to future family members.

This paper’s theory of the dynastic impulse of the Chinese who left Mainland China focuses specifically on the landowning, artisan, and bureaucrat classes. The people in these classes who left the Mainland aimed to achieve new permanent estates for their families and/or to accumulate sufficient wealth to make a esteemed return with their wealth to their families in China. Few actually did return, however. And as their descendants mingled with the other people

in the market economy, they quickly adapted. As a result, the dynastic impulse of the emigrants themselves was replaced by the a-cultural sense of the market economy. The descendants thus became “less Chinese.”

Chinese in the World

In pre-20th century China, opportunities to exercise the dynastic impulse were limited. The sons of landowners could study in the traditional way to manage an estate or aim for a position in government or as a military officer. The sons of artisans could study a craft and also aspire to a government or army post. And the sons of bureaucrats could study to occupy a position in the government or military. A head of household aimed to prepare his sons for such a future and to marry his daughters into rich or distinguished families.

Mao Tse Tung’s communism replaced the landowning class with communist party officials and it suppressed the artisan class. Most importantly from a comparative perspective, it contained no opportunities to succeed in business because of the absence of private property and free enterprise. It did, however, provide a new potential road to success in the form of opportunities within the communist party. Compare this with the market economy. The free enterprise characteristic of the market economy enables a person to choose practically any specialization he wants. If he chooses reasonably well and works hard, he can earn enough money for his family. The private property system assures that whatever money he earns he can keep. If he exchanges his money for durable property, he can keep the property. And, in expectation of his death, he can bequeath his money and property to a member of his family, who

then becomes the new owner. It is true that he cannot succeed without pleasing consumers or other producers. However, he need not worry about having his property confiscated if he fails; as he does if he fails to please a superior communist party official.

The combination of a market economy and the dynastic impulse motivates the head of household to save in other ways besides money and property. He can use both his own time and earnings to provide his children with opportunities and incentives to acquire the specialized talents that he himself lacks and that limit his own success. Thus it is no surprise that a larger proportion of the former landowners, artisans, shopkeepers, and bureaucrats who left Mainland China before the capitalist revolution began in the 1980s succeeded in the more capitalist societies and, more generally, in the rapidly expanding global economy of the latter 20th century.

Hong Kong, Singapore, Taiwan, and the other places to which the Chinese emigrated were not ideal market economies. No nation had or has an ideal market economy. However, the salient characteristics of the leaders of Hong Kong, Singapore, and Taiwan were (1) their desire for economic growth and (2) their recognition that in order to achieve it, they needed the market economy. These leaders gave the Chinese a measure of economic freedom that was sufficient for the dynastic impulse to manifest itself in the form of clearly observable result. In short, a large proportion of the Chinese became super-rich in only a single generation.

3. TAIWAN POLICIES THAT ACTED AS CATALYSTS FOR THE DYNASTIC IMPULSE

The Kuomintang Nationalist Party (KMT) maintained a dictatorial rule over Taiwan between 1945, when Taiwan returned to Chinese rule, and 1989. Its leaders, including the military dictator Chiang Kai Shek, arrived on Taiwan following their defeat on the mainland in 1949. The purpose of this section is to consider ways in which the KMT facilitated growth by catalyzing the hypothesized dynastic impulse. Clearly, a private property system is an important catalyst, since building an estate would be impossible without it. Corresponding to this, a policy that enables a head of household to bequeath his property to offspring is important. In addition to the private property system, free enterprise expands opportunities to gain from hard work and the production of specialized human capital.³ Moreover, by facilitating the competition of copiers, it provides an incentive to innovate. The section begins by discussing private property and free enterprise. It goes on to discuss other policies. The latter can be divided into three classes. The first consists of policies that reduce transactions costs, such as monetary stability and infrastructure of particular types. The second are policies that promote free enterprise, such as privatization, liberalizing international trade, and maintaining low taxes. The third class of policies promote the development of human capital.

³As Adam Smith wrote, the division of labor is limited by the extent of the market. Free enterprise expands markets.

These other ways were especially significant given the special conditions faced by the KMT government when they arrived on Taiwan. This paper identifies seven such conditions. Since these will play a part in the discussion later in this section, it is worth describing them briefly at the outset. The first special condition was the state of the monetary system. At the time of Chiang's arrival, Taiwan was in the midst of a long hyperinflation. As a result the costs of making economic transactions was much higher than necessary. Second, infrastructure on Taiwan, which was considerably better than that of most of Asia, had nevertheless been severely damaged during World War II as a result of allied bombing. By 1949, some had been restored but the drain of resources due to the civil war in China and the uncertainty due to the hyperinflation meant that the infrastructure to which pre-war Taiwanese had become accustomed was, in 1949, still badly in need of repair. The effort to restore monetary stability and infrastructure necessarily put great strain on a budget that was already overburdened by Chiang's commitment to defend against a possible Mainland attack. Third, the U.S. was engaged in an anti-communist policy, particularly after the outbreak of the Korean War in 1950. Taiwan and the United States were obvious allies, although the alliance would necessarily be dominated by the United States. The aid that the U.S. pumped into Taiwan during the 1950s went a long way toward solving the money and infrastructure problems. It also carried some strings, which affected the KMT's economic policies. Fourth, Chiang believed that he had a special mission to demonstrate a successful agricultural policy, and especially one that would benefit the lowest of the farm classes. Fifth, the people who arrived with Chiang numbered about one-sixth of the population and they were mostly adults. They brought with them a tradition that was more distinctly Chinese

than that which had evolved in Taiwan. Thus, a larger per cent of the newcomers probably possessed a strong dynastic impulse than those who were already on the island. Sixth, about half of domestic production was controlled by the government by means of state owned enterprises. Seventh, literacy was quite high by Asian standards. It will be seen that all of these factors played a role in the policies that the KMT adopted and also, it is argued, in the way in which those policies catalyzed the dynastic impulse.

The Property System and Free Enterprise

The most fundamental way that a government can help promote growth is to employ its monopoly over force to create and maintain a private property system and free enterprise. Regarding private property rights, the government bureaucrats assigned to govern Taiwan during the 1945-1947 period were notoriously corrupt and were aided by numerous restrictions on freedom of enterprise. The restrictions often required residents to get permission from bribe-soliciting bureaucrats to carry out ordinary economic transactions, thereby raising transactions costs. The bureaucrats were also acquisitive, raising the level of uncertainty among the native Taiwanese about the prospect for retaining property that was easy to confiscate. In 1947, a revolt by the Taiwanese against the governor led to a brutal suppression and the systematic execution of thousands of the business and professional classes. On top of this Taiwan had to suffer through the hyperinflation, which did not stop until 1950. If Chiang wanted to gain the respect of the Taiwan people he had to begin by establishing trust. This was partly accomplished by establishing and maintaining a private property system. Over time, the hands-on administration

of the new Chiang government was also able to establish a reputation for honoring the property transfers carried out by all Taiwan citizens and for relative fairness in its treatment of Taiwanese market interaction.

In addition to establishing a private property system, the Chiang administration deregulated markets by eliminating numerous restrictions on domestic exchange.⁴ The man most responsible for "planning" the Taiwan miracle, Mr. K. T. Li, introduces his book about his planning experience with the following paragraph:

I have always believed that government can serve only as a guide and catalyst in the process of economic development – that it can help establish the type of environment needed for economic development to take root, but that the true success of any national development effort depends on the will and the commitment of the people. (Li 1988: ix)

Of course, the will and commitment to contribute to economic development is a characteristic of people who have a direct stake in that development. The private property system and free enterprise give them such a stake, as Li and other KMT officials recognized.⁵

The KMT was not acting alone, however. His policies were partly determined by the U.S., upon which he became dependent for aid after 1950. After 1953, the U.S. began to tie future aid to the adoption of market reforms. Indeed, it is possible that the KMT would not have changed its policies on its own. Tsong-Min Wu (2005) writes that the KMT thought that control and regulation was the best way to solve economic problems, but that such policies actually had a

⁴An exception was bank credit, over which the government maintained relatively tight control.

⁵Some writers have emphasized the relatively modest Taiwan program of promoting particular firms and industries, sometimes called the "picking winners" program. However, "there is hardly any evidence that this industry policy of 'picking the winner' has been sufficient to start the industrialization process and to keep it going (Veselka 2005: 9).

detrimental effect on the economy. In any event, at the end of the Korean hostilities in 1953, U.S. aid became partly contingent on a shift toward a market economy. And Taiwan, in fact, made the shift. It is impossible, of course, to determine how large the U.S. influence on Taiwan policy was.

Transaction Costs Policies

Taiwan adopted two kinds of policies that reduced transactions costs: maintaining monetary stability and building infrastructure. We discuss each in turn.

Monetary Stability

Monetary stability is particularly important to people who plan to save, such as those with a dynastic impulse. Following the hyperinflation of the late 1940s, the KMT government was able to achieve stability mainly by adopting a gold standard. The government was helped by U.S. loans beginning in 1953, which relieved pressure on the government budget arising from the continued defense needs in light of the threat from Mainland China (Makinen and Woodward: 1989). The loans from the U.S. were fully repaid by 1970.

Supplying Infrastructure

Another policy that can aid free enterprise is the supply of infrastructure, particularly in transportation and communication. The Japanese had provided substantial infrastructure during its rule, particularly in agriculture. This was both repaired after the war and improved. Gustav Ranis writes:

The colonial administration – if for its own selfish reasons – expended substantial resources on the rural sector, in the forms of roads, drainage, irrigation, and power, as well as on institutional infrastructure, in the form of agricultural research, experiment stations and, most importantly, farmers' associations. All these constituted capital and institutional investments, which together led to a significant Green Revolution in rice long before World War II, with yields rising by 4% a year between 1921 and 1937; even more importantly, they laid the ground-work for the full mobilization of the agricultural sector in the post-war era” (Ranis 2002 : 4).

In addition, the government facilitated Taiwan industrialization during the 1960s and 1970s by vastly improving facilities at its major ports and by building industrial parks. It also greatly improved the road and rail transportation systems.

Free Enterprise Policies

Free enterprise provides the same *general* incentive for anyone who wants to consume goods but, other things equal, people with a dynastic impulse are likely to cause greater growth. The same logic applies to a number of policies that expand the range of free enterprise opportunities.

Privatization

One such policy adopted by the Taiwan government was privatization. The economic philosophy of the KMT was state capitalism. Its aim to control the major industries in the economy was facilitated by the inheritance of Japanese enterprises. In 1951, the government-owned businesses contributed 43 per cent of industrial value added (Cornell 1993). The state monopolized transportation, communications, power, salt, tobacco products, alcohol, sugar, iron and steel, aluminum, cement, fertilizer, and oil refining. Although four companies were

privatized as early as 1953, partly due to pressure from the U.S., the remainder stayed in government hands. However, the share of public sector production in the nation's production fell consistently, if gradually, during the next thirty-five years due to the deliberate decision to leave expansion in the hands of business, albeit small business for the most part.⁶ A concerned effort at privatization occurred in 1989. Between that time and 1993, the government carried out thirty-eight separate privatizations (Wu 2003; H.L. Wu 2005). Overall The importance of state-owned enterprises in Taiwan shrunk from around 50% of GDP in the early 1950s to 9% in 1992.

International Trade Policy

Another policy that expands opportunities is relatively free international trade. At first, the KMT set up a series of stiff regulations on trade and carried out an import substitution policy by levying heavy tariffs on many imports and maintaining an overvalued multiple exchange rate system. Under pressure from the U.S., however, the government began to shift from import substitution to export expansion. By the late 1950s, it had also moved to a single fixed exchange rate that appears to have not been very different from the rate that would have existed if the rate had been flexible.

Import tariffs remained high on consumer goods until the mid-1980s (Wu 1998).

However, in the 1960s and 1970s, under the policy of export promotion, export processing zones

⁶The policy of promoting small to medium enterprises was probably due largely to security concerns, although it is also consistent with the KMT egalitarian ideology. Also it should be mentioned that Alam (1989: 60) has maintained that state owned enterprises played a much larger role than is indicated by GDP and value-added measures.

were set up in which businesses could import raw materials, parts, and machinery to produce products for export. These were complemented by “bonded factories” throughout Taiwan, which were permitted to buy duty-free foreign raw materials and capital goods, again provided that they exported their products. The government also instituted preferential tax treatment (i.e., it reduced taxes) for export firms. It seldom gave direct subsidies. And when it did, it usually had the strength of will (and the dictatorial power) to withdraw them after a period of time.

Ranis summarized the results during this era by writing that the government policy was crucial for making Taiwan producers competitive in international markets; however, it allowed consumers “to be exploited as long as it was politically feasible” (Ranis 2002: 9).

Not until the mid-90s as part of the drive to become a member of the WTO was there a major liberalization in goods and capital markets; but, while it took four decades to really open up Taiwan, especially to trade, it should also be noted that the direction of the trend has always been clear (*ibid.*: 16).

On January 1, 2002, Taiwan became a member of the World Trade Organization after 12 years of effort.

Tax Policy

Free enterprise can be restricted by high sales and income taxes. In Taiwan, although people have always had a legal obligation to pay sales and income taxes, the government adopted a policy of low enforcement, particularly for the traditional outdoor markets, which became an institution in practically every Taiwan neighborhood. The government's lax enforcement of sales and income taxes among low income-earners helped stimulate a large underground market in

untaxed goods. The sellers in the underground markets are highly mobile retailers, who operate outdoors for the most part and who sell practically all of the necessities. Even today, after the institution of a novel government-run nationwide lottery based on sales receipts has led most ordinary businesses to pay sales taxes, the traditional food markets and the traditional night markets are mostly untaxed.

Policies Promoting Human Capital

When the KMT arrived on Taiwan in 1949, the population was already more literate than that of most Asian countries. Due to the colonial policies of the Japanese, which favored primary education, 60% of the population was literate. “This respectable initial stock of human capital was, moreover, substantially enhanced by the massive influx of small traders and entrepreneurs who accompanied Chiang Kai-Shek's army in migrating from the mainland in 1949” (Ranis: 5).

This human capital was critical to Taiwan’s development. Ranis writes that Taiwan’s

initial advantage in human capital and institutional resources and her disadvantage in natural resources undoubtedly helped to mold the decisions at the inevitable end of the easy import substitution subphase in the early 1960s, leading to the general rejection of a secondary (more capital-intensive) import substitution regime and the adoption instead of an export-oriented strategy based on an increasingly competitive human resources-based development path” (Ranis: 6).

The KMT government built on the initial foundation. It expanded the compulsory system from primary to secondary education, and substantially increased its spending on this (Ranis 9).

During the 1960s, primary education, in which 70% of Taiwanese children had participated under the Japanese, became universal, and students in higher education increased many-fold. As Taiwan sought to industrialize, emphasis in higher education “shifted toward engineering and the

natural sciences and away from the traditional humanities and earlier agronomy-related concentrations”(Ranis: 10).

The merits of public education are debatable and there can be little doubt that one of the purposes aimed at by the KMT was indoctrination and control, since the system forced the Mandarin dialect on the majority of children whose language at home was Tawanese.⁷ Given the dynastic impulse among a large per cent of the population, educational achievement might have been even greater if parents had been able to use the resources that the government diverted into public education. On the other hand, it is difficult to know the political ramifications of allowing parents to choose their own type of education. In any case, compared with other types of government intervention in markets, intervention in education under the special circumstances that existed in Taiwan during the early years seems relatively benign.

No doubt the high literacy rate and the dynastic impulse combined to make the Taiwan workforce one of the best, in both motivation and education, in Asia. This was especially important given the fact that Taiwan lacked raw materials and technical knowledge at the outset of its period of high development. Industrial development in the absence of material resources depends on the ability of a nation to import raw materials and produced value added for export through its comparatively superior human capital. Starting in the late 1960s, Taiwan did exactly that and continues to do so today.

⁷These dialects share the same written symbols, but the words used in ordinary speech differ greatly.

An interesting way in which the government inadvertently promoted human capital development was its so-called land to the tiller program, in which it dictated a transfer of land from large landlords to their tenants. A result was to create an incentive for the previous tenants to produce the additional human capital needed to manage the land and to interact with other small farmers with whom irrigation systems and other common property resources could be managed efficiently. Also it gave many previous landlords an incentive to shift their money capital away from farming and into business, which grew in importance after Taiwan began to industrialize.⁸ In an interesting twist, the “debt” to some of the landlords was redeemed in the form of shares of stock in previous state owned enterprises.

The interaction among the emerging class of small farmers was bolstered by the agricultural extension work that occurred after Taiwan began receiving technical aid from the U. S. The Taiwan government was able to import the know-how needed to copy America’s broad agricultural extension program. Because the program’s leaders in Taiwan were largely immune from democratic pressures and because they were motivated to promote agricultural growth (as opposed to helping farmers in any way possible), the result was a boon to agricultural human capital.

Outside agriculture, the Taiwan government embraced the western technological knowledge, which was also provided in the early years by the U.S. It also sought technical and

⁸Landlords were forced “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” (Olds 2003). But the bonds could not be redeemed for many years. Thus, the money became available at just around the time when industrialization took off.

business assistance from other foreign advisors. It set up a program to finance the graduate studies of a large number of Taiwan university graduates in western universities, particularly in the U.S. As many of these emissaries returned, they became the brains behind low-wage electronics and computer products that, beginning in the 1970s, brought Taiwan into the modern age. Many also became teachers at Taiwan universities.

4. CONCLUSION

Taiwan' rapid postwar development was undoubtedly a consequence of its gradually establishing the conditions conducive to market interaction: private property rights, free enterprise, and stable money. The special conditions that existed when the Chinese nationalists retreated to Taiwan in 1949 also played a role. The long period of corruption, acquisitiveness, and instability of the governing KMT required the Chiang government to achieve credibility in private property and finance if it wanted the Taiwanese to be productive. Also, whether it wanted to or not, the government had to adapt to the wishes of the U.S., its much-needed ally, by liberalizing its domestic economy and switching from an import substitution policy to an export promotion policy. Finally, the lack of natural resources made the production of human capital a necessary complement to export promotion. Although the KMT benefitted from the relative abundance of initial human capital, it supplemented this with a deliberate education program.

This provided the know-how needed to operate a successful export substitution policy.

Infrastructure and low taxes also played a part by reducing transactions costs.

The emphasis in this paper has been on another factor, however. The aim has been to highlight the dynastic impulse. Practically everyone wants to help themselves and their families by producing wealth. And, following Adam Smith, one person's production of wealth ordinarily benefits others. What differentiates the traditional Chinese from others is the projection of family approval of one's actions into the distant past and distant future. The dynastic impulse represents a desire to acquire wealth not for personal consumption during one's lifetime but for the family's future. Such an impulse can probably not survive the assault of prolonged exposure to a market economy. Logic suggests that so long as the market economy exists, future generations do not need very much help from the generations of the present. However, the impulse is likely to be strong among the landowners, artisans, and businesspeople in a traditional society of the type that existed in China at the time Chiang and his entourage escaped to Taiwan. If our thesis is correct, the dynastic impulse was an important factor spurring economic growth during the first thirty or forty years of Taiwan's existence. For the future, however, one would expect the impulse to fade away as the Taiwan people become increasingly integrated with the global economy and society.

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