

The Dynastic Impulse: A Speculative Hypothesis

On 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 during the era of high growth than among other cultures at other times (2) the special conditions that existed on Taiwan when Chiang Kai Shek and his Nationalist Party took command in 1949, and (3) the policies subsequently followed by the Taiwan government. We use the term “dynastic impulse” to refer the cultural trait.” It is argued that government policies in post-War Taiwan functioned as catalysts for this impulse, leading the heads of household to work hard, save, and apply their entrepreneurial talents. An important result was a large increase in human capital, which was especially important in light of Taiwan's relative lack of natural resources. The relevant policies were the creation and maintenance of a private property system and free enterprise, 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 before the early 1980s, and the Chinese who had left China and moved to other parts of the world. The Chinese outside China, broadly speaking, 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. Many Chinese in these countries achieved success in international business, often despite harsh anti-Chinese sentiment and envious expropriation, as in Malaysia and Indonesia.¹

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

Prior to the 1980s, the main difference between Communist China and outside is that, in the latter, the Chinese faced conditions that were closer to those of a pure market economy. That is, the conditions were closer to those of a complete 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

¹*The Economist* (2001) reports that the Chinese hold shares of market capitalization that are several times those of their non-Chinese counterparts in Indonesia, Malaysia, The Philippines, Singapore, and Thailand.

market economy than those inside. The result was a contrast that no one familiar with the region could ignore, including the Communist Chinese leaders themselves.

The market economy gives rise to entrepreneurship everywhere. However, it is argued in this paper that there is a special character of Chinese entrepreneurship that distinguishes it from what we can roughly call Western entrepreneurship. It is motivated by what we call the “dynastic impulse.” 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 imagine the head of the Chinese household evaluating his actions partly on the basis of the projected approval and disapproval of his descendants.

The dynastic impulse stems from 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 and to please perceived ancestors. Broadly speaking, this paper speculates that the Chinese who lived under market economy regimes contributed even more to the economic growth of their nations than non-Chinese would have done under similar circumstances due to the dynastic impulse. Of special interest is Taiwan.

This paper will make no effort to provide a theory that entrepreneurship is the engine of economic growth in the ideal market economy and, therefore, more so in economies that are

closer to this ideal than in those that are farther away. It takes it for granted that such is the case.² Part one of the paper clarifies the idea of the Chinese sense of the temporally-extended family and the dynastic impulse. It also shows how the existence of this impulse causes greater growth, other things equal, than otherwise. Part 2 shows how many of the policies followed by the Taiwan government, beginning in 1949, fostered and catalyzed economic growth 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. 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, or imagined, assessments of his behavior by ancestors and unborn descendants. He thinks about ancestors who he never knew and the descendants that he hopes to have. Then he asks how his actions are likely to be viewed by them. Will they regard him as contributing to or taking away from the family?

²Relevant references are Berger 1987, Scully (1988), Haan and Sturm (2000), Heckelman and Stroup (2000), Scully (2002), Carlsson and Lundstrom (2002), Berggren (2003), Rodrik et. al. (2004), Glaeser et. al. (2004) and Gonzalez (2005).

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 actions by his ancestors and descendants. Of course, no one can know how his actions would have been or will be regarded by people who are not now alive. However, the person contemplating suicide builds images of such approvals and disapprovals. 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 they do not ordinarily extend their images to their distant ancestors and unborn descendants. As a result, we speculate, their entrepreneurship as defined above is less strong and has less pronounced effects, other things equal.

The Manifestation of the Dynastic Impulse Under Capitalism

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. In this situation, an obvious way for a person who possesses the dynastic impulse to achieve his goal is to earn income and save it – to build an estate and/or to contribute to the estate built by his ancestors.

Of course, wealth must be gained honorably. A family member who steals, extorts, or embezzles could bring great shame. Even a successful gambler may be remembered as a black

sheep, not as a good emperor. Since business is not dishonorable in a market economy, wealth acquired through successful entrepreneurship is both worthy of note and valuable to future family members.

Chinese in the World

In pre-20th century China, opportunities to exercise the dynastic impulse were limited. The poorly educated sons of farmers could hope mainly to expand the size of the family's land plots. Such an expansion ordinarily went hand-in-hand with an expansion of the family size. Mao Tse Tung's communism collectivized farming and it suppressed the professional and business classes. Most importantly from a comparative perspective, it contained no opportunities to succeed in business because of the absence of private property and free enterprise. The main opportunities for exercising the dynastic impulse were within the communist party. These opportunities were limited and for the vast majority did not permit the accumulation of property.

In contrast, 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 he can keep whatever money he earns. If he exchanges his money for durable property, he can keep the property. In expectation of his death, he can bequeath his money and property to family members.

In a modern market economy, the head of household can save in other ways besides money and property. He can provide his children with opportunities and incentives to acquire the

specialized talents that he himself lacks. The typical Chinese farmer aimed to train his children to become farmers. The father of the Communist Chinese family hoped to train loyal and successful party members. In the market economy, Chinese parents invested in widely diverse human capital for their children.

A large proportion of those who left Mainland China before the capitalist revolution began in the 1980s worked hard, saved, and invested. And they provided incentives for their children to acquire diversified human capital. As a result, their families succeeded in the more capitalist societies and, 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 results. A large proportion of the Chinese became super-rich in only a single generation.³

³An intriguing complementary hypothesis about the success of these societies relating to cultural values is that a strong sense of family values makes a modern welfare system redundant Lal (2000: 27). As a result, there is only a small propensity of citizens in such a society to demand a government-administered welfare system. The absence of a welfare system would have spared the above-mentioned Chinese societies the additional expense and potential corruption of the welfare state.

Limitations of Cultural Assumptions

In writing about culture, one must avoid overgeneralizing. 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 such as that which emerged among the farmers in rural china. It is less relevant for the Chinese who were more mobile and it decreases in relevance as successive generations confront the exigencies of a modern capitalist economy. Life in a modern capitalist economy requires continuous adjustment. Such adjustment is bound to erode the traditional culture.

In rural China, the presumed nurturing place of the dynastic impulse, and in rural Taiwan, multi-task farm work was at a premium. The skills needed to do it were relatively simple and many of them could be learned at a young age. As a result, a young farm worker was a valuable asset and the heads of household had incentives to produce many. In different terms, the cost to a family of producing able farm workers was relatively small and the training needed by such workers could be self-produced by parents and older siblings on the farm. Because farm work was produced at home, the value systems of the traditional family could be seamlessly and cheaply transmitted from generation to generation.

Successful capitalism in modern, industrialized hi-tech Taiwan, which has few natural resources and limited farm land, requires human capital. As Taiwan developed, the human capital demanded became increasingly diverse and specialized, as compared with traditional rural

China and even traditional rural Taiwan.⁴ To produce it requires years of education, special training, and on-the-job experience. As a result, the cost of producing a successful worker in the Taiwan economy is high. Moreover, although the family produces the babies, it is ordinarily not able to produce specialized work, since parents seldom have the skills to train their children appropriately for the progressing economy. Schooling, specialized training, and work experience away from home is required. Such lengthy and specialized education is expensive.

Suppose at first that no public education is available. Then the family would have to buy the education and training at a cost that is many times higher than that of the cost to a rural farm family of training a farm worker. Moreover, such extra-family education is accompanied by value systems that compete with those that would, in a rural China setting, help to perpetuate the dynastic impulse. The children interact more with other children from different families in a highly populated urban setting. They also interact more than traditional rural children with other neighbors, who have many more different roles and functions than the neighbors in a rural setting. Finally, the children are educated by teachers whose value systems are likely to differ markedly from those of the parents.

Anticipating the high costs and the potential outside influence on values, heads of households find it unprofitable to have so many children. Children become a consumer good rather than a producer good.⁵ Parents in Taiwan often lament about the breakup of the traditional

⁴We refer to traditional China and Taiwan, since farmers in these nations now face increasing competition due to WTO membership. As a result, Taiwan agriculture has become increasingly hi-tech. China's agri-technology is also changing.

⁵The birth rate in Taiwan today is about the same as in other developed countries of the world, which of course is several times less than that of rural China before Communism.

family and complain about the growing indifference of the younger generation toward traditional family values.

The situation is somewhat different if education is provided by the government via taxation. Although parents need not pay for at least part of their children's education and training, taxation reduces the income over which they have personal control. More importantly, the value systems to which the children are exposed are further outside parental control. In the case of Taiwan, the dictatorial government imposed an education that sought in some measure to preserve the Chinese sense of family. However, as Taiwan democratized, its education system and media also liberalized, so that children became exposed to increasingly diverse value systems in their schools and homes.

For these reasons, it seems that as a family that is steeped in the culture of the temporally-extended family comes to confront capitalism, its cultural roots are likely 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.

Derivative "Cultural Values"

It has long been observed that the Chinese and other oriental societies have an unusually high rate of saving and a strong work ethic. Other former residents of restricted societies or economies also exhibit these properties, particularly if they are poor immigrants in new lands, like many of the Chinese who left China during the relevant period. But if the Chinese have a

higher rate of saving and a greater work ethic than other poor emigrants from comparably restricted societies, to what should we attribute it? From the viewpoint of the speculative hypothesis of this paper, these characteristics are best regarded as manifestations of a more fundamental cultural value – the dynastic impulse.

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

The dictatorial Kuomintang Nationalist Party (KMT) took control over Taiwan in 1945 in accord with an agreement between China's military dictator Chiang Kai Shek, President Truman of the U.S., and Prime Minister Churchill of England. In 1949, after Chiang was defeated on the Mainland, he retreated to Taiwan, where his Nationalist Party ruled dictatorially until 1989, when Taiwan democratized. The KMT continued to be the ruling party until it was defeated in the presidential election of 2000 after a party split.

The success of Taiwan in development is widely known. From 1953 to 1990, the average annual growth rate was over 8 per cent.⁶ Since 1990, the trend has been gradually downward. In recent years, the average has been about 4 per cent.⁷ The purpose of this section is to consider ways in which the KMT facilitated this growth by catalyzing the hypothesized dynastic impulse. Clearly, a private property system is an important catalyst, since building an estate would be

⁶The Parliament of the Commonwealth of Australia, "Taiwan: The Spectacular Growth of the 'Other China,'" *Current Issues Paper No. 2*, 1989-90.

⁷Taiwan government information office.

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 is important because it expands opportunities to gain from hard work and the production of specialized human capital. Moreover, by facilitating the competition of copiers, it provides an incentive to innovate. This part begins by discussing general policies toward 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 specific policies that promote free enterprise, such as privatization, liberalizing international trade, and maintaining low taxes. The third class of policies promote the production of human capital.

These other policies were especially significant under the special conditions faced by the KMT government when they arrived on Taiwan. This paper identifies six 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 in most of Asia, had nevertheless been severely damaged during World War II as a result of allied bombing. By 1949, some had been restored. However, 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 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 helped to steer the KMT's economic policies toward private property and free enterprise. Fourth, Chiang believed that he had a special mission to demonstrate a successful agricultural policy, especially one that would benefit the lowest of the farm classes. Fifth, about half of domestic production was controlled by the government through state-owned enterprises. Sixth, 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.

It is appropriate to point out the difference between the view of economic policy adopted in this paper and the alternative view of the "developmental state," as expressed for example in the works of Chu (1994) and Weiss (1998). Although we discuss infrastructure and education policy as possible catalysts in development, the main emphasis is on the state's role in establishing and maintaining private property and free enterprise. In this respect, the approach of this paper is similar to that of Smith (2000). Yet we certainly do not maintain that the Taiwan government had a policy of *laissez faire*. Our thesis is only that the Taiwan government provided a greater degree of private property rights and free enterprise than comparable governments. As Deepak Lal puts it, newly industrialized countries like Taiwan

certainly have activist governments, nor have they fully succeeded in avoiding policy-induced distortions in their economies, but, in comparison with the less successful developing countries (such as India, Sri Lanka, and Tanzania), they have concentrated the state's energies and resources relatively more on doing those things that only governments can do and less on those areas of economic life that are by and large best left to private agents (Lal 1987: 61).

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 secure private property rights, the majority of Taiwan residents in 1949 did not expect much. And for good reason. The Chinese representatives assigned to govern Taiwan during the 1945-1947 period were notoriously corrupt and imposed 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 in the business and professional classes. On top of this, the people on Taiwan experienced 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. He partly accomplished this 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 most Taiwan citizens and for relative fairness in its treatment of Taiwanese market interaction.⁸

In addition to establishing a private property system, the Chiang dictatorship deregulated markets by eliminating numerous restrictions on domestic exchange.⁹ 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.¹⁰

The KMT was not acting alone. Chiang's 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 leaders in the KMT thought that control and regulation were the best ways to solve economic problems. In any event, at the end of the

⁸There are many histories of this period. The facts provided here are well known. The interested reader may wish to consult Thorbecke and Wan (1999) and Kuo et al. (1981).

⁹An exception was bank credit, over which the government maintained relatively tight control.

¹⁰Some 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).

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 their rule, particularly in agriculture. 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).

After the war, the material infrastructure was both repaired and improved. The agricultural research and education was also continued and possibly improved, with the help of the U.S. In addition, the government facilitated Taiwan industrialization during the 1960s and 1970s by vastly improving facilities at its major seaports and by building industrial parks. It also greatly improved the road, rail, and air transportation systems.

Specific Free Enterprise Policies

In light of the conditions facing the Taiwan government in 1949, free enterprise policies consisted of (1) reducing the government restrictions on domestic buying, selling, and producing (2) privatizing state-owned enterprises, (3) liberalizing international trade policies, and (4) tax policies. We have already pointed out the general approach to domestic free enterprise taken by K. T. Li. Here we discuss the second three of these policies.

Privatization

The KMT goal was state capitalism and its achievement was facilitated by the inheritance of enterprises from the Japanese. 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 a deliberate decision to leave expansion in the hands of business, albeit small business for the most part.¹¹ A more committed effort at privatization occurred in 1989. Between that time and 1993, the government carried out thirty-eight separate privatizations (H.L. Wu 2003, 2005). Overall, the importance of state-owned enterprises in Taiwan shrunk from around 50 per cent of GDP in the early 1950s to 9 per cent 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 changed to a single fixed exchange rate that appears to have not been very different from the rate that would have existed if it had been flexible. Thus, unlike the U.S. and the U.K., it did not adopt budget-deficit Keynesian policies.

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

¹¹The 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 non-tariffed 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, provided that the factories exported their products. The government also instituted preferential tax treatment (i.e., it reduced taxes) for export firms. It seldom gave direct subsidies. When it did, it usually had the strength of will (and the dictatorial power) to withdraw them after a period of time.

Import tariffs and other restrictions inhibit the growth of globally-evaluated human capital while, at the same time, enabling domestic firms that have little or no expertise in international markets to earn profit. Under some conditions, this may be important politically. But the opportunity cost is high. A large sector of the population becomes motivated to produce human capital that is obsolete when seen from the global perspective. Production of it is profitable only under the shelter of the restrictions. The people who produce it are destined to become dependents on the continuation of the restrictive policy.

Export promotion of the type that frees producers for export to import material resources and to copy foreign technology, spurs growth by exposing the producers to foreign competition. So long as exports are not highly subsidized (in Taiwan they were not), the firms are compelled to produce human capital of comparable value to that used abroad. Eventually, as the technology of domestic firms catches up with foreign technology and as labor costs rise, global competition provides an incentive to produce the kind of cutting-edge human capital (technology) for which Taiwan is becoming famous.

Ranis summarizes 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).¹²

On January 1, 2002, Taiwan became a member of the World Trade Organization with the status of a developed area, 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 market are highly mobile retailers, who operate outdoors for the most part and who sell practically all of the necessities. In recent years, a novel government-run nationwide lottery based on sales receipts has induced most ordinary businesses to pay sales taxes. Still, the traditional food markets and the traditional night markets are mostly

¹²Since some producers are also consumers, the term “exploited” tends to distract one’s attention from the real effects of the policy. The main effects were surely to make producers of consumer goods that are bought by Taiwanese consumers (and capital, including human capital that is specialized in producing these consumer goods) less competitive in world markets. One expects that this lack of competitiveness will be starkly revealed as the full impact of WTO membership is felt.

untaxed and remain a source of cheap consumer goods for low-income families. They are also a source of income for marginal workers and small entrepreneurs.

Policies Promoting Human Capital

When the KMT arrived on Taiwan in 1949, the population was already more literate than in most Asian countries. Due to the colonial policies of the Japanese, which favored primary education, 60 per cent 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). Ranis believes that this initial human capital was critical to Taiwan's development. He 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 the budget (Ranis: 9). During the 1960s, primary education, in which 70 per cent 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 in general are debatable. In the case of Taiwan, moreover, there can be little doubt that among the KMT goals in providing it were indoctrination and control. For example, the KMT forced the Mandarin dialect on the majority of children whose language at home was Taiwanese.¹³ Given the existence of a dynastic impulse among a large per cent of the population, educational achievement might have been even greater if parents themselves had been able to use the resources that the government diverted into public education. On the other hand, many Taiwanese were relatively uneducated farmers who may not have invested in education. Moreover, 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 in light of 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 to produce 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.

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

¹³These dialects share the same written symbols, but the words used in ordinary speech differ greatly.

from large landlords to their tenants during the 1950s. A result was to create an incentive for the previous tenants to produce additional human capital. They needed this in order to efficiently manage the irrigation systems and other resources that they shared with other farmers. 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. 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.¹⁴

Human capital production due to 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, as in the U.S.), the result was a boon to agricultural human capital.

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

¹⁴Landlords 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. As a result, the money became available at just around the time when the export promotion policy was instituted.

computer products which, beginning in the 1970s, helped to lift Taiwan into the modern age. Many also became teachers at Taiwan universities and innovators in the new hi-tech industries of the last twenty-five years.

3. CONCLUSION

Taiwan' rapid postwar development was due mainly to 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 played a role in its decisions. If the Chiang government wanted the Taiwanese to be productive, it had to counter its history of corruption, acquisitiveness, and instability with rights in private property and stable money. Also, whether it wanted to or not, the government had to adapt to the wishes of the U.S., its much-needed ally. It liberalized its domestic economy and switched away from an import substitution policy to an export promotion policy. 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. It was also helped considerably by U.S. and other Western technology. The human capital provided the know-how needed for export promotion to achieve success in low-cost, labor-intensive products. Over time, international competition and rising labor costs compelled Taiwan firms to produce "world class" and cutting

edge human capital. The supply of infrastructure and low taxes also played a part by reducing transactions costs.

This paper has emphasized an additional factor – what we have called the dynastic impulse. The dynastic impulse represents a desire to acquire wealth not for personal consumption during one’s lifetime or even for one’s offspring but for the distant family’s future. It also aims for approval from distant ancestors. The paper has hypothesized that this factor was a unique aspect of Taiwan’s development. One can further speculate that to the extent that it has survived in Mainland China, it will also contribute to its development. Nevertheless, the impulse can probably not survive the assault of prolonged exposure to a market economy.

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