

NOTAS ECONÓMICAS

5

JOHN FEI THE POST-WAR REPUBLIC OF CHINA (ROC) ECONOMY

JOÃO SOUSA ANDRADE A EVOLUÇÃO DO CONSUMO PÚBLICO: WAGNER CONTRA KEYNES?

JOSÉ PEDRO PONTES / VÍTOR SANTOS LOCATION CHOICE IN A DUOCENTRIC URBAN SYSTEM

JOÃO REBELO EFICIÊNCIA PRODUTIVA E RENDIBILIDADE EM COOPERATIVAS AGRÍCOLAS

VÍTOR NEVES CAIXAS REAIS, RESTRIÇÕES DE LIQUIDEZ E CONSUMOS

JOÃO TOLDA INOVAÇÃO TECNOLÓGICA E ESPAÇO

AUGUSTO SANTOS SILVA A SOCIOLOGIA E A HISTÓRIA DO PENSAMENTO ECONÓMICO

JOSÉ REIS ECONOMIA PORTUGUESA — MUDANÇAS NA "ARQUITECTURA DE INTERIORES"

REVISTA DA FACULDADE DE ECONOMIA DA UNIVERSIDADE DE COIMBRA



The Post-War ROC Economy In Historical Perspective

John C.H. Fei Chung-Hua Institution for Economic Research, Taiwan National University

resumo

Este texto do Professor John Fei foi apresentado na *I Conferencia España-Taiwan: Economy and Trade*, em Outubro de 1993, e consta das actas da mesma publicadas pela Universidade Complutense de Madrid em 1994. O autor sustenta que o "milagre económico" de Taiwan se deve a um processo de liberalização económica sustentado (ou de "despolitização" da economia). Assim, descreve as três fases da evolução da economia de Taiwan desde 1950: a fase de substituição de importações (1950-1962); a fase de orientação para a exportação (1962-1980); e a actual fase de orientação tecnológica que decorre desde 1980 e é analisada nas suas implicações até ao ano 2000. Conclui-se que, dado o processo de "liberalização" económica na República Popular da China, estão criadas as pré-condições para a reunificação sob o lema — "um país, um sistema".

résumé / abstract

Le texte du professeur John Fei a été présenté lors de la *I Conferencia España-Taiwan: Economy and Trade*, en octobre 1993, et publié par l'Universidad Complutense, dans les actes du colloque, en 1994. La thèse centrale soutenue par l'auteur est que le miracle économique de Taiwan tient à un long processus de "libéralisation" (ou de "dépolitisation"). Ainsi, les trois phases de ce processus de transition ont été décrites depuis 1950: la substitution aux importations (IS), de 1950 à 1962; l'orientation vers l'exportation (EO), de 1962 à 1980; et, actuellement, l'orientation vers la technologie, une phase qui a commencé en 1980 et qui est analysée à la lumière de ses implications à venir, à l'horizon de l'année 2000. La principale conclusion est que la libéralisation économique dans la République Populaire de Chine a offert les conditions préalables à une politique d'unification de la Chine selon le mot d'ordre "un pays, un système".

This paper by Professor John Fei was presented at the *I Conferencia España-Taiwan: Economy and Trade*, in October 1993 and was published in its proceedings by Universidad Complutense de Madrid in 1994. The author's central thesis is that Taiwan's economic miracle was brought about by a long-run "liberalization" (or "depolitization") process. Accordingly, the three subphases in the transition process of Taiwan are described since 1950: the import substitution (IS) phase (1950-1962); the external orientation (EO) phase (1962-1980); and eventually the technology orientation (TO) phase that begins in 1980 and is analyzed in its implications till the forthcoming year 2000. The main conclusion is that the liberalization in the People's Republic of China brought the pre-conditions for political unification of China into "one country under one system".



From a long-run historical perspective, for today's LDCs (Less Developed Countries), the forty-year period after the Second World War (1950-1990) has been a period of *transitional growth* that ended centuries of "agrarianism" on the one hand and ushered in what was referred to by the late Prof. Simon Kuznets as the "epoch of modern growth" (EMG) on the other. Of the more than 100 contemporary LDCs that are engaged in this transition process, the geographic region surrounding mainland China — formed by the so called "Four Dragons of East Asia" (Taiwan, South Korea, Hong Kong and Singapore) — has been most successful in its march toward modernization. Taiwan, for example, is going to lose her LDC identity as she is expected to join the rank of the DCs ("developed" industrially advanced countries) by the end of this century at the latest. Thus, when the post-war ROC economy is viewed retrospectively, it is primarily an amazing *story of success in transition toward modernization*.

The experience of Taiwan's successful transition and that of the other "dragons" was achieved under the institutional milieu of a free market system that respects private property rights. In this regard, it is helpful to remind readers that, in sharp contrast, the post-war transition of the PRC on the mainland (the largest LDC in the contemporary world) has followed a "socialist path" where private property ownership and the market system were politically suppressed to form a "totalitarian homogeneous Leninist party state." Before 1978, economic development of the PRC was characterized by stagnation due primarily to the inherent weakness of the socialist institutions of central economic planning and political command. Indeed, this was finally realized by the political leaders of the PRC when they launched economic reforms in 1978.

While the focus of this paper is the economic development of Taiwan, her experience of "success" can be interpreted as upholding the thesis that, in sharp contrast with highly politicized socialist institutions (i.e., of the PRC), *the central features of a system based on the free market and private property (i.e., of the ROC) are quite accommodating to the requirements of modernization of contemporary LDCs*. Instead of the usual quantified analysis of economic achievement (based on the use of statistical data to describe, for example, structural change or the growth rates of GNP or exports), we shall, in this paper, concentrate mainly on certain features of the "evolution" of economic organization as the ROC acquired modern social-political-economic institutions during the transition process (1950-1990).

The central thesis of this paper may be briefly stated as follows. While Taiwan initiated the transition growth process in the early post-war period (1950-1962) with a strong measure of "market interference" by the government — not unlike other contemporary LDCs — *the economic miracle of Taiwan was brought about mainly by a long-run liberalization process that signified a gradual withdrawal of political force from interfering with "private economic decisions coordinated by the market force"*. Indeed, it is this experience of "liberalization" (or "depoliticization") that has constituted a most valuable fund of ideas which can be extracted from the "successful" transition of Taiwan and be transferred to benefit other contemporary LDCs — including the PRC on the Mainland. For this reason, we shall make frequent references to the experience of total economic reform of the PRC on the mainland to show the transitional growth experience of Taiwan by contrast.

The point of departure of an evaluation of the transitional growth experience of the LDCs must be based on a firm grasp of the operational significance of *modernization* — which can only be (and will be) examined as a historical concept. Modernization is primarily a technical phenomenon with social-political-economic implications (Section I).

The transition from the "long" epoch of agrarianism toward the "long" epoch of modern growth occurred in a relatively short period (with a duration of some 40-50 years) that can be subdivided into *subphases* to describe the metamorphosis in an evolutionary perspective. A central phenomenon involved in this process is a reorientation of government-society relations in the direction of "liberalization" (see above) that can be analyzed by an examination of the contours of *policy evolution* describable by a *policy matrix*. (Section II).



From a purely economic stand-point, transition from agrarianism to modernization involves the modernization of both the agricultural and nonagricultural (or industrial) sectors. These may be referred as the *basic economic tasks* that must be accomplished in the transition process by all LDCs with an agrarian heritage (Section III).

These basic economic tasks (i.e., modernization of the agricultural and nonagricultural sectors) are conditioned by certain "typological characteristics" which, in the case of Taiwan, include (i) high demographic pressure, (ii) shortage of natural resources, and (iii) abundance of "educated" human resources. These "economic geographic background factors" determine the contours of the modes of operation of the ROC economy as she went through the three phases of transitional growth (Section IV).

The successful accomplishment of the tasks of modernizing the agricultural and industrial sectors (see Section III) must be accommodated by certain changes in the institutional (or organizational) features. In a free market economy such as Taiwan's, the withdrawal of political force in the liberalization process can be examined in terms of "policy evolution." We shall first discuss the modernization of the agricultural sector (Section V), to be followed by the modernization of the industrial sector in the external orientation phase (Section VI) and the technology orientation phase (Section VII).

Our paper concludes with a remark on the notion of a "convergence of institutions" in the direction of liberalization when the transitional growth of the ROC and PRC are considered together.

Section I. Modernization of LDCs in a historical perspective

The Industrial Revolution in England toward the end of the 18th century was a most important event in the history of mankind as it terminated centuries of "agrarianism" and initiated the "EMG" (Epoch of Modern Growth). For the first time in human history, the exploration of the frontiers of science and technology and application of the knowledge so explored as an essential part of the industrial art of production have constituted the primary growth-promoting forces. The modern epoch (1770-1990) is a "long scientific epoch" characterized by a sustained increase in material welfare.

The arrival of the modern epoch has economic as well as social-political implications. Aside from the well-known "economic" (or "welfare") impact, the arrival of the EMG has also led to the gradual formation of a modern society characterized by an ever *widening of the field for exercise of personal choice* that has constituted the best safeguard of the *variety of life* — a life style consistent with "experiment" and "fancy"— the loss of which is the greatest of all the losses of the homogeneous totalitarian state (Keynes, 1973: 380).

It is only natural that the economic liberalization process of the ROC has led to a political liberalization process as a *"quiet revolution for constitutional democracy"* has been a key feature of the evolution of her political institutions in recent years (1989-92). In this regard, we may add that liberalization in the economic and political sense has also been a key evolutionary feature in the PRC as the "totalitarian homogeneous party state" began to give way to one characterized by the "widening of personal choices" and the "heterogeneity (or 'variety') of life style".

Ever since the arrival of the EMG in England, the new political-economic life style has proved to be irresistible as it went through a process of *geographic spreading* to conquer the culture of agrarianism in different parts of the world (e.g., to West Europe and North America in the early 19th century, and to Germany, Canada and Japan in the second half of the 19th century). A process of "transition from agrarianism to EMG" began whenever agrarianism was penetrated by the growth promotion force of science and technology. In this long historical perspective, it is clear that the transition growth of the LDCs in general and the ROC and the PRC in particular are but repetition in the second half of the 20th century, of the historical experience of modernization of industrially advanced countries.

Section II. Evolution through subphases in the transition process



The post-war transition growth of Taiwan went through three phases:

- i) the import substitution (IS) phase: 1950-62
- ii) the External Orientation (EO) phase: 1962-80; and
- iii) the Technology Orientation (TO) phase: 1980-2000

that show a historical periodization to provide an evolutionary perspective.

While the significance of this periodization will be explored below (see Sections IV and V), it is sufficient to point out here that, by 1980, Taiwan had already entered into a new phase of *technology orientation*. Taiwan was quite ready to follow the footsteps of Japan to develop her export base on newly acquired capability to explore the technological potential that lies at the frontier of science and technology. The arrival of the TO phase signifies economic maturity and the beginning of the end of the "transition" process. In this regard, we may add that the "four modernizations" that heralded the "total economic reform" of the PRC after 1978 also stressed the modernization in the sense of science and technology. Thus, in the post-war period, both the ROC and PRC have striven to enter into the EMG.

Evolution through the three phases involves primarily institutional (or organizational) changes centered in the reorientation of the government-society relationship in the direction of liberalization (see Introduction). The gradual withdrawal of the political force from interfering with the economic life of "society" can be investigated by an examination of the contours of policy evolution as shown by the *policy evolution matrix*, given in the Appendix.

This matrix shows that the transitional growth of Taiwan has been facilitated by the implementation of more than 100 *policy measures* (indicated in the boxes of the matrix) classified into ten areas as they occur in three evolutionary phases:

Major Policy Areas

- 1) domestic fiscal policies
- 2) trade-related fiscal policies
- 3) monetary and interests rates policies
- 4) foreign exchange policies
- 5) policies on international capital movement

Sector-Specific Policies

- 6) government enterprise and national construction
- 7) agricultural modernization
- 8) human resources development
- 9) development of science and technology
- 10) policy of development planning

Liberalization of the economy of the ROC can be gauged primarily from changes in the policy focus as the privatized market system became institutionalized and perfected. The policy information contained in the matrix will be used to facilitate our discussion in later sections.

In this regard, we may add the remark that one of the major tasks encountered by the reformers of the PRC after 1978 has been the reconstruction of a system of "indirect control" (i.e., "levers") to replace the centralism of planning and command. What was referred to as "levers" by the PRC reformers are precisely the "policy instruments" indicated in the policy matrix of the ROC. The



PRC reformers are only beginning to learn the art of indirect government control by monetary and fiscal policies. It follows that the policy experience, *especially the experience of policy liberalization*, of Taiwan is in fact the most important "fund of ideas" that can be transferred to the mainland.

It is inevitable that modernization in the narrow economic (technology and welfare) sense will have to be accompanied by political modernization (i.e., institutionalization of constitutional democracy) as an inevitable consequence of the revival of a "heterogeneous society consistent with the widening of the freedom of personal choice." It is perhaps not an accident that, in the case of Taiwan, the institutionalization of democracy occurred around 1990 in the TO phase.

In this regard, we may add that while the privatized social relations (e.g., the market system, private property, the kinship relationship and the educational relationship between teachers and students) of traditional Chinese society were annihilated by the brutality of political force before 1978 on the mainland, there are clear signs that private societies are being revived at the present time. The privatization of the economic system (centered in the re-establishment of the market and the institution of indirect control by policy instrument) is but a component of total liberalization and privatization.

Section III. Basic transition tasks for economic modernization

With the exception of "city states" such as Hong Kong and Singapore, almost all contemporary LDCs have an *agrarian heritage* signified by the coexistence of agricultural and non agricultural sectors. This production-structural dichotomy gives rise to the notion of the transitional growth of a *dualistic economy* in typological perspective. Economic development of both the ROC and PRC are cases of *transitional growth of a dualistic economy* in which the interaction between the agricultural and nonagricultural sectors becomes a key facet in the analysis of the modernization process.

The basic tasks of the modernization of such economies are modernization of the agricultural sector and modernization of nonagricultural sector. Notice that there is a difference in respect to the *location* (or *spatial*) properties of production in these sectors. While agricultural production is spatially dispersed, nonagricultural production takes place primarily in the urban centers (i.e., the hierarchy of cities and towns) with a heavy population concentration. For this reason, the modernization of the agricultural and nonagricultural sectors may be referred to alternatively as the "reform" of the "rural" and the "urban" sectors, respectively.

Modernization of Agriculture in the PRC (or Rural "Reform" in the PRC)

In the transitional growth process, the agricultural sector must fulfil a key "historical mission" of fuelling the expansion of the nonagricultural sector. To fulfil this "mission", a sustained increase of agricultural labour productivity ($p=A/L$) is absolutely essential. Increases in "p" will make it possible for a smaller *percentage of farmers* to produce enough food and raw materials to sustain the life of the urban population.

It follows that a major "criterion of success" of the transitional growth of a dualistic economy is a "structural change" manifested in a sustained decline of the percentage of total population allocated to the agricultural sector. After fulfilling its historical mission, the agricultural sector will be reduced to a mere appendage of the "industrial sector" as is typical for all industrially-advanced countries. It follows as a logical consequence that the modernization of the agricultural sector is a particularly important development strategy issue in the early stage of the transitional growth process.

The success of the transition of Taiwan can be seen primarily from the sustained decline of the agriculture population (from 65% in 1950 to 10% at the present time). The success of agricultural modernization in Taiwan, indeed, occurred in the *early* part of the transition process (i.e., in the external orientation phase in the sixties, Section V — see below.) In sharp contrast, the stagnation of the PRC can be seen from the fact that there was little change in the population



structure before 1978 due to the failure to raise agricultural labour productivity (p). However, when total economic reforms took place after 1978, it was the agricultural sector that was modernized before urban reforms were initiated in earnest.

The experience of Taiwan has shown that a sustained gain in agricultural labour productivity (p) can only occur when there is an *active urban-rural interaction* so that agricultural inputs (fertilizers, farm equipments, seeds) produced by modern science and technology in the “urban sector” must flow into the “rural sector” in exchange for deliveries of “food” in the opposite direction. More over, there must be *political neutrality* in the sense that the urban-rural “exchange” must not be penetrated by political forces calculated to exploit farmers in order to benefit the urban population that is usually favoured politically because of its concentration in the urban centers. That the strategy of agricultural modernization in both the ROC and PRC has followed these “cardinal principles” (i.e., of urban-rural interaction with political neutrality) will be analyzed in Section V below.

Modernization of the industrial sector

With the arrival of the EMG, the industrial sector, formed of large-, medium-, and small-scale urban factories (showing different degrees of capital- and technology-intensity), has demonstrated an amazing capacity of *structural flexibility* manifested in the timely birth and death of products and/or factories with a sensitivity determined by the *dynamics of technological change*. This structural flexibility really reflects a *healthy metabolism* as wave after wave of new product, discovered through innovation, appeared on the scene to replace “old products” rendered obsolete by scientific and technological discoveries.

The advantage of “structural flexibility” was particularly impressive during the so-called “second industrial revolution” in the early post-war Period (1950-1980) as induced by a rapid sequence of epoch-making technology changes: commercial aviation, TV, transistors and printed circuits, computer hardware and software, multiple colour photography and Xeroxing, communication by light fiber, advances in material science, space travel, atomic energy, superconductivity, atomic fusion, etc. It is not difficult to imagine that the “dynamics of science and technology” has benefited human societies to an extent far exceeding the “static allocation efficiency” referred to as the “Pareto optimum” by the economists.

The transitional growth of contemporary LDCs must be gauged against the background of this *technological dynamic* in the post-war period. It is abundantly clear that in a world characterized by the “dynamics of technology”, rapid growth of the industrial sector in aggregate terms becomes impossible without structural flexibility. In the case of Taiwan, this flexibility was demonstrated first in the agricultural sector in the early EO phase (after 1962) when a sequence of new products (mushrooms, pineapples, asparagus) were sent to the world market. Ever since these early successes, the Taiwanese farmers have demonstrated that they have the capacity to produce wave after wave of new products, with a sensitivity to the demand conditions of the world market quite comparable to the commercial entrepreneurs of Hong Kong.

The heart to the success of transitional growth in Taiwan can be seen from the fact that as she entered the TO phase (after 1980), her *human resources* (labour, entrepreneurs, scientists, engineers, lawyers, accountants, etc.) had demonstrated that they are quite readily to accept the challenge of a technologically dynamic society in the exploration of both the “technological frontier” as well as the “world market” — following the footsteps of Japan (See Section I).

A “modern,” technologically dynamic society promises not only a sustained increase of consumption standards — perhaps overly emphasized by the economists — but also a *modern life style*, characterized by the “widening of the field of free choice that ensures the heterogeneity of *variety*” (See end of Section I). This life style provides the opportunity to exercise the potential of *human creativity* that appeals not only to the cultural elites (i.e., the artists, scientists and educators) but, in fact, also constitutes the core of a “popular culture” shared by the vast majority of ordinary workers and farmers who can also engage in something “creative” in their daily lives leading to the routine appearance of new ideas for new products.



In contrast to the structural flexibility demonstrated in the ROC, "central planning and political command" of the socialist system has demonstrated that it is incompatible with the demand for structural flexibility consistent with a technologically dynamic society. Indeed, *structural rigidity* has been a common weakness for all socialistic societies in East Europe or Asia (the PRC, Vietnam, North Korea). The ability to produce an atom bomb, satellites or military hardware that requires "centralism in political planning and coordination" is not to be equated with mass participation in the process of creative thinking and experiments that lie behind the routine appearance of a variety of new products. In fact, political centralism and collectivism may be a stumbling block in the way of human creativity that lies behind the structural flexibility of a modern industrial society.

Section IV. Operation of the open dualistic economy of the ROC

Due to her peculiar geographical economic background factors (i.e., shortage of natural resources and abundance of disciplined and educated human resources), the transition of the ROC has often been referred to in the literature as a case of the development of a *labour surplus open dualistic economy*. While "labour surplus" refers to the abundance of human resources, "openness" stresses the fact that, on account of her shortage of nature resources, international trade must be emphasized to overcome this shortage.

It follows that the operation of the Taiwan economy must be explained in the framework of a *tripartite of sectors* including the "duality" of agriculture and industry internally as well as the "foreign sector" externally. Modernization of the domestic sectors (i.e., agricultural and industrial sectors described in the last section) was accomplished primarily as a result of the operation of an open dualistic economy that went through three evolutionary phases (See Section I).

Import Substitution (IS) phase (1950-1962)

The growth strategy of the IS phase is based on diversion of the foreign exchange earnings of *primary product exports* (e.g., of the agricultural sector in the case of ROC):

- i) from the traditional import of manufactured consumer goods (e.g., textiles) to the import of producer goods
- ii) to build up *domestic import substitution industries*
- iii) with output (e.g., domestically produced textiles) to "substitute" for (i.e., eliminate) the traditional import in the domestic market.

IS growth came about due to the implementation of a *strategy of industrialization* calculated to exclude "foreign goods" from the domestic market. Growth promotion policies instruments (i.e., foreign exchange rate, interest rate and import duties) were exercised to achieve autarky). In view of the fact that *decolonization* was a major social movement after the end of World War II, IS growth was a popular growth promotion strategy adopted by many (if not all) open dualistic economies in the name of anticolonial-nationalism.

It is important to realize that ROC initiated the transitional growth process with a highly politicized system (under a culture of *political paternalism*). The government attempted to control many facets of the socio-economic life of its citizens (e.g., from the hairdo of high school students to the price of haircuts for grown-ups). The cardinal guiding principle of evolution can be characterized as a long liberalization process (see Introduction) as occurred in the EO phase and the TO phase, that affected the social, political and economic life of Taiwan.

External Orientation phase (1962-1980)

The mode of operation of the Taiwan economy during the EO phase centered on:

- i) the promotion of diversified exports, including new products, in both the rural and urban sectors, to the world market

ii) in exchange for needed imports of technologically advanced producer goods (e.g., from Japan) and raw materials (e.g., cotton) from the U.S.

iii) manifested in an “external orientation” as measured, for example, by an ever-increasing “weight” of foreign trade (value of imports and/or exports) as a fraction of GNP.

The export drive was initiated first in the agricultural sector — as can be seen from the replacement of traditional primary products (sugar and rice) of the prewar vintage by the new crops of pineapples, asparagus, mushrooms). However, the external orientation gathered momentum when, toward the end of the 1960's, the *export of labour-intensive manufactural goods* become the primary growth promotion force of Taiwan.

In historical retrospect, we can say that, given the geographical economic background factor, a prolongation of the IS phase — as occurred in Latin American countries, was not a viable alternative for Taiwan. This is due to the fact that Taiwan did not have the foundation (i.e., a favourable endowment of natural resources essential for the *expansion* of primary products) to prolong IS growth. For the ROC, the IS process had to end quickly as “policy reforms” were carried out to overcome the shortage in supply of foreign exchange by devaluation. (See Policy Evolution Chart for the IS phase).

The strategy of export drive based on labour-intensive manufacture exports appears to be a *natural evolutionary course* to follow for Taiwan. Due to the abundant supply of human resources, the promotion of “labour-intensive exports” to the world market provided an outlet such that the potential of her human resources could be fully explored and utilized. The substitution of the internally oriented IS strategy by the externally oriented EO was the basic cause of the “success” of transitional growth (both for Taiwan and South Korea). In a historical perspective, it was a story of the success of full exploitation of human potential in a “labour surplus” economy.

Technology Orientation (TO) phase (1980-2000)

The evolution of the Taiwan economy from the EO to the TO phase occurred because of the enhancement of the quality of human resources achieved via a “learning by doing” process in the EO phase. The switch into the TO phase implies that the comparative advantage of Taiwan has gradually shifted from “crude labour and manpower” to “intellectual power” in the exploration of the frontiers of science and technology and the application of the knowledge so explored to produce a wide variety of new products to the world market. The TO phase is a mass-participant process during which the creative potential of the Chinese can be, and has been, fully explored. This is, after all probably the basic factor that lies behind the success of the transitional growth of Taiwan.

Section V. Modernization of the agricultural sector

The modernization of the agricultural sector via an urban-rural interaction that raises agriculture productivity (p) allows the agricultural sector to fulfil its historical mission to fuel the expansion of the industrial sector. The transitional growth experience of both the ROC and PRC suggests that political neutrality (i.e., *discontinuation of the strategy of exploiting the farmers by unfavourable terms of trade*) is a crucial precondition (See Section I). Spatially dispersed farmers do not need the government as a “friend” which is typical for industrially advanced countries. All it requires is that the government desists from being an “enemy” of farmers which, unfortunately, has usually been the case for contemporary LDCs.

In the case of the PRC, the centralism of planning, executed by the collectivism of communes, has always carried a *pro-urban bias* that discriminated against the farms. Rural reforms after 1978 were heralded by the:

- i) discontinuation of communes and the restoration of the family farming system
- ii) rehabilitation of the market system that facilitated free urban- rural exchange





iii) *initiation of terms of trade favourable to farmers*, and

iv) the tolerance (if not encouragement) of rural families earning and accumulating “family owned assets”.

It was thus this package of policies that are both “liberal” and “politically neutral” that has led to a certain measure of success in rural reform after 1978. In the case of the PRC, the foreign sector is relatively inconspicuous as a factor effecting agricultural modernization because her hinterland is effectively ruled out from “foreign trade” by transportation costs.

In the case of the “open” dualistic economy of Taiwan, the foreign sector has been directly involved in the process of agricultural modernization. The external orientation of the agricultural sector after 1962 was the direct result of “foreign exchange reform” by abandoning a policy calculated to exploit farmers by the overvaluation of domestic currency at the “official rate”. When the government discontinued its policy of exploitation, Chinese farmers could take care of themselves via an orientation to the *world market* with a profit sensitivity comparable to the commercial entrepreneurs of Hong Kong. Thus we see that modernization of agriculture in both the ROC and PRC have been accomplished primarily by a liberalization movement as political interference (in the ROC) and command (in the PRC) was substituted by the automatic mechanism of the market system.

Section VI. Modernization of the industrial sector in the EO phase

With the arrival of the EMG the purpose of modernization of the industrial sector has been to achieve a *structure flexibility* that reflects the healthy metabolism of an economy that grows with vitality. The capacity to produce a variety of new products is the manifestation of creative potential that is gradually being explored in the EO phase (See Section III).

From a technical standpoint, *structural flexibility is really a property of the allocation of investment goods* to the multitude of firms that produce a wide variety of products. In a socialist economy, this allocation of investment goods constituted the very heart of central planning characterized by a “bureaucratic discretion” in determining the direction of allocation. Experiments with socialism in the past have shown that the system has the inherent weakness of “structural rigidity” that PRC reformers are now seeking to overcome.

For the industrially advanced capitalistic countries, structural flexibility is assured by *credit rationing* — i.e. a process that screens the multitude of investment plans (prepared individually by private entrepreneurs) and to award the right to spend monetary purchasing power for the purchase of investment goods- in the finance (or loanable funds) market as regulated by the price system — including the all-important interest rate. As compared with the socialist system, the idealized capitalist system is characterized by *political neutrality* in the sense of a complete *absence of bureaucratic discretion in determining the direction of the allocation of investment funds*.

Taking the capitalist system of credit rationing as a model, the PRC reformers are thinking seriously in terms of “financial reforms” at the present time to achieve structural flexibility. With this knowledge in the background, let us now examine the modernization of the industrial sector for the ROC during the EO phase and the TO phase separately.

The hybrid system of investment fund allocation in the EO phase

The economic institutions that regulated investment finance during the EO phase (1962-1980) was a hybrid (or partially liberated) system based on “market differentiation:

i) the production of exported outputs directed at the *world market* was liberalized and

ii) the production of output directed at the *domestic market* retained essential features of government interference.



Throughout the 1970s this hybrid system was rationalized and, indeed, sloganized as a “planned free economy”. A host of policy instruments were exercised by the government to penetrate the domestic market (see the policy matrix for the EO phase), according to two abstract principles.

The first principle was based on an assumption of *government (i.e., “bureaucratic”) competence in the selection of the direction of investment*. This faith in bureaucratic discretion prevailed all through the EO phase in spite of the fact that bureaucratic discretion was based only on an intuitive “aphorism” — i.e., the rough classification of industries into “sun rising or sun setting”, “backward or forward linking”, the “locomotive” or, simply, the “strategic industries”. While the ROC “planners” did not engage in a comprehensive “ranking” of all investment projects à la “socialistic centralism”, they nevertheless, certainly violated the principle of political neutrality in determining the direction of investment.

The second principle of intervention was that for the industries selected for political patronage, a host of growth promotion policies (e.g., tariffs, monetary and fiscal) were employed to *augment profit* by political force. Since the augmentation of profit to the urban entrepreneurial class by political force can only occur at the expense of other social groups (e.g. the buyers of an automobile or a VCR) that are discriminatory, a strategy of profit augmentation really amounted to a “covert income transfer”. Whether or not such a policy of “silent stealing” should be allowed to continue, in fact, constituted the focal point of heated policy debate in the ROC toward the end of the EO phase.

In the hybrid system, exported products directed at the world market was liberalized for two obvious reasons. First, a policy of “covert income transfer” was out of the question as consumers in the world market (e.g., housewives in New York) could not be coerced by political force to subsidize the ROC exporters. However, the most important reason for liberalization is that, in a technologically dynamic world, *a rapid expansion of exports must be accompanied by a structural flexibility*. Indeed, the export market is a fiercely competitive one as ROC producers must compete with the other “dragons” in terms of the direction of new investment that determines “product cycles”.

Section VII. Liberalization in the TO phase

During the EO phase, ROC planners, while attempting to interfere with the domestic market, were quite appreciative of the fact that they should step out of the picture in the determination of the direction of investment in the export sector. Thus, the isolation of the export sector from political influence has been a key feature of the growth augmentation policy in the TO phase. The major policy measures that have been adopted for this purpose centered on the “export processing zones” and the “tariff rebate system” to eliminate the cost price distortions of import duties.

Thus, we see that “political neutrality” with respect to the determination of the direction of investment, consistent with the requirement of structural flexibility of a modern society, has been demonstrated in both the agricultural sector (see Section V) and the nonagricultural sector during the TO-phase that has lasted for some 20 years. It was a period of “growth” of not only “outputs and exports” but so of “ideas”. Toward the end of the TO phase, the society at large in the ROC apparently have come to the realization that if her producers can withstand the rigor of international competition in the world market, they can also win in such competitions in the domestic market.

In an institution-evolutionary perspective, the initiation of the TO phase was heralded by a social consensus sloganized as liberalization, internationalization and institutionalization. While liberalization has the negative connotation of “depoliticization” (see Introduction), internationalization carries the positive idea that the behaviour of economic agents are to be coordinated and controlled by the economic forces prevailing in the world market.

The idea suggests that the “domestic economy” of the ROC is to be integrated fully with the outside world — as shown, for example, by:



- i) the scheduled reduction of import duties
- ii) the elimination of barriers to international capital movement in and out of the ROC
- iii) privatization of the holding of foreign exchange reserve due to the liberalization of the central reserve system
- iv) legalization in the privatization of gold transactions
- v) initiation of a "clean-floating" system under which the foreign exchange rate will no longer be used as an instrument to promote exports, especially an export surplus
- vi) legalization and encouragement of contact between the citizens of Taiwan and foreigners by the liberalization of the tourism in and out of Taiwan, and
- vii) discontinuation of the statute to encourage investment.

With the arrival of the TO phase, the notion of a "strategic industry" (i.e., of EO vintage) fades into a pale historical memory. Taiwan has finally renounced bureaucratic discretion in respect to the determination of the direction of investment and, for this reason, has finally managed to modernize her industrial sector to achieve a structural flexibility typical of the industrially advanced countries.

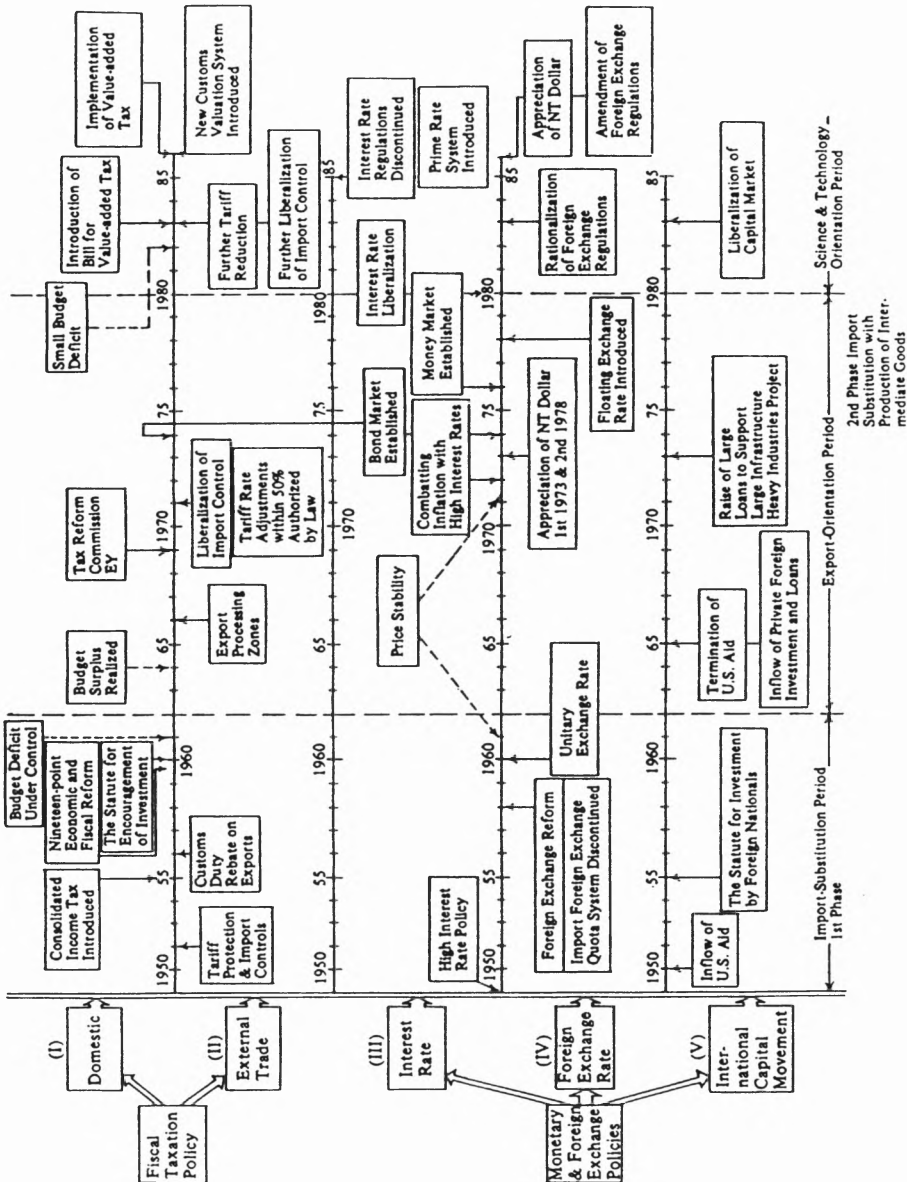
Concluding Remarks

In historical retrospect, the transitional growth of the ROC and PRC share common features of liberalization that are suggestive of a *convergence of institutions* in two geographic regions of China. This convergence into a "free and liberalized" system provides a favourable precondition for the political unification of China into "one country under one system" that is accommodative of the requirements of modern economic life that, with the arrival of the EMG, stresses the exploration of the creative potential of human beings in the economic arena.

Appendix — Policy Evolution Matrix of Taiwan

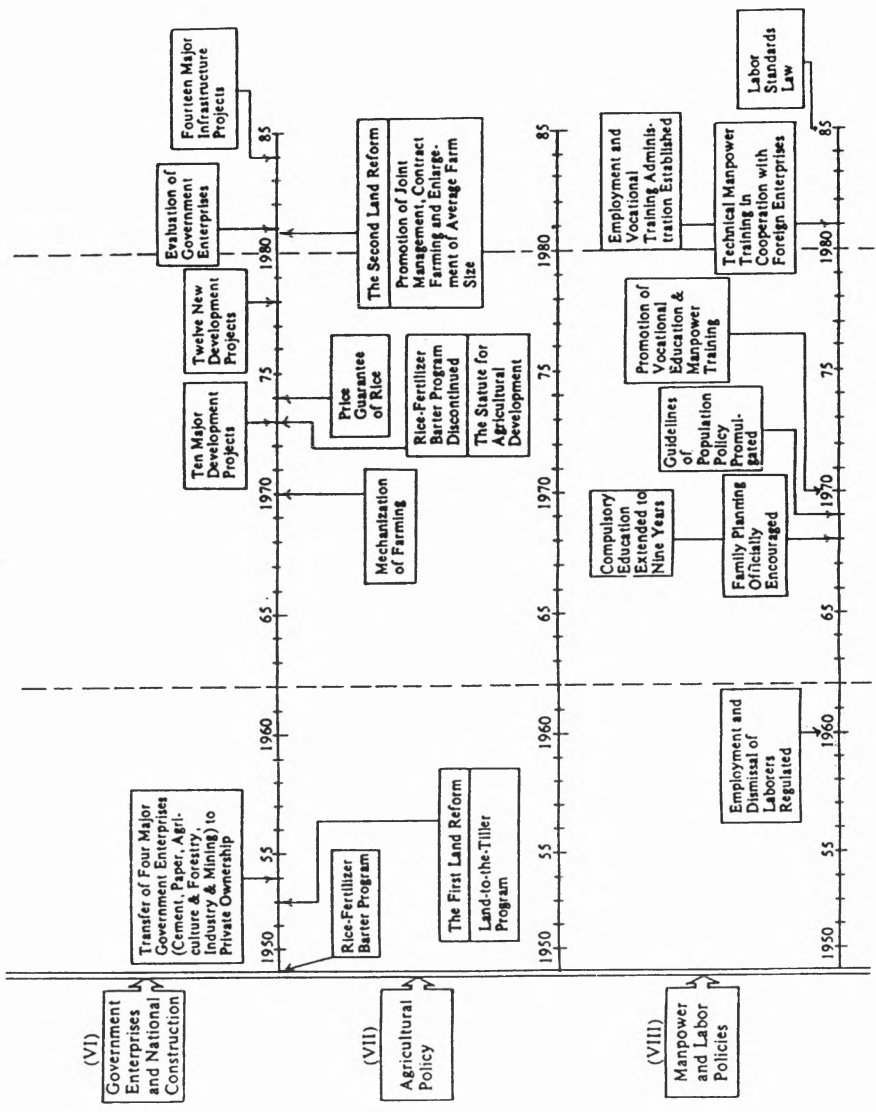


The study of the evolution process of a market-oriented economy by the use of the policy matrix was a methodology first used by Minister K.T. Li of the ROC (Li, 1988).

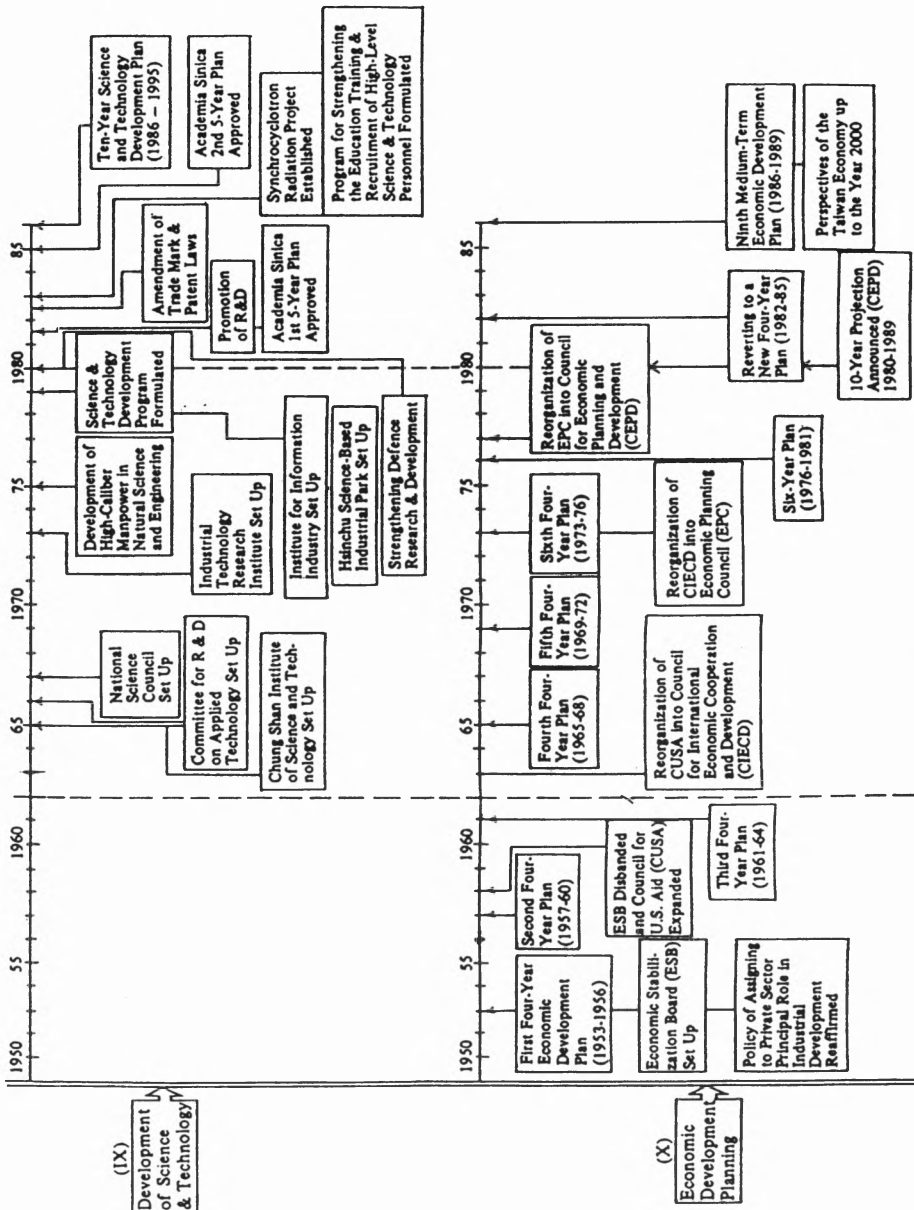




Policy Evolution Matrix of Taiwan (continued)



Policy Evolution Matrix of Taiwan (continued)





References

- Keynes, John M., (1973) *The General Theory of Employment Interest and Money*, London, Macmillan.
- Li, K. T., (1988) *The Evolution Policy Behind Taiwan's Development Success*, New Haven, Conn., Yale University Press.