SUBSTANTIAL CHANGES OF ECONOMIC POLICY
AND STRATEGY IN THE PEOPLE'S REPUBLIC OF
CHINA AND THE REPUBLIC OF CHINA ON TAIWAN:
A COMPARATIVE STUDY

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Abstract

This thesis focuses on an isolated subset of cases where governments have made decisions to substantially change economic development policy and strategy. The two countries under consideration are the Republic of China on Taiwan and the People's Republic of China. The initiation of market opening reforms in China during the late 1970s/early 1980s, the transition to export-led growth strategies during the late 1950s/early 1960s, and the postwar land reform in Taiwan constitute three specific cases of economic policy change. This thesis will attempt to compare and contrast these cases in the hopes of uncovering the underlying rationales explaining the initiation of policy change in China and Taiwan, illuminating some of their important similarities and differences. This thesis will also attempt to draw some theoretical conclusions concerning economic policy change from these unique experiences.

The conclusion presented in this thesis argues that in the cases considered, the sources of economic policy change are multi-causal. Economic, political, international, ideational, and institutional factors are interrelated and together explain economic policy changes. The interrelationships between these variables are elucidated most clearly when particular attention is paid to the political and economic contexts surrounding instances of policy change. In short, it is the multi-causal nature of economic policy change that confirms the insufficiency of exclusively economic explanations of economic policy change.
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Abbreviations

ISI  Import Substitution Industrialization
ELG  Export-Led Growth
PRC  People's Republic of China
ROC  Republic of China (on Taiwan)
KMT  Kuomintang (Nationalist Party)
CCP  Chinese Communist Party
GLF  Great Leap Forward
NIC  Newly Industrializing Country
TNEL  Transnational Economic Linkage
SEZ  Special Economic Zone
GLF  Great Leap Forward

*For Chinese terms and names, the Hanyu Pinyin pronunciation system is utilized. Exceptions are made with respect to commonly accepted spellings such as Chiang Kai-shek and Kuomintang.
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Chapter 1. Introduction and Theoretical Overview

1.1 Introduction

In the latter half of the twentieth century, policy-makers and politicians in developing countries throughout the world have been deeply concerned with the problem of industrialization and economic modernization. In their efforts to modernize, developing countries have designed and implemented a variety of economic development strategies. During the first decades of the post-war period, various paths were taken. Latin America utilized strong state structures to implement programs of import-substitution industrialization (ISI), while East Asia began with ISI, but later shifted towards production geared for the international market, the strategy of export-led growth industrialization (ELG). In the socialist bloc, China and its counterparts in Eastern Europe adopted the Soviet model of development, and later in the 1960s and 1970s, China experimented with the radical strategy of "developmental Maoism."¹

Most of these newly industrializing countries followed their development strategies with substantial yet varying degrees of success; for example: Japan, Argentina, Mexico, and most of the Eastern European countries. Yet what was interesting in most of these countries was that policy and strategy underwent little in the way of significant change. Other developing countries that attempted to industrialize on the other hand, did not sustain such a consistent course of industrialization. The East Asian Newly Industrializing Countries (NICs), of which South Korea and The Republic of China on Taiwan (ROC) are the most prominent, began their industrialization drives in the 1950s by implementing strategies of Import Substitution Industrialization (ISI). But by the early 1960s, both countries had altered strategy and charted a new course. Implemented in place of the original ISI strategies, was the strategy known as export-led growth industrialization (ELG) or export-substitution industrialization.

South Korea and Taiwan however, were not alone in choosing to reorient industrialization strategy. Indeed, the economic history of the postwar period is replete with other cases of strategic innovation. In the late 1970s, nearly two decades after the strategic transitions in Taiwan and South Korea, The People's Republic of China (PRC) also saw fit to reorient its economic development strategy. After many years of economic failure, Deng Xiaoping and his reformist cohorts attempted and largely succeeded in making a dramatic strategic transition. Rather than continue along its previous course, China developed a new and drastically different economic development strategy, one that I will term here "market socialism."

The initiation of reform in China during the late 1970s/early 1980s and the transition to export led growth in Taiwan during the late 1950s/early 1960s, thus constitute two specific cases where significant changes in economic policy occurred and (perhaps coincidentally) preceded extended periods of economic growth. Prior to the initiation of market reform on the mainland, China's economy was centrally planned, and in Taiwan, the developmental strategy of export led growth was preceded by Import Substitution Industrialization (ISI) policies. The postwar Taiwan case is especially rich in that it also provides a second occurrence of substantial economic policy change with the land reform of the early 1950s. The main reason for concentrating on these particular cases is that they mark critical points of departure between previously utilized economic development strategies and the new and innovative policy changes that ensued. Hence, they serve as excellent cases for analyzing the considerable changes that governments sometimes make with respect to economic development strategy and policy.

Comparative studies of economic development experiences are abundant throughout the economics and political science literature. Most of the studies are cross-regionally oriented, comparing the developmental experiences of two regional subsets, while others are intra-regional, comparing the experiences of two specific intra-regional

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3This thesis uses the terms policy and strategy interchangeably. It is generally assumed that one subsumes the other.
Much comparative work on East Asia is structured along these lines. This study is also intra-regional; however, it is distinct in that the two cases selected for analysis are a particular subset of cases that share one central defining characteristic: **substantial change in economic development policy and strategy.**

Several other important factors exist that make the cases of economic policy change in the PRC and ROC appealing subjects amenable to comparison. First and foremost, both countries share a common language, culture, and ethnicity. Legally and historically, Taiwan has been a province of China for over one hundred years. After fifty years of colonial rule by the Japanese, Taiwan was once again united with the mother country in 1945, only to be separated again, four years later in 1949. Since that time, Taiwan has become a de facto independent country, but still one populated by ethnic Chinese. Both countries also share similar political systems and a common heritage of political culture. In both the PRC and ROC, authoritarian governments practiced single party rule and exerted full political control over their respective countries. In addition, both governments were led by Leninist-type parties headed by an indisputable leader who ruled supreme (Chiang Kai-Shek, Mao Zedong, and Deng Xiaoping).

Maybe the most important factor which illuminates the comparability of the two cases is the similarity of political and economic contexts prior to economic policy change. In both the PRC and ROC, major reorientations of economic strategy were preceded by traumatizing political events. In Taiwan, the transition to the strategy of export led growth followed, although not immediately, the 2-28 incident, KMT defeat at the hands of the communists in the Chinese Civil War, and relegation of the regime to the island of Taiwan. In China, the transition to market socialism was preceded by nearly two decades of political and economic turmoil marked most prominently by the Great Leap Forward and the Cultural Revolution, and finally culminating with the death of Mao Zedong in 1976.

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5 Yu-shan Wu, op. cit., p. 144.
The traumatizing events in both countries had important effects on their respective domestic political (as well as economic) contexts. In both the PRC and ROC, the political and economic ramifications of the crises had alienated the domestic populations and severely eroded the legitimacy of the ruling regime in the eyes of the populace. The treachery of the "2-28 incident" (er er ba) destroyed any faith the majority Taiwanese population may have had in the mainland regime, and the utility and legitimacy of Marxism-Leninism and Maoist ideology had been exhausted by the political and economic failures of the past two decades. In short, the political and economic turmoil of the times had brought about critical levels of disenchantment that made it apparent to both leaderships that their respective regimes faced pressing crises of political legitimacy.

In general, the KMT and the CCP began their economic reforms against relatively similar political backgrounds. Both party-states had full control over society and exercised unquestionable authority. The traumatizing political events which had preceded reform were the main reason why both countries shared similar political contexts. Crises in both countries had changed the priorities of elites giving them political incentives to make economic reforms in the face of legitimacy crises with its alienated populations. In order to restore legitimacy in the eyes of the populace, both the KMT and CCP had little choice but to raise living standards and enhance the economic welfare of its people. Thus as Wu emphasizes, in both the PRC and ROC, "the capacity and motive for a restructuring of the economy were present."

In terms of economic structure, Taiwan and China shared important similarities at their pre-transitional phases that likewise accentuate their comparability. At the beginning of the 1950s, Taiwan's economy was characterized by dominant public ownership and state directed administrative allocation. Pre-reform China was no different. As would be expected in a socialist state, industry in mainland China was also characterized by public

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6 Ibid.
7 Ibid.
8 Ibid., p. 147.
ownership and overwhelming state control.9 This type of industrial structure brought about a range of problems commonly associated with state enterprises: inefficiency, overstaffing, rigid pay structures, and bureaucratic interference.10 Thus at the onset of the policy reform periods, both countries also faced similar structural problems. Furthermore, in both Taiwan and China, a state-dominant economic structure created strong institutional interests that exerted pressures to maintain state dominance over industry. Hence, in both countries the political economy was composed of a significant conservative bloc with vested interests in maintaining the institutional framework of the economy and serving as a significant roadblock to change.11 To summarize, both cases of economic policy change exhibit commonalties which enhance their comparability. They are: 1) similar language and culture; 2) single-party authoritarian political systems; 3) a post-crisis political context; 4) crises of political legitimacy; 5) somewhat similar economic structures (and hence similar structural problems); 6) presence of conservative blocs.

This thesis then focuses on an isolated subset of cases where governments have made decisions to substantially change economic development strategy and policy. It will attempt to compare and contrast these two cases in the hopes of uncovering the underlying rationales explaining the initiation of policy change in the PRC and ROC, illuminating some of their important similarities and differences. This study will also attempt to draw theoretical conclusions concerning economic policy change and reform. Hence, an important purpose behind comparing these two cases of economic policy reform, and a key concern of this thesis, is to contribute to our understanding of the reasons why governments choose to reorient and make substantial changes to economic policies and development strategies. Is it simply economic factors that provide the impetus for policy

9Ibid., p. 158.
10Ibid.
change? What considerations, political, domestic or international, shape and explain the policy changes that governments make? Are there other explanations or approaches which may shed light on the matter? This thesis will attempt to address these theoretical questions through a detailed examination of these two cases of economic development strategy changes. In short, this thesis will attempt to answer two central questions:

1) What are the important factors and underlying rationales explaining economic policy changes in the PRC and ROC cases? Are there any similarities between the two cases, or are they both unique?

2) What theoretical conclusions can we draw from these two economic policy change experiences?

Within the political science and economics literature, cases of substantial economic policy changes are often understood in economic terms. That is to say, the recognition of economic difficulties by policy-makers allegedly provides the impetus for major economic policy and strategy changes. This thesis builds on the foundations of an exclusively economic explanation of economic policy change. I argue that economic factors are necessary, yet insufficient explanations of economic policy change. Both the ROC and PRC cases demonstrate that although economic factors are integral to any explanation of economic policy change, factors of politics (both domestic and international), ideas, and institutions also play important roles. As the case studies undertaken here show, economic policy change is a highly complex phenomenon. This complexity makes any single variable explanation incomplete. Rather, I argue in this thesis that a complete and comprehensive

understanding of economic policy reform can only be achieved through a multi-causal analysis that accounts for the range of salient factors which shape and explain the initiation of economic policy change.

The conclusion presented in this thesis argues that in the cases of the ROC and PRC, the sources of economic policy change are multi-causal. Economic, political, international, ideational, and institutional factors are interrelated and together explain economic policy changes. The interrelationships between these variables are elucidated most clearly when particular attention is paid to the political and economic contexts surrounding instances of policy change.

1.2 A Comment on the State of the Field

In the two decades since the passing of Mao Zedong, the world has witnessed astonishing political, economic, and social change in the People's Republic of China. China's economy has taken off at an unprecedented pace and shows no sign of slowing down. Indeed, some analysts believe that early in the twenty-first century, China will surpass Germany, Japan and the United States, to boast the largest economy in the world.13 With the many industrialization success stories and renowned "miracles" residing within the East Asian region, attempting to explain economic development and industrialization success has become a cottage industry for political scientists, economists, and policy analysts working in the political economy and East Asian development fields.

In the case of mainland China, the current conventional wisdom within the field attributes the mainland's economic success to the policy innovations introduced by Deng Xiaoping's "market opening reforms." Twenty years earlier while China was recovering from the disaster of the Great Leap Forward, the Republic of China on Taiwan was at the initial stages of what turned out to be an extended period of economic growth. Bolstered by the strategy of export led growth, Taiwan managed to post successive decades of high

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growth rates. While many explanations have been rendered for Taiwan's developmental success, two schools of thought have been predominant: the neoclassical school and the statist school.¹⁴ Neoclassical explanations of Taiwan's developmental success see economic development as the result of the intelligent application of liberal economic principles and the workings of free markets, while statist theories, following the thinking of Alexander Gerschenkron, stress the role of the state and political institutions as determinants of economic developmental success.

As the above discussion illuminates, most academic analysis on economic development in East Asia has centered on explaining why developmental experiences have turned out to be successful (while China has yet to be rated a newly industrialized country, extensive work has been done explaining its relative success). Among the wide range of explanations proffered throughout the economics and political science literature, many have focused in detail on the effect government policy has had on economic development. However, later developmental success is unable to accurately explain the rationales behind prior policy choices. Indeed, what has often been neglected (and is of extreme analytical interest) is the story behind economic policy choice in newly industrializing countries.¹⁵ If it is the efficacy of the development strategy and economic policy packages implemented by governments that contributes a great deal to the success of any country's industrialization effort, then it is the choice of these policies, and the rationales underlying them that require more theorizing. This thesis focuses its analytical lens towards this


direction. It centers its analysis not on the reasons for successful development and industrialization, but on the story behind why governments formulated particular economic policies that have (arguably) contributed and been integral to developmental success. In particular, I want to look at a subset of policy choices: two which involved the decision to implement substantial policy and strategy change. As David C. Kang has suggested, it may be more productive to theorize about policy choices than to explain development outcomes.16

1.3 Theoretical Overview: Competing Explanations of Economic Policy Change

Before we turn to an in depth look at the two selected cases, a more general, theoretical look at competing explanations for economic policy change is in order. This theoretical overview is not intended to be exhaustive. Indeed, there are a myriad of reasons why governments initiate economic policy change and reform. I intend to introduce to the reader four general categories: 1) economic; 2) power/political; 3) ideational; and 4) institutional. These represent four competing theoretical explanations of economic policy change.

The most widely accepted explanation for the initiation of reform focuses on the economic problems that exist prior to economic reforms.17 Economic rationales and explanations of policy change are clear and straightforward. They derive from the tangible results associated with economic performance. When economic performance is poor, or policies have obviously failed, governments naturally take measures to remedy the situation and improve performance. This entails both the readjustment and reform of previous economic policies and strategies, as well as the implementation of new and innovative ones. However, poor economic performance does not entail automatic reform and readjustment. Governments must first recognize the particular problem before it motivates policy-makers to respond to them. Economic explanations for policy change are thus theories which cite

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16Ibid., p. 557.
economic events as precipitants of policy action, once they have been diagnosed by policymakers as the sources affecting economic performance. Economic rationales for policy change, however, do not stem exclusively from previously implemented economic policies and development strategies. As has been the case with many of the world's centrally planned economies, it can be problems stemming from the institutional structure of a state's political economy and/or its economic system that provides the impetus for policy reforms. In essence, economic theories of economic policy change explain instances of change as the result of the desire by governments to address the economic problems associated with the shortcomings of both previous policy and strategy and the institutional structure of a given political/economic system.

In the international economic sphere, global economic conditions and trends can also act as determinants of national economic policy and strategy. Gereffi and Wyman argue that transnational economic linkages or TNELs (economic aid, export trade, direct foreign investment, and foreign loans) are international economic factors that can have a profound affect on national policy in a variety of ways. First, the presence or absence of the wide range of TNELs facilitates and constrains the choices of national policy-makers. For example, massive foreign aid flows in the post World War II period made primary ISI strategies possible for the cash strapped East Asian countries (Japan, South Korea, and Taiwan). Second, the availability of these resources is conditioned by factors beyond the control of national governments. Global economic conditions and trends can have profound effects on national economic policies, even though they are out of the control of national policy-makers. Third, TNELs are associated with different institutional carriers or agents, which once present in a developing country, become "part of the constellation of interests that seek to influence policy choice." In short, international economic factors

18See White, p. 30.
20Ibid., p. 40.
21Ibid., p. 41.
22Ibid.
can have a profound influence on the policy formulation processes of national governments and hence, serve as potential determinants of national economic policy.

As is the case with economic explanations, the political determinants of economic policy change can be either domestic or international in origin. On the domestic front, political influences can include the interworkings of factional and policy coalitions, elite political conflict and rivalry, regime security, domestic coalitional influences, voter support, and the domestic political perceptions of the current regime. On the international side of the coin, political influences include hegemonic power, colonial domination, and regional political influences. Political factors can influence national policies in a variety of ways. For example, the political necessity of playing to certain political constituencies may encourage or even force policy changes and the implementation of new policy programs that fulfill the various political goals governments may hold. Political factors form the basis of explanations in one of two ways: 1) political factors shape and influence the decision to initiate economic policy change; or 2) economic policy changes become a means to achieving a political end. In general, political explanations, both domestic and international, contend that national economic policy reform is not undertaken solely for economic reasons. Rather, it is argued that underlying the initiation of a reform process are certain political rationales which possess equal if not greater significance than the economic in explaining the motivation and eventual decision to initiate national economic policy reform.

In analytical terms, political explanations of economic policy change are far less apparent than its economic counterpart. While it is often not difficult to pinpoint the economic reasons for policy reform, it is a far more complex task when it comes to identifying and locating the political variables which play a role in economic policy change. Economic stagnation, inflation, structural and institutional inefficiencies, inefficient production, and slow GNP growth are all measurable and fairly discernible phenomena,
which appear within a relatively short time frame. But it is much harder to see how regime security, policy and factional coalitions, and the interworkings of elite politics have influenced the initiation of a policy reform process. One reason for this is that the political rationales underlying the decision to initiate economic reform are rarely if ever pronounced by national policy-makers and political elites.

Like economic explanations, political ones possess both a domestic and international component. As an example of an international political explanation, hegemonic powers can have a powerful effect on the direction of policy and strategy in industrializing countries. The sheer weight of their political, military, and economic resources and capabilities enable them to exert geopolitical pressures which influence national governments. For example, it has been argued by many neoclassical economists that the United States hegemony over Korea and Taiwan during the Cold War stimulated the adoption of liberal trade and investment policies in these two countries. Other possible international political factors could include the role of regional and international policy trends and the recommendations of international organizations, which can all affect the policy formulation processes of national governments.

The third competing explanation is based on the role ideas play in the decision to implement policy change. Theories of economic policy change based on ideas contend that ideational variables have powerful effects on the formulation of economic policy, making them crucial to understanding economic policy change. Ideas, it is argued, are guides for action; hence, we see their impact most clearly when issues of strategy are in dispute, i.e. before instances of strategic change. Thus, the development of new ideas concerning

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23 Of course, this is not always the case. Overriding factors such as state ideology along with other political considerations can delay the initiation of policy reform, even for extended periods of time. The Soviet Union and China are two prime examples. In China, years of political chaos and ideological radicalism delayed the initiation of reforms in response to its obviously ailing economy.

24 Gereffi and Wyman, p. 37.


public policy, it is argued, help explain instances of economic strategy change. The notion that ideas can have an influence on the policy choices made by governments is premised on the assumption that decision-makers are capable of learning and changing previously held intellectual ideas. In other words, decision makers can alter their ideas about appropriate solutions to particular problems and thus enlarge or alter the range of options considered as solutions, (thus facilitating policy change).28

How exactly do ideas play a role in the policy process? According to Judith Goldstein, ideas are part of a four-stage process in the development of public policies.29 In stage one, policy change is prefaced by policy delegitimation. For either economic or political reasons, the status quo no longer meets the needs of political entrepreneurs. At this point, what Goldstein calls a "policy window" opens. When a policy window opens, political entrepreneurs are "willing to believe their present beliefs flawed."30 It is at this stage that an interest in policy change may occur. In stage two, a period of "search" ensues and alternative policy strategies are considered and selected. Stage three is marked by "experimentation," where either a return to the status quo ante or agreement about the virtue of the new policy is reached. In the final stage, the newly adopted policies are institutionalized within the political economy.31 Goldstein's four-stage process is an excellent description of how ideas can come to play a role in the public policy formulation process. Ideas can have an impact in one of two ways. According to Goldstein and Keohane, "policy changes can be influenced by ideas both because new ideas emerge and as a result of changes in underlying conditions affecting the impact of existing ideas."32 Thus when theorizing about ideas, it is not enough to say that one set of ideas had more force than another. Nor is it enough to say merely that ideas had an effect on policy. Rather, we need to, as Hall prescribes, "know much more about the conditions that lend force to one

30 Ibid., p. 12.
31 Ibid., pp. 12-18.
set of ideas." In short, we have to establish how ideas had an influence on the decision to implement policy change. To reiterate this important point, Goldstein and Keohane emphasize that

It is crucial for anyone working on ideas and policy to recognize that the delineation of the existence of particular beliefs is no substitute for the establishment of their effects on policy. Advocates of an ideational approach to political analysis must begin by identifying the ideas being described and the policy outcomes or institutional changes to be explained. We must also provide evidence about the condition under which causal connection exist between ideas and policy outcomes."

The fourth and final competing explanation considered in this theoretical overview is one centered on institutions. According to Haggard and Moon, institutional theories of public policy choices are generally theories which suggest that "institutional arrangements, including regime type, the government's role in organizing interest groups, and the internal structure of the economic policy-making apparatus help to account for variations in policy choice." By "institutions" we do not just mean the political institutional structure of a given political economy, but also the "practices, relationships, and organizations that have developed sufficient regularity and perceived importance to shape the behavior of their members." Peter Hall has come up with the most widely used definition. Institutions, Hall argues, "comprise the formal rules, compliance procedures and standard operating procedures that structure the relationship between individuals in various units of the polity and economy." Hence, when we speak of institutions as determinants of policy change, we refer to both the institutional structure of a polity and economy as well as its procedural and informal dimensions.

34Goldstein and Keohane, p. 11.
Institutional approaches to understanding policy change come in rational choice and historical institutionalist variants. Rational choice institutionalist theories are concerned with how institutions are important as elements of a strategic context, thus shaping the self-interested behavior of rational individual decision-makers.\textsuperscript{38} Policy choices, such as the decision to change economic strategy, are thus understood as the outcome of rational decision-making processes, based on strategic calculations. Historical institutionalist approaches, on the other hand, argue that institutions play a much greater role in structuring and shaping policy and political outcomes. In this view, institutions serve as mediating variables, shaping political strategies as well as goals, the relations of power among contending groups in society, the strategic environment and the process of politics and policy-making within a given set of institutional parameters.\textsuperscript{39} Under this approach, economic policy changes are understood as the outcome of a complicated process where ideas, interests and institutions interact to influence policy outcomes.

Other alternative theoretical approaches to understanding economic policy change merit consideration. However, their applicability to the cases considered in this study are suspect at best. In pluralist approaches to policy analysis, social groups or classes who come into conflict within the polity are the essential units of analysis. According to this approach, public policy results from conflict, bargaining, and coalition formation among a large number of societal groups organized to protect or advance particular interests common to their members.\textsuperscript{40} Public policy is a reaction to pressures from these groups and a product of their interaction with policy elites. The difficulty with using this theoretical approach is that in developing countries (like Taiwan and China) organized societal interests are generally either not articulated or are incapable, both politically and organizationally, of exerting influence on policy elites or the policy process itself.

\textsuperscript{39}ibid., pp. 7-13.
\textsuperscript{40}Merilee and Thomas, p. 22-3.
State-centered models of policy differ significantly from society-centered models—like the pluralist model—in terms of where the initiative for change emerges. State-centered models focus explicitly on decision makers within the organizational context of the state. State-interests arguments, for example, see the state as an autonomous actor and policy change as a result of state initiatives. In the state-interests approach, policy changes come about because of the interaction of policy-makers attempting to generate responses to public problems. The most important difficulty with this model is that it does not answer questions concerning why particular policy initiatives were adopted by the state.

"Bureaucratic politics" models, on the other hand, see state policy as the result of competing activities between bureaucratic entities and actors, constrained by their organizational roles and capacities. In this model, bureaucratic actors compete with the aim of promoting their policy preferences. Policy change is, in this case, a result of this competitive interaction within the state's bureaucratic apparatus. The largest difficulty with this model is its inability to explain or predict the direction of policy. This inability makes it extremely difficult for the model to explain instances of economic policy change.

1.4 Methodology

As this theoretical overview attests, the political science and economics literature contains a multitude of theoretical approaches to understanding the formulation of public policy. However, many of the theoretical tools available to practitioners in the field have been applied to the study of countries with vastly different political-economic systems than those considered here. Hence, approaches such as the pluralist model, statist model or the bureaucratic politics model, have minimal utility in helping us understand the underlying rationales for economic policy changes. Other studies of economic policy making within the literature have been done utilizing single theoretical paradigms such as rational choice or the "new institutionalism." This thesis however, does not confine itself to any single

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41 Hall, p. 16.
42 Applications of the "new institutionalism" have been done on studies of economic policy making in China. For example, see David Bachman, Bureaucracy, Economy and Leadership: The Institutional Origins of the Great Leap Forward, New Jersey: Princeton
theoretical paradigm. Rather, I utilize an eclectic theoretical approach, blending the insights of the competing theoretical perspectives introduced in the overview, in an effort to extrapolate the underlying explanations for economic policy change in the PRC and ROC. Rather than superimpose a single theoretical framework over the problem, this thesis will consider the answers economic, political, ideational, and institutional explanations of economic policy change may have to offer, utilizing them as guidelines for a comprehensive analysis. Finally, the methodology employed here is sensitive to the political and economic setting of reform. This analysis will be undertaken with particular attention to the respective contextual backgrounds.

1.5 Thesis Organization

This thesis is organized into four parts. Chapter one has provided a theoretical overview and a brief introduction to the central questions this thesis will attempt to answer. The case studies undertaken in this thesis proceed in chronological order. Chapter two includes a case study of economic policy change in the Republic of China on Taiwan. In this chapter, I look at the story behind the transition from the strategy of Import Substitution Industrialization (ISI) to the strategy of Export Led Growth (ELG) in the early 1960s period. Chapter three shifts the focus to the People's Republic of China. It examines in detail the initiation of the post-Mao reform process and the central economic policy reforms implemented during the first half of the 1980s. Each chapter covering a case study concludes with an examination of the competing explanations for economic policy change and reform. The concluding chapter, finally, will attempt to tie the two cases together. It will explore the major similarities and differences between the two cases, in an effort to draw some theoretical conclusions.
Chapter 2. Case Study: The Republic of China on Taiwan

This chapter takes an in depth look at the case of economic policy change in the Republic of China on Taiwan, examining the underlying rationales for strategic reorientation. It utilizes the Taiwan case study as a vehicle for analyzing the factors which explain why governments make changes in economic policy and strategy. As discussed in the introductory chapter, the transition in the ROC from import-substitution to export-led growth industrialization strategies during the late 1950s/early 1960s (the key policy reforms began in 1958) represents one significant occurrence of economic strategy reorientation. A second occurrence of substantial economic policy change also takes place in Taiwan with the case of land reform (1951-53). This chapter attempts to highlight and describe both these cases of strategic change (our two dependent variables) by presenting the policy decisions and the economic and political circumstances that surround these particular instances of economic policy change. Both cases demonstrate how a multi-causal construction can explain economic policy change.

I begin this chapter (section 2.1) with a brief background on Taiwan and its political status. The background is followed by a second brief section (2.2) which deals with Taiwan's pre-1949 economic history. It focuses on two main periods: The Japanese colonial occupation and the chaotic interregnum between 1945-1949 after Taiwan's formal retrocession to China in 1945. The historical background is important to consider since it helps account for the domestic and international political context faced by the KMT regime in the immediate post-1949 period, and illuminates the island's economic difficulties as well as its structural dilemmas. The rapid political and economic changes occurring in the late 1940s/early 1950s and the legacy of the colonial period were crucial in determining the political and economic context of post-1949 Taiwan, and it is precisely this context that would profoundly shape the direction of economic development strategy and policy in postwar Taiwan.

Section 2.3 of this chapter provides a detailed assessment of the economic and political (domestic and international) setting of post-1949 Taiwan. Section 2.4 provides an
empirical overview of policy and strategy and section 2.5 provides the analytical component of the case study.

2.1 Background

Situated off the coast of mainland China's Fujian province, across the Taiwan Strait, Taiwan is an island nation about the size of the Netherlands, possessing a population currently edging towards 25 million. The bulk of the population is crowded into one fourth of the island's relatively level and arable surface; the other three fourths, consisting of rugged mountains, is sparsely populated. With the exception of its fertile soil, coal, and natural gas, Taiwan holds little in the way of natural resources.\(^{43}\) Established as the Republic of China on Taiwan in 1949, the former Kuomintang rulers of the Chinese mainland, led by Generalissimo Chiang Kai-shek, set up a provisional government there in the wake of their defeat in the Chinese civil war and the resultant Communist takeover of the mainland. Claiming to be the rightful rulers of the mainland, the Nationalists saw Taiwan as a temporary locale for their government, preceding a recapturing of the mainland. However, the hopes of the Kuomintang leadership never materialized. As members of the international community began to recognize the mainland government as the rightful rulers of China, Taiwan quickly lost its international status. Replaced on the United Nations Security Council in 1971, Taiwan remains officially unrecognized by the majority of the international community today.

In spite of its tentative political status, Taiwan has firmly established itself as one of the world's fastest developing countries.\(^{44}\) Upon taking control of Taiwan, the Nationalist rulers set in motion a massive industrialization effort. Since that time, the achievements of this small island nation have been nothing short of spectacular. The Republic of China has achieved one of the most sustained rates of economic growth in the world today producing


average annual increases of per capita GNP at an 8.8% clip between the years 1956 and 1986.\textsuperscript{45} Even in the early 1980s, following the second oil crisis, while most of the developing world stagnated, Taiwan's real GNP grew by 5.5% in 1981, 3.8% in 1982, and 7.1% in 1983.\textsuperscript{46} Over the course of three decades, Taiwan has succeeded in transforming itself from a relatively poor, largely agriculturally based economy with a per capita income of about $100, to an industrial and urban economy with per capita income in the range of $7500.\textsuperscript{47} Today, Taiwan is a leading exporter of manufactured products and possesses the largest repository of foreign exchange reserves in the world.

2.2 Economic History (pre-1949): The Colonial Period

For much of its history as a part of China, Taiwan remained a rural backwater, with an economy based almost exclusively on subsistence agriculture. After being ceded to Japan in 1895 following the Sino-Japanese War, the island's economy underwent a significant structural transformation. The island's Japanese rulers made the fundamental decision to convert the colony from a subsistence oriented economy to an agriculture exporting periphery of the Japanese metropole.\textsuperscript{48} Japan's original objective for Taiwan was not outright industrialization, but to develop the island's agriculture to supply the mother country with food and raw materials. This would serve to enhance Japan's industrialization drive and improve its ability to feed a rapidly expanding population.\textsuperscript{49} Sugar and rice were to be the primary commodities.\textsuperscript{50} To facilitate the construction of this economic relationship, the colonial administrators took extensive measures in order to transform the Taiwanese economy. It improved the transportation and communication infrastructure, constructed irrigation networks, and introduced technological innovations in the form of

\textsuperscript{46}Ibid., p. 40.
new high-yield seed, fertilizers and advanced agricultural techniques.\textsuperscript{51} The economic relationship that developed between the colony and the metropole was extremely intense. The two commodities of rice and sugar accounted for nearly 50-70\% of Taiwan's exports, with the bulk of it going to Japan. Nearly every year, over 90\% of Taiwan's sugar and 50\% of its rice production was exported to Japan.\textsuperscript{52} By the 1930's, Taiwan's status as an agricultural supplier expanded. As the Japanese prepared for war, Taiwan's industrial processing (which at this point was limited to food processing) began to move into the heavy, defense related industries and raw material processing.\textsuperscript{53} In addition to its new role in production, Taiwan's strategic locale made it an ideal base for Japan's colonial and military operations, as Japan attempted and later failed to establish the Greater East Asian Co-Prosperity Sphere.

In general, the Japanese colonization of Taiwan had a variety of positive economic and social effects. For example, during the period 1912-1960 manufacturing in Taiwan grew by 5.94\%.\textsuperscript{54} Aside from improved economic performance, Taiwan also benefited from exposure to Japanese technology and expertise in agriculture and industry. Research also points to the positive effect of Japanese colonial socio-economic policy on Taiwan. According to Wade, during the Japanese colonial period, welfare levels improved, education levels increased and the death rate per thousand decreased from 40 per thousand in 1905 to 20 per thousand in 1930.\textsuperscript{55} Maybe the most important legacy of the colonial occupation was the development of a communications and transportation infrastructure that left Taiwan as the most developed region of greater China at the end of the civil war.

Taiwan's formal retrocession to China on October 25, 1945, saw the end of her colonial status, but inaugurated a period of rapid underdevelopment on the island nation.\textsuperscript{56} Economically, politically, and culturally it was suddenly removed from the Japanese orbit.

\textsuperscript{51}Gold, \textit{State and Society in the Taiwan Miracle}, op. cit., p. 36-7.
\textsuperscript{54}Ho, p. 72.
\textsuperscript{55}Wade, p. 74.
\textsuperscript{56}Gold, \textit{State and Society in the Taiwan Miracle}, p. 49.
and, as Gold argues, appended to China in what became essentially just another colonial relationship. All aspects of the former Japanese colony now came under the full control of the Kuomintang, who at this time was heavily engaged in civil war with the communists. In need of food and resources, the Nationalists utilized Taiwan's economy in much the same fashion as the Japanese. Usable machines, agricultural surplus, stockpiled raw materials and dismantled factories were siphoned off to the mainland to fuel the KMT war machine. During this chaotic period, the KMT completely disrupted the Taiwanese economy through its pillage of the island's resources as well as its general neglect of the island's fortunes. Allied bombing in World War II had equally devastating effects on the economy.

Outside the economic realm, the KMT persecuted the Taiwanese social and intellectual elite and committed several acts of political repression, the "2-28" incident (er er ba) being one of the most infamous. In short, with the coming of war and revolution, all possibilities of pursuing a rational economic course in Taiwan were lost. By the end of 1949, the KMT had effectively lost control of the Chinese mainland as the People's Republic of China was established on October 1, 1949. On December 9, 1949, the KMT government fled mainland China and moved its capital to Taipei, Taiwan.

2.3a The Domestic Political and Economic Setting of Economic Policy

With the end of Japanese rule and the communist takeover, Taiwan was left cut off from the mainland and in a state of economic dislocation and political disarray when the Nationalists took over in 1949. The problems faced by the regime were daunting. The government was demoralized and disorganized after its defeat in the civil war, the population of Taiwan was disillusioned and hostile after the political repression of the late 1940s, the regime still faced the possibility of attack from the communists, and the island's...
economy was ravaged by the effects of war and economic chaos. The repatriation of Japanese technicians, managers and officials further contributed to the already chaotic economic situation. In addition, the infusion of over 1 million mainland refugees exacerbated the problems of food, housing, and employment. After fleeing to Taiwan, the Kuomintang was determined not to repeat the mistakes it had made in losing control of the mainland. The KMT realized that in order to make a united stand against the communists, it would have to reform itself and establish a new relationship with Taiwanese society, as well as enhance the economic welfare of the populace. Hence, economic development and social modernization along with political reform became chief objectives.

Upon arrival, the KMT transferred its entire formal national-level party and government structures and superimposed them on Taiwan's provincial structures. The KMT party also remained intact in its original form. It was organized according to democratic-centralist principles, disciplined, highly centralized, revolutionary, with a hierarchy of party apparatus dispersed throughout the state structure, and a grass-roots organizational scheme based on a complex network of cells. The KMT wasted little time in establishing complete political control over the entire province of Taiwan. It purged remaining factional leaders, extended its organizational arms into all levels of the government, and quickly disbanded political opposition and any remnants of a democratic political process. As a result, Taiwan's political system became essentially that of a one-party dictatorship based on the overwhelming personal rule of Chiang Kai-shek and his son Chiang Ching-kuo.

The KMT's hegemony over the political system was not solely a product of the one-party dictatorship. Taking advantage of the unique political situation, the party also established what Tien describes as an "emergency regime." On May 10, 1948, the ROC

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62 Gold, op. cit., p. 58.
63 Ibid., p. 59.
64 While on the mainland, the KMT was first reorganized along Leninist lines in 1924, and after arriving in Taiwan, reorganized again in similar fashion between 1950-1952.
66 Ibid., p. 7.
government promulgated on the mainland the *Provisional Amendments for the Period of Mobilization of Suppression of Communist Rebellion*, commonly known as the temporary provisions. These provisions were subsequently extended to Taiwan where they remained in force for over three decades. The temporary provisions suspended many important articles of the ROC constitution and granted virtually unlimited power to the President at the expense of constitutional authorities. In January of 1950, martial law was enacted, again under the pretext of the "unfinished" Chinese civil war. Martial law restricted civil rights and liberties and gave the military extraordinary power over civilian matters. In addition to these provisions, general elections were suspended and the formation of new opposition parties banned.

The concentration of overwhelming political power in the hands of the KMT meant that opposition forces were relatively weak, politically and organizationally. As Gold argues, there was no viable domestic opposition to the KMT. The KMT had already liquidated much of Taiwan's intellectual and political elite and by doing so precluded the establishment of an indigenous capitalist or financial class and an organized political left. Labor, which had been an important force in undermining the KMT's power on the mainland, was also brought under control. Labor unions were permitted, but under the auspices of the state. Union formation was also dictated by the state. For example, state-created labor unions were forced upon both private and public enterprises, and fully penetrated by KMT cadres. Thus, in contrast to the political contexts of other development experiences, the KMT's political power was unconstrained by allegiances with rural elites. The powerful gentry/landlord class in Taiwan had its political clout all but taken away by the KMT through its land reform policies and political maneuvering.

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67 Ibid.
68 Ibid.
69 Gold, *State and Society in the Taiwan Miracle*, p. 64; also see Haggard, p. 80. Another explanation for the lack of an indigenous financial class would be the Japanese colonial occupation. During the colonial period, economic power was placed almost solely in the hands of the Japanese.
71 Haggard, p. 81.
Another component of the political setting was the security of the dominant party's regime and its ability to retain hegemony in a system with a glaring national cleavage. In order to retain hegemony, the party required the support of the business sector (controlled predominantly by the Taiwanese), but at the same time it needed to regulate them to justify its organizational dominance and ideological leadership. In Taiwan, the separation between political power and economic wealth roughly parallels the subnational cleavage between the Mainland Chinese and the Taiwanese. As Cheng points out, because of this fact, "policy choices would inevitably favor those measures that would fragment business, disperse economic power, and expand the latitude for economic distribution in order to buttress the state's power bases in society," and consolidate the security of the regime itself. The Mainlander/KMT-Taiwanese cleavage thus represents an important fact of political life and as such, an integral component of the postwar political context.

In general, it was easier for the KMT to achieve political stability in Taiwan than on the mainland because the island was smaller and more manageable, and most importantly because Chiang Kai-Shek brought a more unified leadership to the island. The sense of threat from the mainland helped consolidate this high level of unity within the KMT and served as a justification for its tight political control of the island. Hence, at the onset of the postwar era, the KMT enjoyed an unusually high degree of political autonomy as it came to dominate the entire political system. The state was both dominant and autonomous from society. It held a monopoly over political and military powers, and had no ties or allegiances to other social classes or political movements. The full blown state bureaucracy had penetrated society down to the residential neighborhood, village, school,

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72 In Taiwan, the population is 85% Taiwanese and 15% mainlander-Nationalist. It is the Nationalist who have effective monopoly on political power, and the Taiwanese who control much of the wealth.
74 Ibid., p. 143.
76 Ibid., p. 17.
and larger work unit. Complementing this overall political power was the presence of an extensive national security network (run by Chiang Ching-kuo) responsible for maintaining KMT rule and suppressing dissent. The KMT state's predominance also extended to the economic realm. All industrial enterprises inherited from colonial Japan remained state-owned and state-run, while the financial sector became a state monopoly.

The elite political context is also important to consider. Haggard and Pang note that while there was general agreement among the Taiwanese policy planners and the American advisors on the general thrust of economic policy and strategy, there existed "policy currents," which form an important component of the (elite) political backdrop to the transition to export-led growth industrialization policies. According to Haggard and Pang, there existed two major policy currents within the Taiwanese state: a "conservative line" and a "developmentalist reformist" line. These policy currents "combined ideological and institutional differences within the state with different social clienteles...[and the policy conflicts between them]...concerned the share of resources to be devoted to the military, the priority to be given to economic versus military objectives, the nature of the industrial policy regime, and the balance between the public and private sectors."

Groups associated with the "conservative" current included the Bank of Taiwan, managers of state owned enterprises, the military, and staunchly conservative political elements within the KMT who remained committed to the goal of recapturing the mainland. The "conservative" line's most important priority was the maintenance of Taiwan's military forces. Hence, the political objective of recapturing the mainland became essentially an "economic" priority. Another aspect of the conservative line was support for the state owned enterprise sector, which formed the basis of the conservative current's

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78 See Gold, *State and Society in the Taiwan Miracle*, pp. 62-3 for details of Taiwan's extensive national security network.
79 Cheng, p. 150.
80 Haggard and Pang, p. 65.
81 Ibid., p. 66.
82 Ibid.
83 Ibid.
views on economic policies. Firm support for the public sector also underlay a critical political issue. Supporters of the conservative line knew that private sector growth would inevitably mean a strengthening of native Taiwanese economic power, which could potentially translate itself into political power.\textsuperscript{84}

The "developmentalist" policy current was led by prominent bureaucrats such as K.Y. Yin, who headed the Industrial Development Commission (IDC) from 1953-55. The "developmentalists" were less concerned with political goals such as recapturing the mainland and more focused on economic development. They saw the strengthening of the private sector as a way of contributing to the long-run political stability of the island through the co-opting of the native Taiwanese into the political system.\textsuperscript{85} Fundamentally, the developmentalists were not opposed to state led intervention in the economy; they were also not supportive of a completely laissez faire economy. Rather, the reformist policy current supported the development of a private sector which combined free markets with a significant role for the state in planning and allocating resources.

In conclusion, the exceptional political autonomy enjoyed by the KMT combined with the party's Leninist organization and strategic outlook and the political and military support of the United States (discussed below) enabled the KMT to exert the type of wide ranging influence necessary to carry out substantial political and economic reforms.\textsuperscript{86} Wade has made the same observation. In his study, he comments on how "the Nationalist-mainlander government had unusually wide room for maneuvering...and.. an unusually dominant position in the economy..." (since it inherited all the productive assets and control mechanisms that the Japanese had built up over the colonial period).\textsuperscript{87} The extensive political autonomy enjoyed by the KMT allowed it to consolidate the political stability it deemed crucial for the achievement of socioeconomic development. In sum, these constituent elements--political stability, one party dominance, political autonomy--

\textsuperscript{84}Ibid., p. 68.
\textsuperscript{85}Ibid. This strategy was also strongly urged by American advisors. It formed the basis of American support for ELG.
\textsuperscript{86}Haggard, p. 76.
\textsuperscript{87}Wade, p. 75.
comprised the political context in which economic policy was to be formulated and implemented in postwar Taiwan.

2.3b The International Political Setting: The American Presence

The domestic political setting of postwar Taiwan constitutes one major element of the relevant context. However, as many scholars have emphasized, Taiwan's postwar economic development cannot be separated from the international context of the early 1950's. During its years on the mainland, the KMT was heavily supported by the United States. However, after its humiliating defeat in the civil war, the United States concluded in 1949 that the KMT was beyond hope and ceased providing assistance. However, international political events in the early 1950's ensured that Taiwan would retain political importance to the United States. On June 27, 1950 President Truman--previously uncommitted to the defense of Taiwan--ordered the Seventh Fleet to patrol the island against any military action by the communists. The rapid chill of the Cold War and the outbreak of war in the Korean Peninsula had galvanized political support (in the United States and throughout the Western alliance) for an anti-communist foreign policy: the policy which came to be known as containment. Taiwan became "Free China," making it a key post in the defense against the further spread of international communism. As a result of Cold War developments in East Asia, the external security of the Taiwan regime was provided for by the United States. The security arrangement was formalized in December 1954 as Taiwan and the United States signed the Mutual Defense Treaty, and the U.S. Congress passed a resolution authorizing the President to assist Taiwan militarily against renewed Communist aggression.

88Gold, State and Society in the Taiwan Miracle, pg. 58. Also see Richard E. Barrett and Martin King Whyte, "Dependency Theory and Taiwan: Analysis of a Deviant Case," American Journal of Sociology, March 1982, 87-3, pp. 1064-1069; Greenhalgh and Winckler, eds., Contending Approaches to the Political Economy of Taiwan; Cal Clark, Taiwan's Development: Implications for Contending Political Economy Paradigms; Robert Wade, Governing the Market, op. cit.; Alice H. Amsden, "Taiwan's Economic History: A Case of Etatisme and a Challenge to Dependency Theory," Modern China, July 1979; Frederick C. Deyo, ed., The Political Economy of the New Asian Industrialism; for detailed discussions of the U.S. role in Taiwan's postwar economic history.
89Wade, p. 82.
90Gold, State and Society in the Taiwan Miracle, p. 64.
The fate of the KMT thus became intertwined with the larger context of the Cold War, making it a key target of American support. As its policies dictated for Korea and Japan, the United States provided both military security and financial aid for the island nation. In this position, Taiwan received amounts of military and financial aid unparalleled in history. Between 1951 and 1965, over $4 billion was made available to the KMT government in the form of grants, loans, and military equipment. In addition to financial assistance, the U.S. also dispatched advisors to assist in Taiwan's economic development efforts. To illustrate the extent of American support, Wade's research shows that during the 1950's, economic aid equaled 6% of GNP and nearly 40% of total investment, and U.S. military assistance to Taiwan was approximately twice as great as the already lavish amounts of economic aid. In sum, the United States presence forms an important component of the international political setting in postwar Taiwan. Combining it with the domestic political context (discussed above), completes the contextual picture of postwar Taiwan that will serve as the foundation of the analysis to follow. The importance of the political and economic setting lies in its illumination of the variety of factors which shape and influence the decision to initiate reform and the political and economic environment surrounding those decisions.

2.4a Postwar economic policy and industrialization strategy in Taiwan: The Postwar Land Reform.

The first major policy initiative of the postwar era was land reform. Realizing that its failure to initiate land reform had alienated much of the mainland peasantry, the KMT was careful not to repeat its mistakes and made land reform a top priority in Taiwan. The Americans also strongly urged land reform on the Nationalists and supplied experts, advice, and funds to ensure its success, all funneled through the Joint Commission on Rural

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92 Wade, p. 82.
93 Hagen Koo, “The interplay of state, social class, and world system in East Asian development: the cases of South Korea and Taiwan,” pp. 165-81, in Frederick C. Deyo, ed., *The Political Economy of the New Asian Industrialism*, op. cit., p. 168
Reconstruction (JCRR).\textsuperscript{94} The willingness of the KMT to implement land reform lay in stark contrast to its pre-1949 policies. In its nearly three decades on the mainland, the KMT never saw fit to implement land reform despite the fact that a small landlord class owned the majority of the country's land.

The objective of land reform was simple: remove the economic and political base of the indigenous elite and prevent peasant upheaval.\textsuperscript{95} Carried out between 1949 and 1953, land reform was implemented in three stages: compulsory rent reduction, the sale of public land to actual tillers, and the compulsory sale of private land to actual tillers.\textsuperscript{96} These reforms reduced rents, significantly decreased the holdings of the landlord class, and redistributed land in a more equitable manner. Land reform was the first step in the economic recovery process and lay the groundwork for economic development.

Complementing the land reform program, the government aggressively pushed the development of agriculture through the introduction of new techniques and cash crops. In short, agricultural expansion allowed the state to squeeze agriculture to feed its urban population, supply funds for industrialization (through exporting of agricultural products), and acquire badly needed hard currency.\textsuperscript{97}

\subsection*{2.4b Postwar economic policy and industrialization strategy in Taiwan: The Transition from Import-Substitution Industrialization to Export-Led Growth}

As discussed above, economic policies and development strategies in postwar Taiwan were heavily influenced by American advisors. The two key economic bureaucracies responsible for management of the economy, the Taiwan Production Board, (TPB) and the Economic Stabilization Board (ESB) were overseen by American advisors who, through The Agency for International Development (AID), had final say over economic matters in Taiwan. In terms of the larger strategic approach to economic

\textsuperscript{94}Gold, \textit{State and Society in the Taiwan Miracle}, p. 65.  
\textsuperscript{95}\textit{Ibid.}  
\textsuperscript{96}Ho, p. 159. Discussion of the land reform in China can be found in Gold, \textit{State and Society in the Taiwan Miracle}; Ho, op. cit.; Vogel, \textit{op cit.}; and K.T. Li, \textit{op cit.}, pp. 59-64.  
\textsuperscript{97}Gold, \textit{State and Society in the Taiwan Miracle}, p. 67.
development, both the Americans and the Chinese agreed on the necessity of an import-substitution strategy. In the immediate postwar period, the KMT followed an inward-looking strategy of primary import-substitution industrialization in light industry manufacturing. To promote import substitution, Taiwan employed a typical package of protectionist controls: tariffs, import controls, import quotas, and multiple exchange rates. These strong protectionist controls were designed to protect the domestic consumer goods market from foreign competition and aid the rapid accumulation of capital and foreign exchange for raw material imports. Between 1945 and 1955 the average nominal tariff rate for all imports more than doubled, rising from 20% to nearly 45%. This assortment of trade and exchange controls effectively sealed off the greater proportion of Taiwan's consumer goods markets from foreign competition and conserved capital for raw material imports.

The policy of import-substitution industrialization spurred a decade of light industrial growth. From 1949 to 1954, manufacturing production increased at an average rate of 22% a year. According to one estimate, value added in manufacturing reached the 1940 prewar peak by 1951 (a period of only two years) and then more than doubled during the three years between 1951 and 1954. Industrial production's contribution to net domestic product increased from 18% in 1952 to 24% in 1958, while that of agriculture declined from 36% to 31%. The swiftly shifting ratio between industry and agriculture was evidence of a modernizing economy. By the mid-1950s however, the growth of output in several light-manufacturing sectors had slowed down and the domestic market

99 Ho, p. 191.
100 Pang, p. 159.
101 Ho, p. 191.
102 ibid., p. 192.
103 ibid., p. 187.
105 Pang, p. 161.
had quickly begun to saturate.\textsuperscript{106} This was the case particularly in the subsectors producing textiles, wood products, and rubber goods.\textsuperscript{107} This slowdown in economic growth was an outgrowth of problems commonly associated with ISI. As an industrialization strategy, ISI is highly dependent on the continued expansion of domestic demand. If demand tails off or decreases, the market tends to saturate, as fewer sources are available for the consumption of that production. Taiwan was no exception to this phenomenon during the 1950s, as growth in manufacturing light industry slowed down considerably after an initial surge, and domestic markets for nondurable consumer goods became rapidly exhausted.\textsuperscript{108} It had undoubtedly become clear to many economic policy-makers that the protectionist policies dictated by ISI had reduced economic efficiency and hampered exports of manufactured goods made from import materials.\textsuperscript{109} GNP growth rates dropped every year from 1952 to 1956.\textsuperscript{110} Many plants producing simple manufactures were also operating at low levels of capacity utilization. These included, canvas shoes (23.3%), soap (38.1%), synthetic fabrics (49.7%), and woolen yarn (52.6%).\textsuperscript{111} As a result of the economic slowdown and the growing inefficiency of industry, economic officials and representatives from the business community began lobbying the government for policy reforms.

The economic downturn of the mid 1950s is critical in understanding the transition from ISI to ELG. The KMT knew that for growth to continue, either the manufacturing sector had to enter the intermediate and capital goods production market, or the recently established import substitution activities, primarily in nondurable consumer goods, had to penetrate the world market.\textsuperscript{112} As Ranis points out, there are essentially two paths open when initial ISI begins to run out of steam: 1) move to secondary import substitution,
increasing and expanding the production of previously imported goods; or 2) direct production to international markets, i.e. export substitution.\textsuperscript{113} In the Newly Industrializing Countries (NICs) of Latin America, the first option was taken, as primary ISI was followed by the adoption of secondary ISI policies.\textsuperscript{114} Taiwan however, did not follow the same path. Instead of intensifying ISI (or staying the course with primary ISI), the KMT chose the second path, implementing a series of policy packages emphasizing export-led growth industrialization.

It was not until 1958 that the bottleneck problems associated with ISI, the small size of the domestic market, the continuing pressure of surplus labor, and the rising costs associated with the expansion into more capital and skill intensive industries shifted the balance of private and public opinion in favor of an export-substitution industrialization path.\textsuperscript{115} In the face of the economic downturn, policy factions within the KMT elite became staunch supporters of trade liberalization and export promotion. More importantly, this "developmentalist" faction received the support and backing of Chiang Kai-Shek. Beginning in this period (1958-61), the KMT implemented a series of policy packages designed to facilitate the transition away from ISI to the strategy of export-substitution industrialization. The main economic policy reforms were: 1) a reform of foreign exchange and trade; 2) a Nineteen-Point Program of Economic and Financial Reform; and 3) a Statute for Encouragement of Investment. The reforms were intended to increase production, liberalize trade, simplify the exchange rate system, loosen import restrictions, encourage exports, stimulate the creation of an investment climate, and orient labor intensive manufacturing towards production for international markets.\textsuperscript{116} In short, the reform policies intended to reorient the economy from ISI to ELG.

\textsuperscript{114}For a detailed tracking of the comparative development trajectories of Latin America and East Asia, see Stephan Haggard, Pathways from the Periphery.
\textsuperscript{115}Ranis, p. 219.
\textsuperscript{116}Pang, pg. 175; also see Lin, ch. 3.
In response to both political and economic pressures, beginning in 1958, Taiwan began to rationalize the existing import substitution policy package and reduce some of its discriminatory features against the export sector. Many of the protectionist controls were lifted, the formation of export cartels was supported and approved, and manufacturing began to expand into new secondary import-substituting industries, including chemicals, rayon fiber, urea, and plastics. The first major policy initiative of the reform period was the *Program for Improvement of Foreign Exchange and Trade Control* in 1958. Keeping in line with the KMT’s larger developmental goal of export promotion, the reforms were implemented with three key objectives in mind. They aimed at eliminating the multiplicity of exchange rates, reducing the strict controls on foreign-exchange allocation, and strengthening the policy incentives given to export activity, such as reducing tariffs and loosening import and export controls. These policies, it was hoped, would create incentives for manufacturers to produce for the international market. This would address the two main bottlenecks inflicted by ISI, that were holding back the economy: market saturation and productive inefficiency and underutilization.

The government’s first step was to devalue the overvalued currency and replace the multiple exchange rate system with a single exchange rate system. The new and unified exchange rate simplified the administration of foreign exchange, but more importantly, it assured exporters of reasonable earnings and allayed fears of exchange rate uncertainties. The government proceeded to loosen import controls. It gradually liberalized and abolished the commodity import quota system, and restrictions on imports of materials and equipment to be used for export production were subsequently eased and eliminated.

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117Ho, p. 195. The political pressures pressing the government at the time were mainly generated from elite political circles. Many political elites saw policy change as effective method of dealing with its domestic political problems with the native Taiwanese (co-optation).
118See Ibid., pp. 195-6 for a succinct discussion.
119Ibid., p. 196.
121Lin, p. 75; and Lee and Liang, p. 315.
122Lee and Liang, p. 315.
123Ibid., p. 315.
addition, tariffs were reduced and quantitative restrictions eased. In contrast to its former protectionism under ISI, the government reduced its protection of domestic producers of certain consumer nondurables and preferential loans were being made to exporters. As the policy reforms demonstrate, the former ISI structure was rapidly becoming dismantled in favor of an export-oriented economic structure.

The late 1950s and early 1960s saw trade policy in Taiwan continue to head in the direction of export promotion. Numerous export incentives were implemented. They comprised rebates of customs duties, exemption from business and stamp taxes, a tax deduction on total export earnings, provisions for the retention of foreign exchange earnings to import raw materials and machinery, and government financing for imports of raw materials. In addition to these policies, export promotion facilities such as trade organizations, research institutes, and government agencies were set up to aid in the export promotion process.

The 19-point Program of Economic and Financial Reform of February 1960 and the Statute for Encouragement of Investment of September 1960 were the other major policy initiatives of the 1958-61 transition period. Adopted in February 1960, the nineteen-point reform program encompassed the country's entire economic and fiscal policies. Promoted by leading economic officials, and with the prodding of AID, the reform program further liberalized control on trade and industry, promoted exports, called for improved banking and tax systems, and created a business climate to stimulate private local and foreign investment. The reforms also recommended the revision of import duties, further reduced tariffs on imported inputs, liberalized controls on exchange and trade, reduced taxes and duties on exports, revised import duties, and encouraged savings and private investment. The 19-point program was unusual in that its was drawn up as an internal document for the administration rather than as a piece of legislation. It served as a
policy guideline for top officials as Taiwan attempted to implement the policies and construct the economic institutions necessary for an export-oriented economy. While the *Program for Improvement of Foreign Exchange and Trade Control* and the 19-point reform program dealt with changes in foreign exchange and trade policy, the *Statute for Improvement of Investment* focused on the creation of a favorable investment climate. Such an investment climate was necessary in order for the KMT to make complete the transition from ISI to ELG. The most salient components of the statute are as follows: 1) a five year income tax holiday; 2) preferential business income tax rates; 3) tax exemption for undistributed profits; 4) tax deduction of exports; 5) tax exemption of foreign currency debts. Applied to both foreign and domestic sources, the investment statute's main purpose was to facilitate the acquisition of plant sites and to provide tax exemptions and deductions for potential export-oriented enterprises.

Both the 19-point program and the investment statute built on the policy foundations of the 1958 exchange rate and trade policy reform discussed previously. These policy packages together formed the foundation of Taiwan's new development strategy of export substitution industrialization. The reform programs combined export promotion policy incentives with the creation of a business climate conducive to private local and foreign investment. In general, most scholarly analysis of Taiwan's economic development concludes that the trade policy reform program was relatively successful. Exports expanded rapidly after devaluation and trade liberalization, and the downturn in the economy began to pick up as per capita growth rates surged upwards towards 10% during the 1960s, and industrial output rose at an annual rate of 17.3 percent. Lee and Liang also conclude that the outward oriented strategy has been highly successful. They argue that the expansion of manufactured exports had other positive economic effects such as the

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128 Kuo, pp. 301-03; and Pang, pp. 190-91.
129 Fei, Ranis, and Kuo, p. 32. Also see Lee and Liang, p. 317.
efficient utilization of comparative advantage in industrialization and the stimulation of technological improvement and production quality.\textsuperscript{131}

This empirical overview has detailed the major economic policies and strategies of the postwar period in the ROC, dating from 1949 to the early 1960s. It has examined two major cases of policy change: land reform in the early 1950s and the transition away from ISI towards ELG industrialization policies.\textsuperscript{132} The most important points of this discussion are the economic facts of economic policy change. The remainder of the chapter focuses on explaining why these policy changes occurred.

2.5 Analysis: Understanding Economic Policy Change

The following section utilizes the competing theoretical perspectives introduced in chapter 1 to extrapolate some of the underlying explanations for economic policy change in the Taiwan case. Both cases of policy change in the ROC support the argument that no single explanation tells the story of why governments make the decision to engage in economic policy change. While economic reasons are often salient (and indeed the starting point of policy change), they do not in themselves explain why governments initiate economic policy changes or what form that change takes. As the ROC and the following PRC case study demonstrate, economic, political, ideational, and institutional explanations of policy change all contribute answers to this critical question.

2.5a Analysis: Land Reform in Postwar Taiwan

As discussed above, land reform was one of the first major policy initiatives of the postwar era. In its nearly four decades on the mainland, the KMT never saw fit to implement land reform, yet it immediately implemented an extensive land reform shortly after arriving on the island. What explains this sudden and substantial change in policy? Why did the KMT decide to attack the landlord/gentry class on Taiwan, when it declined to

\textsuperscript{131}Lee and Liang, p. 317.
\textsuperscript{132}A key difference between the two cases should be kept in mind. The transition from ISI to ELG constitutes a change between economic policies implemented on the island. The land reform program represents a change between policy on the mainland and its differences with policy on the island.
The primary purpose of the program remained intertwined with the KMT's domestic political agenda. The larger political goals of garnering popular support for the regime among the populace and crippling potential political opposition underlay the KMT land reform program. With the changes brought about by land reform, landlords were deprived of their means for exerting social, economic, and political control over the rural populace. This increased the socioeconomic mobility of rural residents, creating a more
egalitarian society in the countryside and solidifying the regime's popularity with that constituency. Land reform thus served critical KMT political objectives: garnering reliable political support and maintaining domestic political stability.

The case of land reform in postwar Taiwan illustrates quite clearly how political factors can dictate the direction of economic policy even while salient economic factors can explain the reasons for economic policy change. Apart from economic and political factors, other factors also contributed to the implementation of land reform, such as the influential pressures of U.S. advisors, the infiltration of alternative policy ideas, and the influence of ideological precepts such as Sunism (Sun Yat-sen ideology). In short, the postwar land reform in Taiwan illuminates how both economic, political and other factors mesh rather than compete to explain why governments engage in economic policy change. As the discussion below will demonstrate, a similar argument can be made about the shift from ISI to ELG.

2.5b Analysis: The Shift from ISI to ELG: Economic and Political Rationales

What were some of the economic reasons underlying the decision to shift from ISI to ELG? As documented above, the economic downturn of the mid-late 1950s, brought on by many of the problems associated with ISI, goes a long way in explaining why the initiation of economic policy change took place. As economic performance began to deteriorate towards the end of the decade, bureaucrats, government officials, and business leaders began to take notice of the country's economic difficulties and their concerns created pressures for policy change. Once ISI was diagnosed as the root of the problem, the groups interested had the motivation they needed to either adjust current policies or implement completely new ones. Towards the end of the 1950s, this is approximately what happened as the developmentalist faction gained a significant advantage in its policy battles with the conservatives and the export-substitution policy program was implemented in place of ISI. It is in this sense that economic factors explain why economic policy change

\[136\text{Ibid.}\]
occurred. When economic performance is poor or previously utilized policies and strategies falter or perceived to have failed, governments will often take measures to respond (since it is not in their interests to have an ailing economy). In the case of Taiwan, the response was a reorientation of national economic strategy in the form of the adoption of export-substitution policies. Poor economic performance and perceived policy deficiencies are thus the starting point for understanding the shift in economic policy at the end of the 1950s.

Like the case of land reform, the decision to shift from ISI to ELG industrialization policies was not made entirely on the basis of economic factors. In fact, important political considerations shaped the decision to shift from ISI to ELG. For example, the need to play to certain political constituencies affects all sorts of government decisions with regards to economic policy. As I have described, a central defining feature of the Taiwanese political-economic landscape is the subnational cleavage between the native Taiwanese and the Mainlanders. When considering major issues of national policy, policy-makers in Taiwan can ill afford to ignore this important fact of political life. In the context of postwar Taiwan, this was all the more crucial as the fragility of the political situation made political stability extremely difficult to maintain.

The decision to make the transition from ISI to ELG was made with these facts in mind. The KMT realized that it could not afford to allow wealth to concentrate in the hands of the Taiwanese, since a preponderance of economic power could enable them to eventually challenge the political structure. However, the KMT also realized that alienating the Taiwanese economically could have equally detrimental effects. By moving to an ELG strategy, the KMT could potentially resolve both its economic problems and its domestic political dilemmas. Adopting export-substitution policies would allow the KMT to expand the private sector of the economy. This would facilitate the activities of Taiwanese businessmen, providing them with more economic opportunities. As Cal Clark describes, "the government's policy of rapid, export-led industrialization was centered on

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137Kang, p. 571. Also see Haggard, Pathways from the Periphery, p. 88.
the private-business sector and opened up another avenue for advancement and mobility for native Taiwanese who possessed the skills and resources to become entrepreneurs."\textsuperscript{138} Underlying this economic benefit however, lay an equally if not more important political motive. The KMT shrewdly calculated that an increase in economic power would create an entrenching of vested interests and provide the Taiwanese with a larger stake in the system.\textsuperscript{139} By co-opting the Taiwanese into the system, the KMT hoped to maintain domestic political stability, thus enhancing the long term security of the regime.

The desire to co-opt the Taiwanese into the system was an important political rationale underlying the decision to shift from ISI to ELG and was related to another of the regime's larger political objectives. As military action against the mainland regime began to dissipate as a realistic option, the view of developing Taiwan into a "showcase" of Chinese development under free economic institutions became increasingly appealing to Chiang Kai-shek.\textsuperscript{140} The KMT leadership realized that economic development and social modernization could augment the legitimacy of the Nationalist regime on the island, and also had powerful propaganda values in the ideological battle with the communists.\textsuperscript{141} With strong urging from the United States, Chiang himself became sympathetic to this view despite opposition from the military and conservatives. These opposing factions were unable to override Chiang's policy preferences. In short, political goals such as co-optation of the Taiwanese and developing a strong economy to acquire domestic and international political legitimacy made the decision to shift from ISI to ELG less difficult. The KMT saw ELG as an effective tool for improving lagging economic performance, and improved performance also promised the attainment of its political objectives, both domestic and international.

International political factors also explain why the KMT decided to shift from ISI to ELG. As Gereffi and Wyman point out, hegemonic powers can have a powerful effect on

\textsuperscript{138}Clark, op. cit., 127.
\textsuperscript{139}Ibid., p. 126.
\textsuperscript{140}Pang, p. 179.
\textsuperscript{141}Ibid.
the direction of policy and strategy in industrializing countries. The postwar relationship between the United States and Taiwan was a good illustration of this as the United States exerted tremendous influence over the direction of Taiwan's economic policy and strategy. In Gold's assessment, the Chinese government initially did not even have final say over its own economy.\textsuperscript{142} The Americans, through AID, had de facto veto power through their control of the KMT's economic lifeline (i.e. economic aid), and exercised this control by steering the direction of economic policy and strategy. The profound American influence was not limited to policy formulation. The United States also exercised its influence by facilitating the filtration of economic ideas. For example, the postwar land reform and the adoption of an ISI strategy were pushed strongly by American advisers as was the transition from ISI to ELG. Thus, any explanation of the strategic reorientation in Taiwan must consider the element of the American influence. As was the case with all the major policy initiatives of the immediate postwar era, the decision to shift from ISI to ELG was in no small part a product of America's policy wishes.

Looking at both the postwar land reform and the ISI to ELG transition elucidates how political and economic factors both have the power to influence economic policy changes. In both cases, change was driven by certain economic rationales, but political rationales were also intertwined with them. Between the two cases however, the political rationales were somewhat different. In the case of land reform, ameliorating the political crisis of legitimacy was one of the key political objectives. With the immediate crisis largely taken care of by the late 1950s, the transition to an ELG strategy was dictated more by auxiliary political goals such as political co-optation and political prestige. Yet, political matters related to the crisis setting would remain pertinent. I elaborate on this in the concluding chapter.

\textsuperscript{142}Gold, \textit{State and Society in the Taiwan Miracle}, p. 68.
2.5c Analysis: The Shift from ISI to ELG: Ideas and institutions

Ideas have also been important as determinants of national economic policy in the ROC. Indeed, economic officials often claim that they formulate economic policies according to the intellectual ideas and teachings of Sun Yat-sen. Ideas also played an important role in the transition from ISI to ELG in postwar Taiwan. As Hao notes, ideas of neoliberalism appeared in the KMT’s platform during the late 1950s/early 1960s, particularly in the area of economic policy. The growing influence of neoliberal economic ideas was due in no small part to the influence of American advisors and the fact that many of the leading technocrats in the Taiwanese bureaucracy had received advanced academic degrees from American universities. Neoliberal ideas began to acquire influence as ISI quickly became discredited due to lagging economic performance and the perception that ISI was the source of many of Taiwan's economic ills. The discrediting of ISI allowed the opening of a "policy window" as officials in the government began to reconsider previously held beliefs and ideas and began searching for alternative policy strategies. It was at this point that neoliberal ideas conveniently presented themselves at the forefront of the policy agenda. As a viable alternative course of action with support from a substantial portion of the bureaucracy, the political establishment, (the developmentalist faction), as well as the United States, neoliberal ideas of economic policy represented viable alternatives worthy of policy experimentation. In the case of Taiwan, policy experimentation resulted in the final institutionalization of ELG. Rather than a return to the status quo ante, i.e. ISI strategy, the government decided to follow its new policy course, hence the transition from ISI to ELG.

The extent to which neoliberal economic ideas had an impact on the transition from ISI to ELG is extremely difficult to determine with exactitude. Ideas may have not been the critical factor, but to overlook their importance would be greatly detrimental to a comprehensive analysis. The most important question to ask is how the causal connection

144 Ibid., pp. 5-6.
can be made between neoliberal economic ideas and economic policy change. Goldstein and Keohane argue that ideas can have an impact in one of two ways (see chapter 1, section 1.3). In Taiwan, as in China, ideas made their impact as a result of changes in the underlying conditions affecting the impact of existing ideas. The changes that occurred towards the latter half of the decade--the economic downturn, market saturation, the change in the political context, and the discrediting of ISI--created a set of political and economic conditions that facilitated the impact of new economic ideas, allowing them to exert influence on the policy process. Equally crucial as a facilitating factor was the institutional structure of the economic policy-making apparatus, which allowed Chiang and his advisors to redraw policy and strategy almost at will. Once the door was open for new economic ideas, it set in motion a process analogous to Goldstein's four-stage process in the development of public policies. Under this process, political entrepreneurs become interested in policy change and begin searching for alternative policy solutions, which are experimented with and either adopted or discarded. In sum, the case of economic policy change in Taiwan clearly illuminates how ideas did have an influence on the decision to shift from ISI to ELG.

Institutional theories of economic policy change suggest that the institutional framework of a given political economy explains economic policy change in one of two ways: 1) institutional change could explain the changes in policy; or 2) some aspect of the institutional framework could help explain why policy shifted. In Taiwan, institutional change was minimal. As outlined in the contextual discussion, much of the political institutional framework of Nationalist China was transferred over to the island in 1949. The second of the propositions presented here also merits consideration. In the Republic of China, certain institutional aspects of the economic policy-making apparatus were conducive to economic policy reform. The centralized economic policy-making structure facilitated economic policy reform. As in China, the institutional framework of the policy-making apparatus was controlled by a small group of officials and bureaucrats, led by President Chiang Kai-shek and his inner circle of advisors. Their preeminence ensured that
economic policy could change direction only when they desired it. Nowhere was this more clear than in the case of the ISI to ELG transition. The decision to make such a drastic change in economic policy was not adopted immediately and was controversial for several reasons. First, while there existed a substantial foundation of support for implementing export-substitution policies (the "developmentalists"), the more conservative elements within the regime remained opposed to a strategy of export-substitution. Many conservatives were skeptical and did not believe that Taiwan's light industries could be competitive on international markets.\(^{145}\) Furthermore, they feared that liberalization would endanger the dominant position of the state in the domestic economy. Giving up the dominant position of state corporations in the industrial sector meant the dismantling of economic controls and threatened the position of many bureaucrats in the government and party. Finally, export liberalization also meant jeopardizing the heavy industrial sector vital to the military.\(^{146}\) Despite the opposition, the developmentalist faction gained the support and backing of President Chiang Kai-shek.\(^{147}\) With two policy currents battling each other, Chiang merely had to side with one of the factions to enable its policy recommendations to reach fruition.


\(^{146}\) Ibid.

\(^{147}\) Haggard and Pang, p. 78.
Chapter 3. Case Study: The People's Republic of China

This chapter provides a case study of economic policy reform in the People's Republic of China. It begins with an outline of the political and economic background of the immediate postwar period in the PRC (section 3.1a) and a synopsis of economic policy and strategy in the Mao years (section 3.1b). In detailing the important economic and political events of the Maoist era, I intend to achieve two objectives: to highlight the substantial changes in economic policy and strategy made between the Mao and Deng eras; and to provide a political and economic contextual background to the immediate post-Mao reform period. Particular attention is also paid to the political debates surrounding the policy-making process in both eras.

Section 3.2 looks at the content of the post-Mao economic reforms. Section 3.2a, looks at the ideational and intellectual debates taking place at the time of the economic policy changes, and section 3.2b provides the empirical overview of economic development strategy and policy in China during the first phase of reform in the Dengist era. Section 3.3 contains the analytical component of this case study. In section 3.3a, I elaborate on the most salient elements of the political and economic context in explicating the respective political and economic rationales underlying the initiation of reform in post-Mao China. Section 3.3b delves into the question of how ideas and institutions can or cannot explain the transition from socialist/Maoist to market-oriented economic policy and strategy in the post-Mao period.

3.1 Economic Policy in the Mao Years (1949-1976)

Throughout the Mao years, the CCP continually reoriented its approach to economic development in response to, or as a result of, an extremely fluid political environment. Indeed, economic policy in the Maoist era has often been hostage to the continual cycle of political developments. Further exacerbating the oscillation of policy
was the role of Mao and his influence on the formulation process. As Lieberthal argues, in the Mao Zedong years, China's development strategies and economic policies were "spasmodic," and subject to major changes every five to ten years. He argues that between 1949 and 1976 (the year of Mao's death), China's economy experienced six phases of economic policy variations (thought they were not substantial policy reorientations per se). The periodization of the era can be drawn as follows: 1949-56, economic and political recovery and basic socialist transformation; 1956-57, contradictions and rethinking the Soviet model; 1958-61, The Great Leap Forward; 1962-65, recovery and growing elite divisions; 1966-69, Red Guard phase of the Cultural Revolution; 1970-76, final phases of the Cultural Revolution and the struggle for succession. While these six periods encompass significant oscillations in both political and economic policies, it is important to note that throughout these six periods, policy and strategy remained within the parameters of the socialist and developmental Maoist frameworks. Section 3.1b below closely mirrors Lieberthal's periodization and highlights the major economic policies and strategies of the Maoist era.

3.1a Background: The Post-war Situation

When the Chinese Communist Party (CCP) came to power in 1949, China was a country devastated by years of civil war, foreign invasion, and general political and social chaos. Further compounding the situation faced by the new regime was an economy in dire circumstances. Inflation had run out of control, floods had affected 30-40% of the arable land, and industrial and food output had been reduced to 56% and 75% of the prewar peak.

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150 The variations in economic policy referred to here are not to be understood as equivalent to those substantial economic policy changes that occurred between the Maoist and post-Mao eras. The policy changes occurring in this period were more variations within a given framework than fundamental changes.
151 ibid.
respectively. Consumer goods output had also fallen to 70% of previous peak levels. The Sino-Japanese and Chinese civil wars had inflicted devastating effects on China's economy. It destroyed large parts of China's industries, severely disrupted normal domestic trade and economic patterns, interrupted interurban and interregional transportation, and cut off cities from their rural markets. In conjunction with the problems created by the disruptions of war were some more basic structural problems, which magnified the problems of economic reconstruction and modernization. For example, traditional production methods dominated agriculture, forcing some 80 percent of China's labor force to provide food and other vital agricultural products. Transportation links were weak and modern industry had only sprouted in a few coastal cities under foreign influence. Isolated from the outside world, China had limited access to foreign science and technology, trade, and capital. The revolutionary leaders of the new Chinese state thus faced serious challenges. Out of this desperate situation, it had to construct new political and economic institutions, bolster the hapless economic situation, raise living standards, and build national morale. Along with these more immediate objectives, the CCP was faced with long term goals such as socialist transformation, nation-building, bolstering domestic political legitimacy, and acquiring international recognition.

3.1b Economic Policy in the Mao Years (1949-1976)

In setting out to accomplish the difficult tasks of reconstruction and development, the new regime implemented a socialist development strategy based heavily on the Soviet model, which seemed to have been the only viable model available for emulation that conformed to China's national objectives and its Marxist-Leninist ideology. According to Lieberthal, Mao saw the Soviets as the only people who understood how to build a socialist system that functioned effectively, therefore making it, in his opinion, a logical

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155 Lieberthal, p. 87.
156 Selden and Lipitt, pp. 3-6.
choice for emulation. In seeking to emulate the Soviet model, China completed agreements with its Soviet ally calling for monetary loans, military assistance, reciprocal trade agreements, and Soviet technical assistance. Beginning in the early 1950s thousands of Soviet experts were placed in China and many of China's top students were sent to the Soviet Union for practical training and education in Soviet universities. As Teiwes notes, in the early years of the republic, emulation of Soviet methods and theory, placing Soviet experts in key ministerial, enterprise, military, and other advisory posts, and publications of Soviet literature had become a central part of political life.

Thus, in the early years of the People's Republic, its economic policies and development strategies were built essentially around the example set forth by the Soviet Union (with a few deviations). Agricultural collectivization was pursued, land was redistributed and its system of ownership reformed, and Soviet style political and economic institutions were developed to facilitate the implementation of a centrally planned economy geared towards heavy industry. The strategy of emulating the Soviet system of state socialism was pursued with a substantial degree of success. By 1952, production in China had recovered, nearly attaining prewar levels, and the objectives of the First Five Year Plan (1953-57) were attained ahead of schedule. More importantly, the leadership had fulfilled its fundamental objective of socialist transformation and had successfully lay the groundwork for the construction of a communist society. Political and economic institutions were constructed and the basic socialization of the means of production had been achieved in both agriculture and industry. The success of the First Five Year Plan and the large strides taken in the first years of the new republic kindled the revolutionary enthusiasm of the CCP elite and prompted the government to launch an even more

157 Lieberthal, p. 88.
160 Clyde and Beers, p. 452.
ambitious Second Five Year Plan in 1957.\textsuperscript{161} This plan called for even greater (and seemingly unrealistic) overall increases in industrial and agricultural production for the years 1958-1962, and reflected the optimistic thinking of large elements of the CCP elite.\textsuperscript{162}

It is important to observe that despite the emphasis on the Soviet model and its government's heavy involvement in China's socialist transformation, its influence did not eliminate independent thinking in China.\textsuperscript{163} After succeeding in transforming and revitalizing the war torn economy, the CCP readjusted its approach to development and began questioning the use of the Soviet Union as a developmental model. Indeed, the new regime's economic policies did not follow such a steady pattern after the initial successes of the 1950s. During the years 1956-1957, Mao and the CCP leadership debated intensely on matters regarding economic development, and it was during this time that the shortcomings of the Soviet model were identified and considered.\textsuperscript{164} For example, the balance between heavy and light industry, which the Soviet Union had set at 8:1, was a topic of considerable controversy. In his famous speech "On the Ten Major Relationships," Mao addressed this issue, airing his concerns with the Soviet model's over concentration on heavy industry and exploitation of agriculture, and suggested that the ratio be reduced. The debates over economic policy within the CCP leadership during this period were largely a result of the perceived incompatibility between the Soviet model and the Chinese situation. Whereas in the Soviet Union, industry was fueled to a large extent by the cruel exploitation of agriculture, in China this was not possible since the CCP's main constituency was the country's peasants.\textsuperscript{165} Other possible explanations for the reconsideration of the Soviet model are diverse. Analysts note how Mao's dissatisfaction with the slow pace of progress

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\item \textsuperscript{161}The five year plan is largely unmentioned in most historical accounts of the period. It was announced during the period when the leadership was heavily engaged in economic policy debate. The outcome of the debates being largely inconclusive, the second five year plan was essentially abandoned as China engaged itself in the disaster of the Great Leap Forward.
\item \textsuperscript{162}Hsu, p. 654. The Second Five Year Plan called for an overall increase of 7% in both agricultural and industrial production by 1962 and a 50% increase in national income. For example, target figures included: coal, 190-210 million tons; steel, 10.5-12 million tons; electricity, 40,000-43,000 million kwh; crude oil, 5-6 million tons; grain, 275 million tons; and cotton, 2.4 million tons.
\item \textsuperscript{163}Teiwes, op. cit., p. 44.
\item \textsuperscript{164}For a very detailed look at the economic policy debates of the 1956-58 period, see David Bachman, \textit{Bureaucracy, economy, and leadership in China: The institutional origins of the Great Leap Forward}, Cambridge: Cambridge University Press, 1991.
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vis a vis the West and his utopian visions (as well as ideological passions) for a classless, socialist society engendered his push to reorient the nations' development strategy and rewrite national economic policy. Other possible explanations point to the political problems associated with the impending Sino-Soviet split.

The reconsideration of the Soviet model within CCP leadership circles had three strands.\textsuperscript{166} The central planning, administrative approach adopted from the Soviet Union represented one position. Supporters of this position came mostly from those whose bureaucratic and career interests originated from within the heavy industry ministries and the state planning apparatus. Opposing this position was the "market socialism" option, articulated most forcefully by the economist Sun Yefang and the leading economic official Chen Yun.\textsuperscript{167} The advocates of market socialism supported the introduction of material incentives and basic market mechanisms within the framework of a state led command economy. Mao on the other hand rejected both positions, and it was his profound influence on the policy process that shaped the direction of policy during this turbulent period.\textsuperscript{168}

The critical years of 1956-57 saw a series of fateful decisions made by the CCP leadership regarding economic development strategy. Rather than continuing to duplicate the Soviet model, or introduce market mechanisms into the economy, what ensued was change of economic policy in a distinctively Maoist direction.\textsuperscript{169} Even before the goals of the Second Five Year Plan had been attained, the government announced a new economic policy initiative, the Great Leap Forward Movement (GLF), which Mao believed would expand Chinese industrial production to the point of surpassing Great Britain within fifteen years (1972). Formally adopted at the Second Session of the Eighth Party Congress in May 1958, the Great Leap Forward was a new and innovative approach to economic development which shunned technical expertise and Soviet style planning in favor of mass


\textsuperscript{167}See Bachman, op. cit. In \textit{Bureaucracy, economy, and leadership in China: The institutional origins of the Great Leap Forward}, David Bachman identifies a planning and financial coalition which represent these two lines I have discussed.

\textsuperscript{168}See Frederick C. Teiwes, \textit{Leadership, Legitimacy, and Conflict in China: From a charismatic Mao to the politics of succession}, op. cit., for a detailed delineation of the Mao centered / "Mao in Command" policy model.

\textsuperscript{169}See Gordon White, \textit{Riding the Tiger: The Politics of Reform in Post-Mao China}, op. cit., ch. 1 for a discussion of the tenets of "developmental Maoism."
mobilization and political exhortations. Rather than providing the work force with economic and material incentives, the logic behind the new strategy was to provide motivation through revolutionary ardor and political zeal. The fundamental idea behind the GLF was that China could bypass the normal stages of economic development through the expenditure of extraordinary efforts by the entire society for a period of several years.\(^{170}\) However, as history has shown, the GLF was a failure of massive proportions. Tens of millions of people starved to death and the economy spiraled into a deep recession. Schemes such as the attempt to fashion "backyard" steel furnaces were an enormous failure as they produced large quantities of useless, low quality materiel. Further exacerbating the situation, the years 1959-1961 saw the withdrawal of Soviet aid and technical expertise (due to the Sino-Soviet split) and consecutive years of bad harvests due to bad weather.

The disaster of the Great Leap Forward was a direct articulation of China's break with the Soviet model and its adoption of the Maoist paradigm of development.\(^{171}\) "Maoism" or "developmental Maoism," as Gordon White terms it, was an effort to construct a distinctive form of state socialism which served as an alternative to the Soviet model and conformed to China's national situation. As White describes it, "the Maoist experiment seemed to represent a serious attempt to break the classic Soviet mold of communist-led state socialism and establish a new pattern of development led by a new form of state committed to socialist values of equality, mass participation, and collective solidarity."\(^{172}\) Mao believed that the party had to galvanize the state's administrative machine and mobilize the entire population for developmental purposes. The revolutionary state was to lead the developmental process, mobilizing a continuous revolution of leaps forward, in a continuous struggle against economic backwardness.\(^{173}\)

By late 1960, it had become clear that the economic policies of the Great Leap Forward had created an economic disaster of serious proportions. Faced with severe food

\(^{170}\) Lieberthal, op. cit., p. 103.
\(^{172}\) White, p. 3.
\(^{173}\) Ibid., pp. 22-3
shortages and the threat of widespread famine, the leadership was forced to take emergency measures to remedy the situation. What began as a series of ad hoc emergency measures, became what Maurice Meisner calls the "new economic policy."\textsuperscript{174} Meisner argues that the economic policies adopted by the Chinese in 1961-65 were similar to those implemented by Lenin in 1921.\textsuperscript{175} That is to say, the government retreated and deviated from socialist economic policies in an effort to combat a poor economic situation. The strategy of the "new economic policy" was officially announced at the Ninth Plenum of the Eighth Central Committee in January 1961, its guiding slogan being "readjustment, consolidation, filling out, and raising standards." It put agriculture at the forefront, recognizing "agriculture as the foundation of the economy, and industry as the leading sector."\textsuperscript{176} It also gave small concessions to non-socialist economic methods. Greater emphasis was placed on the criterion of "profitability" in the operation of enterprises, authority of managers and technocrats were strengthened, and wider scope was given to the free play of market forces and the role of material incentives.\textsuperscript{177} With Mao personally taking a back seat at the time, the readjustment policies of the post-GLF period were drawn up and implemented by many of China's leading figures, most notably Liu Shaoqi. The readjustment policies of the period were thus a departure from the radicalism of the previous years. It was designed to help the economy readjust and recover from the devastation of the GLF, and avert any further economic and human disasters. For the most part, it was largely successful in doing so. In the judgment of one observer, by 1965, the economy appeared to have recovered from the setback suffered under the Great Leap Forward.\textsuperscript{178} According to official reports, grain output rose from a low of 193,000,000 tons in 1961 to 240,000,000 tons in 1965; and between 1963-65, industrial production grew at an annual rate of approximately 11 percent.\textsuperscript{179}

\textsuperscript{175}ibid., pp. 275-76.
\textsuperscript{176}Riskin, p. 149.
\textsuperscript{177}Meisner, p. 275.
\textsuperscript{179}Meisner, p. 280.
The most important consequence of this period however, was not its economic outcomes but its derived political significance and the effect this would have on future economic policy. As in 1956-57, the period 1961-64 saw the reemergence of an intellectual debate over economic development strategy. The lines of debate in this period can be drawn between: "Maoism" and "Liuism." Maoism was represented by those who supported the helmsman's policies, such as Lin Biao. Liuism represented economists and officials who sided with the general direction of "market socialism." Identified with important names such as Liu Shaoqi, Bo Yibo, Chen Yun, and Deng Xiaoping, Liuism favored extended scope for individual enterprise and market-oriented activity in the countryside, readjustment of the command economy in favor of increased enterprise autonomy, and professionalization of economic management along with its separation from local political control.

The relative success of the period's economic policies, based on the use of non-Maoist, non-Stalinist methods had socioeconomic consequences that were antithetical to the Maoist vision of China's future. Mao and his followers found these consequences both distasteful and intolerable, and it was this sentiment that fueled Mao's return, in the summer of 1962, to the forefront of the policy process. While the new economic policies had succeeded in restoring economic health, it had not come without social consequences. The price to be paid for economic progress was new forms of inequality. These emerging inequalities were the growing disparity between an upper and lower stratum of peasants, a rising stratum of industrial workers and a newly emerging technological-bureaucratic elite. The other emerging inequality of concern was the growing economic and cultural gap between the countryside and the cities. It was precisely these socioeconomic consequences that Mao was deeply concerned with and which prompted him to return to the forefront of policy-making.

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180 Ibid., p. 275.
181 Riskin, p. 179.
182 Meisner, p. 280.
The Socialist Education Movement of 1963 was Mao's first response to the perceived decay in China's socialist system. The chairman was deeply concerned with the growing social inequities, rising bureaucratic elitism, and the process of ideological decay that the first decade and a half had produced. He felt that such trends were leading away from the ideals of his revolution. As Hsu points out, one of Mao's most pressing concerns was the apparent reluctance of the party ranks to perpetuate revolution.183 The Socialist Education Movement, which originated in 1962, thus lay the groundwork for the rejection of the Liuist line and the eventual implementation of the policies of the Cultural Revolution.

The Great Proletariat Cultural Revolution was a completely political campaign, and unlike the Great Leap Forward, did not include any major innovations in economic policy and strategy. On the economic policy front, the period did however, mark the end of the Liuist prelude and the market socialist option. Many key figures representative of more "liberal" policy lines, such as Deng Xiaoping, were in fact disgraced and purged from the CCP during this chaotic period. Insofar as economic policy existed during the Cultural Revolution, it was based on the Maoist principles of "self-reliance" and "egalitarianism."184

During the first few years of the Cultural Revolution, the Chinese economy largely stagnated because of disruptions in transportation, decline in worker discipline, and virtual destruction of the central statistical apparatus.185 Industrial output fell some 13% in 1967, but by 1971 had fully recovered.186 Gross value of agricultural output also improved, having grown 35.7% between 1966 and 1975.187 In the assessment of Harding, the Cultural Revolution had surprisingly few deleterious effects on the domestic economy. This might be a somewhat generous conclusion; the Cultural Revolution did impede any significant economic progress that may have taken place during these years.188 Moreover,

184 See Riskin, ch. 9 and 10.
188 Harding, p. 240.
the apparent growth within the economy articulated by these aggregate figures was misleading. They masked increasing problems and structural imbalances in the Chinese economy as well as the fortuitous discovery of oil.\textsuperscript{189} More importantly, economic growth was not felt by the populace as living standards did not improve. By 1973, the Cultural Revolution had largely died down as Mao's health forced him to recede from the forefront of the political scene. The remaining three years till Mao's death (approx. 1973-76) witnessed a seesaw battle for political control between two factions: the "moderates" headed by Zhou Enlai and later Deng Xiaoping, and the "radicals," led by Jiang Qing. Again, little progress was made in the areas of economic policy and strategy during these years.

The death of Chairman Mao in 1976 marked the end of an era in Chinese politics. However, it did not bring the cessation of socialist/Maoist economic policies as the radical faction continued to hold on to the reins of power. In fact, Mao's designated successor, Hua Guofeng, attempted to continue the Maoist course, minus its more radical elements.\textsuperscript{190}

At the First Session of the Fifth National Party Congress in February 1978, Hua announced the details of a new ten year plan, which embodied developmental Maoist ideals and traditional notions of central planning, production targets, and state management. According to Riskin, Hua's plan contained a "curious mixture of pre and post Mao ideology and policy."\textsuperscript{191} The logic of the new ten year plan was simple: dismantle the more radical Maoist elements of economic policy and emphasize the rehabilitation of the command economic system.\textsuperscript{192} The ten year plan was somewhat of a return to the ideas of Stalinist political economy practiced in the early years of the People's Republic. It emphasized heavy industry, mega projects in industry and transport, as well as lofty production targets.

\textsuperscript{189}Saich, p. 14
\textsuperscript{190}Hua Guofeng and his supporters became known as the "whatever faction" because of their adherence to the "two whatevers": whatever Mao had decided would remain valid, and none of Mao's instructions should be contravened (Lieberthal, \textit{Governing China}, p. 124). With the disgrace of the Gang of Four, the "whatever factions" represented the "radicals" within the CCP.
\textsuperscript{191}Riskin, p. 260.
In an effort to portray his continuity with the chairman's policies (whose endorsement Hua desperately utilized for legitimation) Hua had no inclination to fundamentally change China's approach to economic development or to implement new and innovative economic policies. He and his supporters were satisfied with reinventing the Maoist course, complementing it with minor modifications as dictated by economic circumstances. For Hua, power and policy were inextricably intertwined. However, as history has shown, Hua's ten year plan failed and his tenure at the apex of the Chinese political system was short lived. The turning point came at the Third Plenum of the Eleventh Central Committee in December of 1978 as the head of the moderates, Deng Xiaoping, emerged from the political graveyard once again; this time as China's new paramount leader.

Deng Xiaoping's eclipsing of Hua Guofeng's position concluded nearly three decades of socialist and Maoist economic policy in the PRC. This synopsis has highlighted the major economic policies of that period, during which economic policy and strategy was subject to variations, but overall, not representative of fundamental change. More importantly, this overview of policy has helped us draw up the contours of the political and economic setting of the post-Mao reform period. After nearly three decades of socialist and Maoist economic policies, economic stagnation and political uncertainty characterized the economic setting of the immediate post-Mao period. China's post-Mao economy was beset with a wide range of difficulties that made economic policy reform a very attractive policy alternative. The political context of the post-Mao period was marked by a serious crisis of legitimacy for the CCP as well as the issue of succession. Decades of political and economic turmoil had brought on a strong sense of disillusionment among the Chinese populace. This sentiment, combined with a stagnant and underdeveloped economy had much eroded the people's support for the regime, creating a political crisis impossible to ignore. As the argument presented later in this chapter will show, both economic and political factors potentially explain the decision to adopt market opening economic reforms.

193See Ibid., pp. 70-74 for details.
3.2 The Era of Reform: Economic Policy in the Deng years (1978-present)

In December of 1978, Deng Xiaoping and his moderate supporters gained power at the Third Plenum of the Eleventh Central Committee of the Chinese Communist Party. Deng and his group of supporters had long concluded that the enormous political and economic problems facing China required a major overhaul in policy and strategy. Beginning in 1978, Deng used his position to launch a reform program aimed at economic development and opening the door to the outside world. Barry Naughton divides the reform era in China into three periods: 1978-83, the initiation of reform; 1984-88, the second phase of reform; 1989-93, renewed reform and the move towards a market economy. The following section looks at the first and second of Naughton's three periods: the initiation and extension of reform in post-Mao China. The economic reforms which took place in the first six years of Deng's rule (a period which covers both the first and second of Naughton's phases of reform: 1978-1984), mark the point of departure from economic policy and strategy in the Maoist era. The transition from state socialism to market opening reforms in the PRC thus represents our dependent variable: i.e. a definitive case of substantial economic policy and strategy change. An exact date for the transition is difficult to establish since many key reforms occurred over the course of the first two phases of reform. Many important reforms took place in the 1978-81 period, before the retrenchment, while other key reforms occurred in 1981 (the explicit decision to decollectivize) and 1984 (the ratification of the 1984 document, which specified far-reaching industrial reforms). For the purposes of this case study, it is assumed that 1984 marks the culmination of the transition from state socialist to market oriented economic policy and strategy. Section 3.2b below attempts to highlight and describe the policy and strategy reforms that took place during this period. As a prelude to this largely empirical discussion, section 3.2a outlines the intellectual debate surrounding the initiation of

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\(^{194}\) Ibid., ch. 2.
economic policy reforms. It illuminates the reintroduction of alternative policy ideas into the Chinese policy process.

3.2a The Intellectual Debate: The Rise of Alternative Economic Ideas

At the end of 1979, The Chinese Academy of Social Science economist Xue Muqiao published a book, *Studies on China's Socialist Economy*, strongly critical of China’s neo-Stalinist centralized planning economic system. Xue's book made a strong case for systemic economic reform. It proposed several fundamental reforms: comprehensive price reform; granting of greater autonomy to enterprise managers in personnel matters (hiring and firing); and the retention of enterprise profits for investment. Xue also suggested that managerial efficiency and productivity could be increased through the economic discipline of the marketplace rather than through the administrative direction of state planning. In another book published in 1980, *Current Economic Problems in China*, Xue suggested that the lack of market regulation mechanisms was the greatest weakness of China's national economic management system. In his words: "the greatest weakness of our national economic management system, was to replace economic management with administrative management. There was only plan regulation, and no market regulation...It is not possible to do away with market regulation." While he stopped far short of calling for the dismantlement of central planning, Xue endorsed the idea that "to regulate production according to market demand is ideal as a supplement to regulation...by planning." Xue's book is but one example of the reform debate taking place in the period between 1979-1981. In a succinct discussion, Fewsmith provides an overview of another debate forum, The Wuxi conference of 1979, which brought together

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196 Baum, op. cit., p. 94.
198 Baum, p. 94.
leading economists for a discussion on the direction of reform. At the Wuxi conference, many economists displayed their willingness to critically question the fundamental underpinnings of the Marxist-Leninist economic system.\footnote{Joseph Fewsmith, op. cit., p. 66.}

In general, the period between 1979-81 saw the flowering of fresh, new ideas with respect to economic policy and strategy. In this more relaxed intellectual and political environment, debate was open to ideas concerning China's economic system and its national development policies and strategies. Deng's ascension to power had facilitated this reemergence of open political debate in the Chinese political system, unseen since the years of the Hundred Flowers Movement in the 1950's. Another important factor was the return of Chen Yun to the politburo, and his assumption of responsibility over economic policy.\footnote{Naughton, p. 75.} In short, the political positions of Chen and Deng returned legitimacy to economic ideas previously relegated to the scrap heap of infeasible policy choices.

3.2b The Content of the Reform Program: Economic Policy (1978-present)

In December 1978, at the Third Plenum of the 11th Central Committee of the CCP, the government proposed sweeping changes in rural economic policies, which were implemented in the period following the Plenum. The new policies proposed the replacement of the heavy emphasis on grain production with the development of a more diversified agricultural economy. The primary measures were raising agricultural prices and providing greater economic autonomy to the agricultural collectives.\footnote{Ibid. p. 139.} For example, an important policy innovation was the Plenum's adoption of a 20% increase in agricultural procurement prices, to be combined with a corresponding decrease in the prices of agricultural inputs.\footnote{Ibid. p. 75.} Policy-makers hoped that this would return agricultural production to profitability and make it less difficult to enforce output targets.\footnote{Ibid. p. 139.} In addition, production teams were granted more freedom in decision-making, private plots of land

\footnote{Joseph Fewsmith, op. cit., p. 66.}  
\footnote{Naughton, p. 75.}  
\footnote{Ibid. p. 139.}  
\footnote{Ibid. p. 75.}  
\footnote{Ibid. p. 139.}
were revived and expanded, diversified production was encouraged, greater material incentives to production were introduced, sales and purchase channels were diversified, and procurement quotas were later replaced by voluntary contracts between peasant producer and state.\textsuperscript{204} The objectives of such policies were: 1) to increase the volume of production, and contribute to the development of a more dynamic agricultural economy; 2) to attempt to equalize rural and urban income inequalities; and 3) to put into peasants' hands money that would be used on productive investments.\textsuperscript{205} In short, the agricultural sector reforms were designed to move away from direct state control over agriculture towards more market-oriented methods of regulation. As the discussion below details, the agricultural policy reforms would have far reaching effects on China's rural economy.

The single most important agricultural reform aimed at altering the previous mode of production was the introduction of the "household (or production) responsibility system." (shengchan zirenzhi). This reform would ultimately entail the dismantlement of the agricultural people's communes, the centerpiece of Mao's rural economic structure. It is important to note that the reform polices of the Deng era were not constructed or implemented according to a clear blueprint.\textsuperscript{206} In fact, the reforms were often undertaken in a piecemeal and incremental fashion, often as a reaction to specific problems within the economy. In the case of agriculture, reforms often began cautiously as small scale experiments in selected areas.\textsuperscript{207} The agricultural responsibility system was no exception to this. The "responsibility system" grew out of the experiments undertaken in Sichuan and Anhui provinces in the period between 1978-1979, under Zhao Ziyang and Wan Li,


\textsuperscript{205} Kathleen Hartford, "No Way Out? Rural Reforms and Food Policy in China," pp. 74-114, in Marta Dassu and Tony Saich, eds., The Reform Decade in China: From Hope to Dismay, London and New York, Kegan Paul International, 1992; Riskin, Chapter 12; and Naughton, ch. 2-4.

officials who would later rise to prominent positions within the CCP leadership. The success of these experiments led to its emulation in other regions of the country and it eventually became co-opted by the government as official policy.

The household responsibility system was the driving force behind the growth of agricultural output in the 1980's. By 1982 nearly all rural households had adopted the new system, which all but replaced the commune system's rural structure. In the face of this rapidly changing reality, formal blessing by the government was given in the same year. Under the responsibility system, land is contracted to individual households for a period of fifteen years (or more). After fulfilling procurement quota obligations, farmers are free to sell their surplus on the open market or to the state at higher than quota prices.\textsuperscript{208} Under the new system, individual households were responsible for the entire process of production and the management and distribution of revenue. By introducing market mechanisms, real material incentives were placed into the system which had the effect of spurring production, raising living standards and income levels, and diversifying agricultural output. The growth rate in annual grain production rose from 2.1\% during the period 1957-58 to 4.9\% during the period 1979-84.\textsuperscript{209} 1984 saw a record harvest of 407 million metric tons.\textsuperscript{210} Per capita farm income also rose, from 134 Yuan in 1978 to 310 Yuan in 1983 and 463 Yuan in 1987.\textsuperscript{211}

Another important consequence of this system was the stimulus it provided for rural industry and private enterprise, thereby promoting growth in the non-state sector of the economy. With the increase in productive efficiency, excess workers created a growing labor base which rural and urban industry could potentially absorb. Likewise, the corresponding increase in rural incomes created a consumer base with additional income and a vociferous demand for new consumer goods. The institutionalization of the responsibility system also had the effect of encouraging peasant households to move into

\textsuperscript{208} Lin, p. 158; and White, \textit{Riding the Tiger}, p. 101.
\textsuperscript{209} Hsu, p. 846.
\textsuperscript{210} Ibid.
\textsuperscript{211} Ibid. For a detailed look at agricultural performance after 1979, see Riskin, p. 290-99. Riskin's chapter look at the increasing diversification of the rural economy and the narrowing of the rural-urban income gap for the period 1979-1984.
various kinds of private enterprise, almost unheard of in the Maoist era. Since less time was required of peasants to attend to the land, this gave them the opportunity to work in the burgeoning non-state sector emerging in the townships and villages. The flourishing of township-village enterprises has been documented by many analysts. According to one study, by the end of 1992, township-village enterprises produced anywhere from one quarter to one third of China's industrial output.

Reforms in agriculture were also accompanied by reforms in government policy toward rural enterprises. As Naughton notes, the crucial shift in policy was not support for "rural industry" per se, (for the state had been supporting rural industry since at least 1970); rather, the change in policy was the abandonment of the restrictive model of rural industrialization that had confined its growth primarily to a few agricultural producer goods. Taking a new approach, the state relaxed its monopoly on the purchase of agricultural materials, allowing producers to make them available to rural enterprises for processing. This liberalization contributed to both the expansion of rural industry and the growth of the non-state sector as well as to the increase of agricultural production.

The post-Mao reforms were not confined to the agricultural sector. Between the years 1978-1980, the Chinese government began a vigorous program to reform Chinese industry and the entire state sector. Reform centered around two central initiatives: expanding enterprise autonomy and combining plan and market in the domestic economy. Like reform in agriculture, the reform policies in the industrial sector have not been introduced in accordance with a clear blueprint. They have occurred in a piecemeal and incremental fashion, sometimes the result of local experiments, sometimes the result of special agreements between Beijing and the provinces, and sometimes a consequence of

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212 Riskin, p. 289.
214 Naughton, p. 147.
215 Ibid.
216 For a detailed examination of China's industrial reforms, see Gene Tidrick and Chen Jiyuan, eds., China's Industrial Reform, New York: Oxford University Press, 1987. Also see Barry Naughton, Growing out of the plan; and Riskin, China's Political Economy.
217 Naughton, p. 97.
central government policy. The centerpiece of the industrial reform program is the enterprise profit retention system or the "Industrial Responsibility System." Under this system, a state enterprise signed a "profit and loss contract with a supervisory body, agreeing to remit a quota of profit to the state and retaining the remainder of the above quota profit.218 These "extra" profits could be used for bonuses, employee welfare benefits, investment, and other innovations. The profit retention system was a micro level policy innovation designed to allow enterprises to bear more responsibility for their operation, and to give them incentives for production and innovation. Other reforms implemented included permission for enterprises to sell extra-plan output through market channels, decentralization of resource allocation, raising of wages between 1978-1980, and the reinstatement of bonuses.219 By decentralizing control over finances and material resources, the balance between state and enterprise, and plan and market was transformed.220 Enterprises were to be given increased autonomy and to rely more on the role of the market in guiding output, motivating production, and managing the work force.

The reform policies of the early 1980's illustrate the extent to which the reformers were interested in increasing labor productivity by watering down the "iron rice bowl" system of lifetime employment and equity in compensation. Reformers advocated the use of bonuses, giving increased leverage to enterprise managers over the management of personnel, and lessening the role of the party representative within the enterprises. Despite the attempts at reform, there has been a substantial amount of resistance from those elements with vested interests in the state sector and central planning bureaucratic apparatus.

The issue of price reform was saddled with similar difficulties. It was the subject of intense debate between the policy coalitions within the top leadership and was faced with strong resistance from various institutional sectors. On October 20, 1984, the CCP passed a new "Resolution on the Reform of the Economic System." The 1984 document marked a

218Hsu, p. 850.
219Perry and Wong, p. 12.
220Ibid.
second important turning point in the economic transition. Spurred by the successes of the first half decade of reform, the party sought to accelerate the pace of urban and industrial reform. The CCP boldly announced that price reform, was "the key to reform of the entire economic structure," and would be gradually implemented. Price reform, championed by then Premier Zhao Ziyang, would enable the state to withdraw its subsidies and allow prices to float according to the market forces of demand and supply. It was a critical step in the move towards combining plan and market within the economy (the dual track economy). Price reform was the central component of a reform strategy designed to freeze the role of the plan and eventually gravitate towards an economic system based on the role of market forces. Enterprising were to eventually become self-managing entities responsible for profits and losses, and with the authority to determine their own prices, labor force, and organizational structure. In short, the 1984 document marks a second more intensive phase of industrial policy reform. Building on the reforms of the first phase, the 1984 document sought to implement more far-reaching reforms aimed at making more considerable strides towards growing out of the central plan into a market economy.

In addition to restructuring the relationship between state and enterprise, the reformers also took steps to decentralize power to the provinces. The provinces were given greater autonomy in running the economies within their jurisdiction and more state-owned enterprises controlled by the central government were delegated to local government control. As Montinola, et al. conclude, because of the decentralization of authority, regional and local governments "have assumed the primary responsibility for economic development" in their respective regions. They argue that measures such as the new fiscal contracting system have created incentives that make it in the interest of local and regional government officials to foster prosperity. Augmenting these increased powers, some of the provinces were given authority to open Special Economic Zones

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221 Riskin, p. 347.
222 Hsu, p. 855.
223 Naughton, p. 180. See chapters 5-6 for details of the second phase of reform.
224 Montinola, Qian, Weingast, p. 12.
225 Ibid., p. 15.
(SEZ) in 1979. Shenzhen, Shantou, Xiamen, and Zhuhai (located in the provinces of Guangdong and Fujian) were the first cities given special permission to open these zones. The SEZs were modeled after the export processing zones constructed in the East Asian NICs. Foreign firms were encouraged to invest in the SEZs where economic and fiscal regulations were relaxed, taxes were minimal, and labor was cheap and plentiful. The opening of the SEZs and the fourteen "coastal open cities" was an important aspect of decentralization, since it gave increased power to the provinces over economic development.

The establishment of SEZs was a centerpiece of the Open Door Policy adopted by the party in September of 1978. Deng Xiaoping and his reformist allies concluded that because no country had ever achieved modernization by "closed door-ism", China must join the world economy in order to achieve its developmental goals. Beginning in 1978, the Chinese government opened the country's borders to foreign trade, travel, and political, educational, and cultural exchange, and set up export processing zones. In order to modernize, China must import the technology, science, capital, and management skills that could only be acquired through access to foreign expertise.

In sum, in the first six years of Deng's rule, substantial changes in economic policy and strategy occurred. Comparing the policy reforms undertaken in this period with the policies and strategies of the Maoist era has illuminated just how comprehensive the reform process was.

3.3 Analysis

In the analytical section that follows, I show how economic, political, ideational, and institutional factors form the basis of a multi-causal explanation of economic policy

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227 Hsu, p. 858.


change in post-Mao China. As is the case with policy change in the ROC, the argument presented here contends that no single explanation tells the story of why the PRC made the decision to engage in economic policy changes. Section 3.3a looks at the political and economic variables, while section 3.3b looks at how ideas and institutions can contribute to our understanding of economic policy change in the PRC.

3.3a Analysis: Economic and Political Rationales

By the mid 1970s, China's economy was in a shambles, yet paradoxically, not in crisis. China's economy was not submerged in a deep and long recession. In fact, from the late 1960s to the post-Mao reform period, China's economy had been growing at what Perkins describes as an "unremarkable but nevertheless quite respectable rate."\textsuperscript{230} Perkins' research shows that China's GNP has steadily increased (with the exception of a few years during the GLF and Cultural Revolution), nearly quadrupling since 1949.\textsuperscript{231} There was every reason to believe that policy continuity would allow the economy to continue on its mediocre course for several years.\textsuperscript{232} However, as most economists noted, China's relatively healthy aggregate economic performance concealed an array of major economic problems.\textsuperscript{233}

The economic problems faced by China at the end of the reform era were legion. After decades of central planning and Maoist economic policies, the Chinese economy had not yielded any significant economic results in the way of improved living standards, technological modernization, or productive efficiency. Slow income growth, inefficiency in agricultural production, and inept transportation systems produced urban food shortages. State industry was plagued by chronic inefficiency, as well as production and coordination inadequacies. In 1976, over one third of all state-owned enterprises were running at a

\textsuperscript{232}Naughton, p. 64.
\textsuperscript{233}Perkins, pp. 40-1; Saich, p. 14; White, p. 31.
loss.\textsuperscript{234} Shortages of fuel, electric power, and transportation facilities caused 20-30 percent of industrial capacity to go unutilized, resulting in an estimated 75 billion Yuan in output foregone.\textsuperscript{235} Inefficiency in resource utilization had gradually increased over the Maoist period. According to reports, the national income produced per 100 Yuan of fixed assets averaged 34 Yuan during the 1976-1979 period, compared with 52 Yuan during the First Five Year Plan.\textsuperscript{236} Macroeconomic mismanagement was another predicament. Excessive concentration on heavy industry starved other sectors of funds and retarded their growth. Agriculture was hit extremely hard as output per laborer rose only 5\% in real terms over the period 1952-1978.\textsuperscript{237} The productive inefficiency of the Chinese economy was rooted in structural and systemic factors; that is, deficiencies in economic organization, planning, and management. As Wu and Zhou have asserted, the fundamental problem with the Chinese economic system was the over centralized, administrative nature of the economic management system, which concentrated authority over economic decision-making in the hands of a small minority\textsuperscript{238} and left implementation to a massive, highly inefficient state bureaucracy.

With regard to the labor force, in 1978 urban unemployment stood at around 9.5\%, 20 million people were "waiting for work," and in the rural areas, the estimated number of underemployed, or "latent unemployment" was estimated at 100 million.\textsuperscript{239} In addition to unemployment, underemployment was a serious problem throughout the Chinese economy, as workers did redundant work or sometimes no work at all. Absenteeism was rampant and the core of the work force lacked motivation as well as a basic work ethic. Morale was extremely low. All of these problems combined to stagnate the productivity of labor. One of the major reasons for low labor productivity was the lack of material incentives,

\begin{footnotesize}
\begin{enumerate}
\item Perry and Wong, p. 4.
\item Ibid., p. 3.
\item Ibid., p. 4.
\item White, \textit{Riding the Tiger}, pp. 31-2.
\item Riskin, p. 276.
\end{enumerate}
\end{footnotesize}
which Maoist economic policy had almost entirely eliminated.\textsuperscript{240} Despite such circumstances, under the "iron rice bowl" system, workers were still guaranteed pay, access to housing, and the other numerous benefits distributed by the state through the work unit (danwei).

Structural imbalances in the economy also provided impulses for reform. Because of the overemphasis on heavy industry and the abolition of private enterprise during the Cultural Revolution, products geared towards household and individual consumption were noticeably absent within the Chinese economy.\textsuperscript{241} The collective economy was ill equipped to provide the incentives and means to replace the small, private entrepreneur. This created difficulties for the Chinese consumer as well as for China's foreign trade potential. In essence, a wide range of economic difficulties in the Chinese economy provided a clear impetus for policy reform. As this synopsis elucidates, policy reform had become a necessary response to a sour economic situation. Towards the end of the 1970's, as many Chinese political leaders and economists began to realize that the economic policies and system of planning and economic management practiced in the first three decades of the People's Republic had produced such economic problems, these concerns created internal pressures for policy reform.

Economic explanations of economic policy change are merely one side of a complex story. In fact, the more interesting questions and elusive answers pertain to the political explanations for the post-Mao economic reforms. The political rationales underlying economic policy change in the PRC are diverse: political variables such as regime security, elite political conflict and rivalry, and domestic political perception found their way into the political calculations of elite policy-makers, affecting all their policy decisions. Post-Mao economic policy reform in the PRC would not prove to be an exception.

\textsuperscript{240} Barnett, pp. 28-40.
\textsuperscript{241} Riskin, ch. 14.
In the case of the PRC, poor economic performance also had grave political implications for the leadership. By the immediate post-Mao period, the political costs of the numerous economic deficiencies were rapidly mounting. A stagnant and inefficient economy had retarded the rise of living standards (which in the late 1970s were not substantially higher than those in the mid 1950's). The lack of progress in this area created political difficulties for the regime in the form of a political legitimacy crisis. How could a regime continue to justify its mandate when it was incapable of improving the people's well-being? After three decades, the ideals of the revolution, which so many of the Chinese had based their hopes and aspirations on, remained unfulfilled. The years of political turmoil and economic stagnation had eroded popular trust in the party as well as brought loss of faith in the ideology of socialism. The classic image of the CCP as a great revolutionary savior had been tarnished and there was a pervasive sense of national disillusionment. After years of sacrificing for the revolution, the Chinese people sought for themselves a higher standard of living. Restoring the legitimacy and prestige of the CCP meant improving economic performance and raising living standards. As Perry and Wong confirm, the party had to shift its base from virtue to competence and demonstrate that they could provide for the people and "deliver the goods." Economic reform not only promised improvements in popular welfare, but also increases in national power. This also had significant political ramifications. Strengthening national power meant prestige not only in terms of domestic legitimacy, but international reputation as well. Since the turn of the century, successive Chinese governments have struggled to place China into the exclusive family of great powers and shed the humiliations of foreign domination.

Further evidence of the national prestige argument can be found in the international political context of the 1970s. In the postwar period, Japan, the East Asian NICs, and

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242 Riskin, p. 261.
243 The lack of growth in living standards was marked by stagnation in personal income and purchasing power growth (in the areas of housing, food, and consumer products).
246 Shirk, p. 23.
other developing countries had moved decades ahead of the mainland in economic
development, technological advancement, and general socio-economic progress.\footnote{White, p. 35; and Naughton, p. 63.}
Particularly humbling was the recognition of the success and dynamism of Asian capitalism
in East Asia (most notably in Taiwan). Visits to countries throughout the world opened
the eyes of China's leaders, who with the aid of a comparative perspective, expressed
shock, dismay, and disillusionment at the state of affairs in their own country. It was
market capitalism not state socialism that had succeeded in providing the most outstanding
developmental results over the postwar decades. China's leaders began to realize that years
of high growth rates (measured in terms of gross output) had done little to develop the
economy and advance the well-being of its populace. The effect of what was going on in
Chinese centers such as Hong Kong, Taiwan, and Singapore greatly damaged China's
national prestige, thus providing a strong political rationale for reform.

Another type of political explanation of economic policy change in the PRC stems
from elite political conflict within the CCP (the "succession competition" thesis).\footnote{The "succession competition thesis" is explicated in Shirk, The Political Logic of Economic Reform in China. For a critique see Yasheng Huang, "Information, Bureaucracy, and Economic Reforms in China and the Soviet Union," World Politics, October 1994, 47:1, pp. 102-33.} The period between 1976 and 1978 saw an intense succession struggle between moderate and radical factions within the CCP. Economic policy reform became Deng's main platform in his competition against Hua Guofeng for the CCP leadership.\footnote{Shirk, pp. 36-7.} As Shirk argues forcefully, Deng shrewdly promoted market reforms "not only because he clearly believed they were the best solution to improving economic performance and raising living standards but also because they offered political advantages."\footnote{Ibid., p. 37.} By adopting a reform stance, Deng separated himself from the legacy of Maoism, discrediting Hua while presenting himself as a more appealing alternative.\footnote{Ibid., p. 38.} Championing reform also endowed Deng with political resources.\footnote{See Ibid., 36-8 for an extended discussion.} Deng realized that he needed to enlarge his network of
supporters. By breaking with the Maoist past, Deng could gain valuable political allies by handing out special economic benefits to various localities and bureaucracies. By creating vested interests in economic reform policies, Deng ensured the political support and loyalty he required to gain political control. Equally important, Deng solidified crucial support for his economic reform program.

Deng's desire to show his divergence with Hua Guofeng was intimately related with both the succession battle and the struggle to repair the domestic political legitimacy of the CCP. Research shows that new leaders commonly launch reform initiatives to shed the stigma of past associations. Therefore, succession in socialist systems, because of their infrequency, make it exceedingly likely that policy change will occur.\textsuperscript{253} Breaking with the Maoist legacy offered Deng political advantages in both these realms. By assuming the mantle of change, Deng presented himself as a bridge to the future, while linking Hua to the failures of the past. This image not only gave Deng powerful political advantages in the elite political struggles of the late 1970s, but the tactic also made domestic political sense vis-à-vis the wider population. In order to take strides towards reestablishing the legitimacy of the party, it was politically prudent for the new leadership to attempt to demonstrate a clear break with the past. Economic policy reform represented a pivotal step in this direction. This disgust with the past was not only important in terms of domestic political perception, it also had significance within CCP elite circles. Perry and Wong have suggested that the bitter experience of the Cultural Revolution was one of the key political reasons compelling China's leaders to demand a dramatic departure away from the legacy of radical Maoism.\textsuperscript{254} Many of the leaders rehabilitated after the death of Mao had suffered enormous public humiliation during the years of chaos, and it was this distaste for the past which provided the incentive for fundamental change.

The succession struggle within the CCP provides a proximate answer to why economic policy changes were adopted in post-Mao China. However, the key point to

\textsuperscript{253} Perry and Wong, p. 7
\textsuperscript{254} Ibid., p. 5.
emphasize is that as rationales underlying reform, the political and economic spheres were interrelated. They were designed largely for the practical purpose of raising productivity and improving the standard of living. But interrelated with this objective was the desire of the leadership to prevent the onset of more political chaos, to forestall the crisis of legitimacy looming on the horizon, and maintaining the communist hold on political power. As Perry and Wong note, the package of reform enunciated in December 1978 had "both economic and political precipitants...and the goals of the reforms had both economic and political objectives." 255

The recognition of economic problems thus forms the starting point of any explanation of substantial economic policy change in the PRC. As this case study demonstrates however, economic factors are a necessary yet insufficient explanation. A wide range of political factors also provide compelling evidence that the decision to initiate economic policy reform was not simply a policy shift designed to alleviate economic difficulties. However, political factors alone do not confirm the insufficiency of an exclusively economic explanation. As the discussion below shows, ideas and institutions also illuminate important reasons for economic policy changes.

3.3b Analysis: Ideas and Institutions

Ideas have been extremely important as determinants of national economic policy in the PRC. This comes as no surprise in a country where ideology plays such a central role in politics. As Halpern demonstrates quite conclusively, ideas of Stalinist political economy were extremely influential in determining economic policy choices during the Maoist period. 256 In the 1960s and 1970s, the ideas of developmental Maoism were likewise able to attain an equally powerful stature.

The key to understanding how ideas influenced the initiation of economic policy change begins with the loss of credibility of Stalinist and Maoist economic ideas. Towards

255 Ibid., p. 6.
the end of the 1970s, there was a growing perception that the economic policies which these ideas gave birth to were the root cause of the country's economic ills. Policy delegitimation led to the opening of a "policy window" as officials began to reconsider the merits of previously employed economic policies and strategies, in addition to their ideational foundations. Once the policy window is open, policy-makers are given the opportunity to begin considering alternative policy strategies. If a certain set of ideas is relinquished, there is a natural need and desire to replace it. In post-Mao China, it was initially more a recycling of discarded economic ideas than the adoption of new and innovative economic ideas that took place. The political rehabilitations of Deng Xiaoping and Chen Yun were the main reasons that this recycling of ideas was allowed to take place. Deng was responsible for restructuring the stifling intellectual and political environment of the Maoist era. Academics, policy-makers, and bureaucrats were given increased political and intellectual freedoms. A wider range of debate was tolerated and this facilitated the flowering of economic ideas which had been buried amidst the political turmoil of the 1960s. The most notable of these ideas were those of market socialism. Chen Yun's return to the forefront of economic policy-making breathed new life into these ideas, giving them a new found credibility. They would take the place of the discredited economic ideas at the center of the ideational framework.

Without new ideas, substantial economic policy and strategy reform would have difficulty taking place. By the late 1970s, Stalinist ideas had become deeply institutionalized within the political-economic system. Bureaucracies had vested interests in the system of central planning practiced for nearly three decades, elite politicians found critical political support within various central planning ministries and bureaucracies, and broad policy coalitions existed which reacted with fierce resistance when faced with threats to key bureaucratic interests.\(^{257}\) In short, deeply entrenched bureaucratic interests served as barriers to substantial economic policy changes.

\(^{257}\)Bachman, p. 30.
According to Goldstein and Keohane, ideas can have an influence in one of two ways (see chapter 1, section 1.3). In China, ideas made their impact as a result of changes in the underlying conditions affecting the impact of existing ideas. Various changes occurred—economic stagnation, the discrediting of Stalinism and Maoism, a change in leadership; i.e. an overall change in the contextual background—that facilitated the search for and acceptance of alternative economic ideas. While the ideas that emerged were not entirely new, they shaped the direction of economic policy by changing the intellectual parameters of economic policy debate. Without a change in the intellectual boundaries, it would have been extremely difficult to initiate strategic and policy reorientation within the ideational framework of the Maoist period.

Institutional explanations of economic policy change suggest that the institutional framework of the Chinese political economy (the multitude of political/bureaucratic institutions and actors) explains economic policy change in one of two ways: 1) institutional change could explain the changes in policy; or 2) some aspect of the institutional framework could explain why policy shifted. In terms of the PRC case study, the first of these explanations is of minimal use. No significant institutional changes occurred between the Mao and Dengist periods. Economic policy reforms were implemented in the late 1970s within the same institutional framework that existed during the Mao years, making institutional change a weak explanation for economic policy reform. Institutional change was in fact more a byproduct of policy changes in the immediate post-Mao era than it was an inducing factor.

The second of the propositions presented here possesses greater explanatory power. Certain aspects of the institutional structure of the economic policy-making apparatus were conducive to economic policy reform in the PRC. Since the CCP came to power in 1949, a top group of "twenty-five to thirty-five" leaders headed by a core group of leaders have determined the direction of policy in all important spheres, particularly
economic matters.258 The status of this top leadership does not coincide with official political position.259 For example, included in this group are between four and seven party elders who are semi-retired and hold no formal positions or official responsibilities, yet continue to exert an extremely high amount of political influence. The party leaders can greatly influence policy direction and leadership composition and have the capability of challenging even the preeminent leader's initiatives.260 The rest of the group is composed of what Lieberthal and Oksenberg describe alternatively as "generalists" and "functional specialists." These leaders are involved with supervising and managing bureaucratic affairs and deciding on major policy issues.261 In short, the preeminent leader, revolutionary elders, and the remainder of the "group of twenty-five to thirty-five" play a dominant role in the formulation of economic policy and strategy. It is the dominant role that these institutional actors play that helps explain why economic policy change was able to take place. Since control over policy is concentrated into this core group, substantial changes and reforms are naturally, easier to come by. The political elite in China can shape both the parameters of policy debate and the direction of policy itself.

As this analytical section concludes, economic, political, ideational, and institutional factors all contribute insights to our understanding of economic policy change in the PRC. Economic factors, as they often do, serve as the starting point for economic policy changes. Strategic reorientations are often initiated to alleviate economic problems, but as this case suggests, they are seldom the sole factor underlying the initiation of policy change. Interrelated with the economic variables are political considerations which have an equally significant influence on economic policy decisions. Finally, institutional and

259 Ibid., p. 35. Lieberthal and Oksenberg point out that membership within this inner circle is based more on a "combination of intangible attributes": standing with the preeminent leaders within the country, respect and influence one commands with his colleagues, network of personal ties, attractiveness of one's ideas and visions.
260 Ibid., p. 36. Also see Joseph Fewsmith, op. cit., for a discussion of the influential role of party elders in a policy-making context. Fewsmith focuses on elite conflict within the upper levels of the CCP and devotes special attention to the activities of Chen Yun. Fewsmith's discussion is very illuminating and it lends support to Lieberthal and Oksenberg's argument that party elders have a significant amount of influence on the policy process.
261 Ibid., p. 36.
ideational factors also explain in part why governments decide to engage in strategic reorientations. I elaborate on these conclusions in section 4.2 of the final chapter.
Chapter 4. Conclusions

This chapter attempts to compare and contrast the cases of economic policy change in the ROC and PRC and provide some theoretical conclusions. Section 4.1 presents a comparative examination of the two cases. It outlines some of the important similarities and differences between the two cases. Section 4.2 attempts to draw the two cases together in an effort to derive some theoretical conclusions. I argue here that both cases illustrate the extent to which economic explanations are insufficient as exclusive explanations of economic policy change. Economic policy change is a complicated phenomenon, and therefore unamenable to single variable explanations. It is argued here that we should move towards a multi-causal explanation of economic policy change that pays attention to the political and economic context within which instances of change occur. It is the interrelationships between the range of relevant variables that together produce economic policy change; and these interrelationships can only be studied when a historical perspective is adopted and the contextual background drawn up and considered.

4.1 The PRC and ROC: Economic Policy Change Compared

Beginning with the similarities, both cases exhibit how the economic and political spheres intertwine rather than compete to explain economic policy change. Each case was replete with important economic and political constituents, yet neither the economic nor the political predominated over the other. In Taiwan, the transition to ELG was both a policy response to economic difficulties as well as a political strategy designed to co-opt the Taiwanese into the system. Economic difficulties may very well have been the original impetus influencing the initiation of policy change, but as the process of policy change evolved, it was definitely not the only factor influencing change. In China, economic policy change exhibited a similar combination of economic and political logics. The post-Mao reforms were driven by both the economic imperatives of the period as well as its political necessities.
Another similarity was that both instances of reform exhibited domestic political rationales. In Taiwan, the strategy of co-optation that underlay the ISI to ELG transition was designed to alleviate some of the KMT's domestic political dilemmas. By co-opting the Taiwanese into the system, the minority mainlander government engendered (at the very least) neutrality towards its rule and maintained the domestic stability it required to preserve political power. Land reform had similar domestic political objectives as the KMT aimed at checking political instability in the countryside. In China, economic policy change was also implemented with the intention of resolving domestic political problems. Most of these domestic problems were related to the crisis of political legitimacy marking the post-Mao period. In short, economic policy changes in Taiwan and China were initiated with domestic political considerations squarely in mind.

Why might we have found such similar intertwining of political and economic rationales in these two cases? Both Taiwan and China shared similar political institutional frameworks: authoritarian political rule and top down control over the policy decision making process. In terms of context, after experiencing traumatizing political events, both regimes were strongly committed to economic reform in an effort to improve economic performance and restore political legitimacy. In authoritarian political systems such as these, this was of vital importance in order for the regimes to preserve political stability and maintain political power. These contextual similarities also helped in shaping similar sequences of policy outcomes. They did so by creating background conditions conducive to economic policy changes. In Taiwan and China, traumatizing political events created situations of economic and political crisis leading towards crises of political legitimacy. The initial crisis stage subsequent to the conclusion of traumatizing events was followed first by an initial lag of relative policy inaction. In China, the beginnings of economic policy reform did not take place until late 1978, but the crisis of legitimacy had already set in beginning as far back as the death of Zhou Enlai in early 1976, and more definitively with the death of Mao later that same year. In Taiwan, a similar lag of initial inaction took place. Late 1949 saw the remainder of the KMT military and government leave for the
Taiwan island. But the seeds of the crisis of legitimacy were sown as far back as 1947 with the "2-28" incident. Yet initial policy reforms did not take place until 1952-53.

After initial periods of relative inaction, moderate changes in policy took place: land reform and the implementation of ISI policies in Taiwan. Shortly thereafter, these initial changes were succeeded by another lag of a few years, which would in turn be followed by more extensive policy changes: the ISI to ELG transition. In many ways, the course of policy change in Taiwan paralleled the reality in China.  The crisis in China was also followed by a short period of inaction, which was then followed by a period of initially moderate changes: the reforms undertaken in the first few years after the 1978 Third Plenum. After the first phase of reform took place, another short period of inaction took place (the 1981 retrenchment). Ultimately, after another short lag, the more moderate changes would be followed by further substantial changes to economic policy in the late 1981 to 1984 period, marked by the decision to decollectivize and the 1984 document. The parallels in timing are striking.

Chapter one outlined the similarities between the two cases in order to elucidate their comparability. Boasting such an array of matching characteristics, we would logically expect that the two cases of economic policy change would exhibit a host of similarities. Indeed, the two cases do just that; however, that is not to say that the cases of economic policy change in the ROC and PRC were mirror images of each other. One major difference between the two cases was the presence of a strong American influence in Taiwan. In the PRC, the political context of economic policy reform had no equivalent international political influence. As the case study details, American economic advisors were very active in directing U.S. aid and exercised considerable influence over the direction of economic policy and strategy. In Taiwan, the United States financed economic development and reconstruction, helped develop policy initiatives, and facilitated the infiltration of neoliberal economic ideas. In China, foreign aid was absent, while economic

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262 I am indebted on this point to Nina P. Halpern.
policy and its underlying ideas were generated domestically. Foreign influence on a scale equivalent to the case of Taiwan was absent. In short, international political actors played an influential role in effecting economic policy change in the ROC, whereas in China, no similar influence existed.

Another important difference between the two cases lies in the area of political rationales. The political rationales underlying economic policy change in the ROC were in certain ways different from those in the PRC. Economic policy change in the ROC was not related to a succession struggle or the interworkings of elite political conflict. At the time economic policy change took place in the ROC, Chiang's position atop the KMT was in little doubt and no serious contenders existed to contest his position. In China, economic policy change took place within an extremely fluid elite political environment. In the immediate post-Mao era, unrest at the apex of the Chinese political system, meant that economic policy would be subject to the vagaries of elite political conflict. As Fewsmith argues, "economic policy, particularly the critical decisions about the direction of reform and macroeconomic policy, were inextricably intertwined with the struggle for power." 263

Maybe the most critical difference between the two cases lies in the variance in timing. In Taiwan, policy reform occurred approximately ten years after the KMT took over Taiwan, whereas in China, policy reform took place nearly three decades after the founding of the republic. What explains the disparity in timing? The American influence partly explains why reform occurred earlier in the ROC. Once the utility of ISI had run its course, American advisors were there to push the KMT government towards policy reform. The disparity in timing can also be explained in economic terms. In Taiwan, the economic problems associated with ISI revealed themselves within a relatively short time frame. China was a completely different story. The strategy of state socialism consistently churned out growth rates, yet they were deceiving in that they masked deeper economic

263 Fewsmith, p. 7.
problems that took much longer to identify (nearly three decades in fact). But maybe the most important reason for the variance in timing lies in the timing of the political crises of legitimacy. Following the establishment of the regime on the Taiwan island, the KMT was forced to deal with the ramifications of political crisis. In China, the establishment of the People's Republic did not coincide with any equivalent political crisis. Economic difficulties existed, yet the regime was able to deal with them with quite adequately in the first decade. It was not until after the turmoil of the 1960s and 1970s that an economic and political crisis emerged.

While the two cases exhibit important patterns and similarities in terms of the sequence of policy outcomes, subtle differences between the two cases remain and should be identified. In the case of the PRC, the political crisis of legitimacy originating from the traumatizing events of the previous two decades was much more critical than was the case in the ROC. In China, the economic policy changes that took place in the 1978-1984 period were driven in large part by political incentives related to the political crisis of legitimacy facing the communist regime. In Taiwan, by contrast, political considerations remained crucial, but the ISI to ELG transition was less directly a consequence of the political crisis of legitimacy created by the traumatizing events of the late 1940s and early 1950s. Prior to the transition, other significant policy reforms were undertaken with the intent of relieving the crisis of legitimacy. As discussed earlier, land reform in the immediate postwar period was an economic policy reform undertaken largely for political reasons related to the political crisis of legitimacy.

While the land reform was successful in dealing with the crisis, it was not able to do away with it altogether. Land reform was only successful in ameliorating the problem temporarily. By the mid 1950s, a situation somewhat similar to a crisis of legitimacy had in many respects reemerged. This time it was less the result of a traumatizing event, than of

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264 One could argue that the economic disaster of the Great Leap Forward suggest that the weaknesses of the system were in fact not masked to such a degree. However, the GLF is mostly ignored, since the economic disaster that it wrought is largely attributed to Mao's excessive radicalism.
economic problems, i.e. the economic downturn brought on by the ISI policies of the early 1950s. Lagging economic performance combined with the economic alienation of the Taiwanese brought on by the state monopoly on economic enterprises, which benefited primarily mainlanders, shaped a new crisis of legitimacy, creating political incentives for reform similar to those which earlier motivated land reform in Taiwan and later economic policy change in China.

4.2 Theoretical Conclusions: Towards a Multi-causal Explanation of Economic Policy Change

What kind of theoretical conclusions can we draw from the case studies undertaken in this study? First, the cases studied here suggest that economic policy changes seem to originate from traumatizing political events which serve as preludes to situations of both political and economic crisis. It is the volatile combination of economic and political turmoil that grow out of these traumatizing events that create crises of legitimacy for these regimes. For example, in China, the failure to significantly improve the people’s living standards was an economic factor contributing to the political crisis of legitimacy facing the CCP. These types of crises force the hands of governments, especially those in authoritarian political systems. In authoritarian political systems governments can ill afford to not act in response, since failure to deal with such crises can lead to political instability and turmoil that jeopardizes authoritarian rule. The crisis situations which often precede economic policy reforms also seem to develop during or not shortly after monumental political changes. In the late 1970s, China was undergoing a transition from the leadership of Mao Zedong, and Taiwan, between the years 1945 and 1950 experienced Japanese rule, mainland Chinese rule, and then KMT rule on the island of Taiwan.

Once regimes are faced with such crises, it is natural for them to search for solutions and make concerted efforts to respond. The search for solutions involves changing accepted ideas concerning economic policy and strategy. As Grindle and Thomas observe, learning and reflection are not outside the purview of policy elites. Indeed, they
are capable of altering their ideas concerning the appropriate policy solutions to particular policy problems. In order for new ideas to emerge and exert influence, there must first be a change in the underlying conditions affecting the impact of existing ideas. Both cases examined here show how flux in the economic and political setting created a new set of conditions that facilitated ideational change concerning economic policy and strategy. Once new ideas emerge and gain acceptance by policy elites, existing economic and political pressures induced in large part by the crises themselves, serve as conduits, translating these ideas into government policy.

As the discussion above illuminates, considering the context and circumstances surrounding reform initiatives is critical to understanding the reasons for economic policy change. Other analysts have made similar observations, acknowledging that the historical, institutional, political, and economic context within which specific instances of policy reform operate are essential to their understanding. A critical contextual feature to consider when analyzing cases of policy change is to determine whether a reform initiative is considered under conditions of perceived crisis or under conditions that can be termed "politics as usual." Substantial economic policy changes emerge on policy agendas and are taken into consideration far more readily when crises exist, since governments are compelled to act in response to the situation or be left to face the consequences of inaction. Policy initiatives are also likely to be more innovative and even radical in crisis situations versus when crisis does not exist; making substantial changes in economic policy an increasingly likely policy outcome. Thus, crisis situations, if they are serious enough to threaten the interests of political elites, apply pressures that are conducive to policy reforms. The evidence provided by the case studies undertaken in this study confirm such theorizing. Situations of crisis are a critical contextual feature and a natural starting point for major reorientations of economic policy and strategy.

265 Grindle and Thomas, p. 9.
266 Ibid., p. 5.
267 Ibid., p. 9.
To summarize, economic policy changes often begin with traumatizing political events such as those examined in the case studies. These events are crucial for they set in motion political and economic currents that create crisis situations for ruling regimes. The crisis situations developed out of these currents often lead to legitimacy crises which in turn generate pressures for ideational, and eventually policy change. As is evident, the persuasions forged by crisis environments are critical since they: 1) supply rationales for the initiation of reform; and 2) provide the impetus which translates ideas into new policy.

Economic, political, and ideational factors play important roles within this process. Economic and political factors generate the pressures which policy elites must respond to in crisis situations leading to policy change. Ideas are also a part of this process, for new and innovative ideas about economic policy are required in order for previously utilized policies to change. The institutional framework of a political economy is also important to consider when examining the theoretical underpinnings of economic policy change. As the ROC and PRC cases demonstrate, certain institutional features can facilitate or impede economic policy changes once governments have made the decision to initiate them. In sum, the factors which shape and explain economic policy change are interrelated with each other and coalesce in a complex process to bring about economic policy reorientations. I provide a diagram below to summarize the process and illustrate how these factors interlink with each other to generate economic policy changes.
Traumatizing Political Events

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\[ \leftrightarrow \] Situations of political and economic crisis

- change in the political and economic context
- change in the underlying conditions affecting impact
- emergence of new ideas concerning economic policy and strategy
- governments faced with consequences of inaction
- search for policy solutions

Crisis of Political Legitimacy

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- political and economic pressures created by crisis:
  1) provide rationales for policy change
  2) serve to translate new ideas into policy

Economic Policy Change

The case studies of economic policy change undertaken in this thesis illustrate the complexity of the problem and illuminate the most important theoretical conclusion of this study. Rarely if ever are economic variables the sole contributing factor to economic policy changes. As I noted in the introductory chapter, there is a substantial amount of literature within the political science and economics disciplines that explains reform in the ROC and PRC in essentially economic terms. In an intriguing study of economic policy reform in China and the Soviet Union, Yasheng Huang argues that the formulation "economic problems, therefore reforms," is quite problematic, and that the economic explanation should read "reforms, therefore there must have been economic problems." According to Huang, economic problems are necessary, but not sufficient explanations for
economic policy change and reform.\textsuperscript{269} The argument presented in this thesis sides with this thinking. Although economic factors are integral to any explanation of economic policy reform (economic factors are often, if not always the starting point), political, ideational, and institutional factors also play significant roles in explaining why governments make reorientations to economic policy. The case studies undertaken here have demonstrated this.

It is worth reiterating that I am not arguing against economic explanations of economic policy change per se. Both of the case studies undertaken here elucidate quite clearly that economic factors are crucial to explaining policy changes. What I do take issue with are exclusively economic explanations of economic policy change. These explanations often overlook and disregard the ramifications of politics and other very salient factors which influence the process of economic policy change, making them analytically incomplete. It is the complex nature of policy reform (illustrated in the discussion above) that makes it impossible to confine an explanation to a single variable. By incorporating additional variables, our explanations will better account for the inherent complexity of the reform process and the array of important factors which influence government decisions to initiate economic policy change.\textsuperscript{270}

In conclusion, the case studies conducted in this thesis substantiate the insufficiency of exclusively economic explanations of economic policy change. If policy reorientation were indeed solely a response to economic problems, we would expect more immediate policy reactions to economic problems. Both cases have shown how political and economic factors are interlinked and mesh rather than compete to explain economic policy change. Also integral to this complex process of policy change are the role of ideas and institutions. Ideas and institutions shape and influence the process of economic policy change thus having an effect on the ultimate policy outcomes. The ROC and PRC case studies prove that a more effective explanation of economic policy reform is cognizant of

\textsuperscript{269}Yasheng Huang, p. 107
\textsuperscript{270}Ibid., p. 109.
the range of factors which can influence economic policy changes. Hence, we need to construct a multi-causal explanation of economic policy reform that better accounts for the array of salient factors which influence government decisions to initiate economic policy change. It is the interaction of these factors that together produce economic policy changes. Taking the contextual background to instances of policy change under consideration is thus critical to understanding economic policy change. Only by paying close attention to context can we as analysts, illuminate with precision how the range of pertinent factors interlink with each other to produce economic policy change. The findings of this thesis concerning the cases of economic policy change in the ROC and PRC have contributed to the theoretical conclusions arrived at in this conclusion. This is hopefully just a beginning for scholars working in both the economics and political science disciplines. Further research in this fascinating area awaits.
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I. Books


II. Journal Articles


