

## “Fuel for the Good Dragon”:

The United States and Industrial Policy in Taiwan, 1950–1965

In the summer of 1965 the Agency for International Development (AID) celebrated a small victory. Ambassador Jerauld Wright formally closed the aid office in Taipei and declared Taiwan the first country to “graduate” from U.S. foreign assistance. After fifteen years and \$1.5 billion in economic aid, Taiwan was now a going concern, its growth, according to Wright, “one of the marvels of the present age.” “What has happened on Taiwan is what we want to see happen throughout Africa and Asia and Latin America,” AID chief David Bell affirmed. “Taiwan is an especially impressive case.” American and Taiwanese officials stressed the contrast between Communist failures on the mainland and the Republic of China’s successful development through “free institutions” and “private enterprise,” a theme echoed by journalists covering the event. *Reader’s Digest* heralded “Asia’s newest economic miracle” and offered Taiwan as “proof of the wisdom of depending mainly upon private enterprise for economic growth.”<sup>1</sup>

The World Bank recently ratified this explanation in a report designed to discourage developing nations from drawing other conclusions about the Asian “miracle.” “Getting the fundamentals right was essential,” the report affirmed. Taiwan and other Asian tigers succeeded by liberalizing their economies in line with the development philosophy long advocated by the Bank and AID.<sup>2</sup> But a growing number of area specialists disagree, arguing that Taiwan succeeded by devising a type of political economy unlike the liberal developmentalist ideal, one in which the state—not markets—governed the use of private resources for industrial growth. Cultural factors, they contend,

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1. Max Frankel, “U.S. Economic Aid to Taiwan Ended; ‘Graduation’ Hailed,” *New York Times*, 1 July 1965; *Congressional Record*, 80th Cong., 1st sess., 14 July 1965, A3759; David E. Bell, “The Challenge to the Developing Countries,” Department of State *Bulletin* 53 (26 July 1965): 175; Keyes Beach and Clarence W. Hall, “Formosa: Asia’s Heartening Success Story,” *Reader’s Digest*, February 1966, 142.

2. International Bank for Reconstruction and Development, *The East Asian Miracle: Economic Growth and Public Policy* (New York, 1993), 354–55, 366. For other neoclassical views see David Aikman, *The Pacific Rim: Area of Change, Area of Opportunity* (Boston, 1986), 22; Leonard Unger, “Chiang Kai-shek’s Second Chance,” *Policy Review* 50 (Fall 1989): 98–99; and Milton and Rose Friedman, *Free to Choose: A Personal Statement* (New York, 1980), 57.

enabled Taiwan to resist U.S. pressure to liberalize. A close look at the actions of U.S. aid officials, however, reveals that the gap between development policy and practice was wider than these studies suppose. Instead of toeing the liberal developmentalist line, U.S. officials helped devise many of the strategies and institutions behind the Taiwan "miracle."

Outside of the World Bank it is widely recognized that Taiwan's, Japan's, and Korea's economies work differently than the United States's. "Stated briefly and far too boldly," a member of President Clinton's Council of Economic Advisers explains, "the Japanese have succeeded by doing everything wrong according to standard economic theory." Since the early 1980s, Chalmers Johnson and Alice Amsden have argued that the miracle economies violated the rules of Anglo-American economics, creating their own market forces, getting the prices wrong, and using the government to adjust "economic parameters" like wages, investment, exchange, profits, supply, and demand. New studies by Robert Wade and Stephan Haggard focus on Taiwan, described by Johnson as "perhaps the purest example of the type" called, variously, "etatisme," the "developmental state," or "guided capitalism."<sup>3</sup>

All states meddle in their domestic economies, and some Taiwanese protest that theirs is a "mixed" economy like the United States. But according to the state-oriented analysts, Taiwan engages in forms of manipulation that differ in type and degree from anything found in the West. The state sets goals through long-range "indicative" plans, allowing private and public firms to compete in their fulfillment and offering rewards and penalties along the way. It encourages growth in desirable sectors with tariff protection and easy access to investment capital. Taiwan controls critical industries and services through state enterprises and guides consumption, savings, and investment by fixing prices, wages, profits, and interest rates. Some markets operate freely—labor, for instance—but with its hand on the principal levers, the state can steer investment, manage risks, and set goals in ways the U.S. economy cannot.

These differences mean that Taiwan's economy is neither "market-oriented" nor "integrated" with the world system in the ordinary sense of

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3. Quoted in James Fallows, *Looking at the Sun: The Rise of the New East Asian Economic and Political System* (New York, 1994), 6; Alice H. Amsden, "Taiwan's Economic History: A Case of Etatism and a Challenge to Dependency Theory," *Modern China* 5 (July 1979): 341–80; idem, "The State and Taiwan's Economic Development," in *Bringing the State Back In*, ed. Peter Evans, Dietrich Rueschemeyer, and Theda Skocpol (New York, 1985), 78–106; Chalmers Johnson, "Political Institutions and Economic Performance: The Government-Business Relationship in Japan, South Korea, and Taiwan," in *The Political Economy of the New Asian Industrialism*, ed. Frederic C. Deyo (Ithaca, 1987), 136–64; Johnson quoted by Gregory W. Noble, "Between Competition and Cooperation: Collective Action in the Industrial Policy of Japan and Taiwan" (Ph.D. diss., Harvard University, 1988), 3; Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (Princeton, 1990); Stephan Haggard, *Pathways from the Periphery: The Politics of Growth in the Newly Industrializing Countries* (Ithaca, 1990).

those terms, since it employs both markets and foreign linkages in highly conditional ways. Taiwan's successful application of these practices challenges the core precepts of the Anglo-American "free enterprise" economies, according to Johnson, by suggesting "that their faith in the market mechanism without explicit political direction is misplaced." If countries could make their own comparative advantage, relying on private enterprise was a prescription for failure. "Unless a country deliberately rigged the markets to 'get the prices wrong,' " according to James Fallows, "it had no hope of catching up in the industrial race."<sup>4</sup>

These studies raise new questions about the United States's role in shaping Taiwan's industrial economy. Recasting the economic miracle as a political achievement, they stress cultural and historical explanations for Taiwan's choice of development strategy. Defeat on the mainland, the teachings of Sun Yat-sen, hostility between mainlanders and the Formosan majority, and Confucian traditions laid a cultural and political foundation for the developmental state. State-oriented analysts hand some credit to American aid – which bankrolled Taiwan's plans in the early years – but discount the value of American advice, which the Taiwanese either ignored or applied rarely. Taiwan's system is so nearly the opposite of the type of economy the United States encouraged that American advice simply could not have been important. "All that is certain," according to Amsden, "is that freer trade and freer enterprise (including freer foreign enterprise) were preached by the American aid mission. In view of the preferences of its major benefactor, the extent to which the Guomindang government persisted in its 'etatisme' is all the more impressive."<sup>5</sup> Until recently, most of the evidence supported this conclusion.

Without access to primary sources, most accounts rely on the conclusions of AID officials, the first to announce Taiwan's achievement and analyze its lessons. Shortly after Taiwan's graduation, AID published a study by Neil Jacoby, a former member of the Council of Economic Advisers and a consultant to aid missions in India and Laos. It remains the most authoritative on the subject. Following the official line, it discounted the importance of state guidance and emphasized the success of U.S.-sponsored private-sector expansion. "By far the most important consequence of U.S. influence," it concluded, "was the creation in Taiwan of a booming private enterprise system."<sup>6</sup> Analysts of Taiwan's development policy cite Jacoby to show that the United States either discouraged or overlooked Taiwan's statist tactics.

4. Johnson, "Political Institutions and Economic Performance," 137; Fallows, *Looking at the Sun*, 203.

5. Amsden, "The State and Taiwan's Economic Development," 91.

6. Neil H. Jacoby, *U.S. Aid to Taiwan: A Study of Foreign Aid, Self-Help, and Development* (New York, 1966), 138. Nancy Bernkopf Tucker "depends heavily on the outstanding work of Neil H. Jacoby." Her account also employs the work of the state-oriented theorists, particularly Wade, Gold, and Haggard. She concludes that the United States was partly successful in imposing market-oriented reforms, and that this partial success accounts for Taiwan's growth. Tucker, *Taiwan, Hong Kong, and the United States, 1945–1992* (New York, 1994), 56–72.

In Jacoby's account, Taiwan confirmed the assumptions of both development theory and U.S. policy, assumptions that linked U.S. aid to liberalization and growth. But more importantly from the agency's perspective, it contradicted the 1963 report of the Clay Commission, which attacked AID's support for state enterprises and its failure to encourage recipient countries to see their "essential choice between totalitarian, inefficient, state-controlled economies on the one hand and an economically and politically freer system on the other."<sup>7</sup> The report provoked cutbacks and a revision of policy, but it should also have raised questions about Jacoby's interpretation. The newly opened papers of U.S. aid agencies confirm that the United States was far from dogmatic in promoting market-oriented reforms. In the pursuit of short-term economic and strategic goals—price stability, job growth, or more military spending—aid officials often found that direct action by the state worked better and faster. The United States supported state-oriented policies systematically, not by tolerating Taiwanese backsliding. On closer examination, Taiwan's system of state guidance looks less Confucian and more like a collaborative project.

Taiwan's story reveals the breadth of the gap between development policy and its execution. While official pronouncements seldom strayed from the liberal developmentalist creed, in actual practice U.S. aid and advice often responded creatively to particular threats and opportunities. Dennis Merrill and Linda Wills Qaimmaqami, for example, find that strategic imperatives led U.S. officials to back state planning schemes in India and Iran. In the Philippines, Argentina, and Turkey, according to Sylvia Maxfield and James Nolt, the United States supported import substitution, a strategy it officially opposed. Instead of reproducing a single model of political economy around the world, U.S. aid officials, faced with local crises, experimented. "You cannot hold fixed ideas," a member of the China aid mission discovered. "You must keep fluid, face things as they are rather than as you would like them to be." In Taiwan, U.S. officials were forced to jettison free-market nostrums from the start and collaborate with Chinese officials in creating a type of political economy that would only later be described as an "Asian" development model incompatible with "Western" models.<sup>8</sup>

7. Committee to Strengthen the Security of the Free World, *The Scope and Distribution of United States Military and Economic Assistance Programs* (Washington, 1963), 5, 12–13. Headed by Lucius Clay, the committee was appointed by President Kennedy in December 1962 to review foreign military and economic aid programs. It amplified the criticisms of William J. Lederer and Eugene Burdick's *The Ugly American* (New York, 1958), which attacked aid officials' preference for colossal state-controlled projects over small, private ones.

8. Emily Rosenberg notes that after World War II, "policymakers tended to apply their liberal canons selectively," allowing actual policy to diverge from developmentalist dogmas; Emily S. Rosenberg, *Spreading the American Dream: American Economic and Cultural Expansion, 1890–1945* (New York, 1982), 231; Dennis Merrill, *Bread and the Ballot: The United States and India's Economic Development, 1947–1963* (Chapel Hill, 1990), 161–67. Linda Wills Qaimmaqami, "The Catalyst of Nationalization: Max Thornburg and the Failure of Private Sector Developmentalism in Iran, 1947–1951," *Diplomatic History* 19 (Winter 1995): 1–31; Sylvia

From the beginning, officials of the Economic Cooperation Administration recognized that they would not find in Asia the same combination of ingredients that made the Marshall Plan a success. The European experience, one observer noted, "was far less relevant than had been supposed. Advice from foreigners was not awaited with bated breath. Pat solutions toppled like tenpins." Meeting at the Brookings Institution in April 1948, economists from the State and Treasury departments, the Bretton Woods institutions, U.S. aid agencies, and the Federal Reserve conceded that "a fundamental contrast exist[ed] between 'recovery' in Europe and 'development' in Asia." Except for Japan, none of the Asian countries had a corporate or banking structure to support a program like the Marshall Plan. Without private institutions, development efforts would have to be organized around other "political and social bases. . . . Governments will have to play a considerable role in developing trade in the immediate future. When trade has been started, private traders may step in on the heels of governments."<sup>9</sup> For the moment, circumstances favored a state-centered strategy.

Chiang Kai-shek's tottering state could do little to help relief efforts in 1948. In the Nationalists' shrinking zone on the mainland, army confiscations and thousands of refugees fueled a hyperinflation that undermined the ECA mission's efforts. Administrators Roger Lapham and R. Allen Griffin concentrated their energies on Shanghai, distributing commodities and buying gold in an attempt to ease the panic, but to no avail. Speaking to Congress in February 1948, Secretary of State George C. Marshall warned that little could be accomplished in China, even with the \$570 million that had just been appropriated. He urged aid officials to avoid undertaking projects that would connect the United States with the Nationalists' defeat. By April 1949 Griffin conceded that "from the beginning the cards were stacked against us. . . . All that is left to do is to conduct an orderly liquidation of our affairs in the midst of a situation that is, in other respects, in disorder."<sup>10</sup>

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Maxfield and James H. Nolt, "Protectionism and the Internationalization of Capital: U.S. Sponsorship of Import Substitution Industrialization in the Philippines, Turkey, and Argentina," *International Studies Quarterly* 34, no. 1 (1990): 49–81; Roger D. Lapham to Paul Hoffman, 30 June 1949, U.S. Department of State, *Foreign Relations of the United States, 1949* (Washington, 1974), 9:666–67 (hereafter *FRUS*). On the emerging Confucian Bloc see Samuel P. Huntington, "The Clash of Civilizations?" *Foreign Affairs* 72 (Summer 1993): 28.

9. Harry B. Price, quoted in Robert A. Packenham, *Liberal America and the Third World* (Princeton, 1973), 39; A. B. Hersey to J. Burke Knapp, "Summary of Discussion at IPR Dinner Meeting, Brookings Institution, April 20, 1948," 22 April 1948, Records of the Board of Governors of the U.S. Federal Reserve, Country Files: Asia, Australia, and New Zealand—general, U.S. Federal Reserve, Washington, DC.

10. The ECA took over aid operations in June 1948. Roger Lapham to Paul Hoffman, 30 June 1949, *FRUS, 1949* 9:656–67; "Statement by Secretary Marshall," Department of State *Bulletin* 18 (29 February 1948): 270–71; Robert Allen Griffin to Harlan Cleveland, 14 April 1949, Records of the U.S. Foreign Assistance Agencies, Office of the Administrator, Country Subject Files, 1948–50, Record Group 286, box 1, Washington National Records Center, Suitland, Maryland (hereafter RG 286, with filing information).

Anticipating a longer struggle on the mainland, ECA had dispatched dozens of experts to China on the eve of the Nationalists' collapse. Land reform specialists formed a *Joint Commission on Rural Reconstruction* (JCRR) to set up cooperatives in the Yangtze Valley. Five engineers from the J. G. White Engineering Corporation, a New York firm specializing in colossal, government-funded projects, arrived at Shanghai with an ambitious program for industrial expansion. In late 1948, these experts moved to Taiwan where they began surveying the island's resources and potential for development. What they saw looked promising. The Japanese Empire's agricultural heartland before 1945, Taiwan had the most literate population in Asia, a commercialized agricultural system geared for export, rail and road networks, and a small but important industrial base. Port facilities, fertilizer and cement factories, the oil refinery, and the aluminum smelter had all been damaged by Allied bombing during World War II, but skilled machinists and engineers stood ready to run them once they had been repaired. The loss of the mainland, officials recognized, might simplify the ECA's problems. When President Harry S. Truman announced his Point IV economic aid program in January 1949, Harlan Cleveland, chief of ECA's Far Eastern Division, suggested Taiwan as an ideal site for a pilot program that could be "successful enough to serve as a model" for the rest of Asia.<sup>11</sup>

The ECA's optimism was no match for the State Department's despair. Diplomatic officials recognized that Taiwan was an unlikely sanctuary for the Nationalists, who had treated the islanders like defeated enemies since 1945. When the Japanese left, Chiang's armies seized all Japanese-owned businesses—almost the entire industrial economy—and imposed trade restrictions and heavy taxes on native Formosans, merchants and landowners who had migrated from China in the nineteenth century. In February 1947 the government-controlled Bank of Taiwan moved to confiscate the remaining independent businesses by recalling loans to private merchants. The actions of the hated Monopoly Bureau provoked an incident on 28 February that soon led to open revolt across the island. Reinforcements arrived from the mainland on 8 March and suppressed the uprising, killing over six thousand Taiwanese, many of them from the business and professional

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11. One of the nation's leading civil engineering firms since World War I, J. G. White had constructed naval bases, airfields, and the Muscle Shoals steam generating plant for the U.S. government as well as hydroelectric dams in Chile and irrigation projects in the Sudan. Its president, Gano Dunn, defined an engineer as someone "who can do with one dollar what any fool can do with two." "Gano Dunn is Dead," *New York Times*, 11 April 1953; Harlan Cleveland to Paul G. Hoffman, "China Aid Program," 22 July 1949, RG 286, box 1; Harlan Cleveland to Paul G. Hoffman, "Taiwan," 27 January 1949, RG 286, box 1. State Department officials were less enthusiastic about Taiwan's economic prospects in 1948 but thought the island could be made viable as a sort of agricultural hinterland for Japan. State Department, Office of Intelligence and Research [OIR], "Prospects in Formosa, November 1948," 22 November 1948, General Records of the Department of State, Record Group 59, R&A Report No. 4807, National Archives, Washington, DC.

classes.<sup>12</sup> An uneasy peace settled over the island during the next two years, but as thousands of undisciplined troops, corrupt bureaucrats, and refugees streamed into the island in the spring of 1949, American observers considered another rebellion likely.

For most of 1949, the ECA redirected fertilizer, petroleum, and cotton shipments from the mainland to Taiwan while J. G. White engineers refurbished the aged factories. In July, Shanghai fell, and Chiang Kai-shek, now in "retirement," moved to Taiwan with thirty-seven tons of gold. For the rest of the year, Secretary of State Dean Acheson maneuvered to salvage as much as he could from the China disaster. Anxious to preserve both Taiwan and Hong Kong, and seeing advantages in recognizing the People's Republic, he hoped to establish a UN trusteeship in Taiwan with the help of a Formosan independence movement or Nationalist defectors. To keep his options open, he wanted the ECA to remain in place, but without helping Chiang, arousing the Communists, or encouraging more refugees to flee to the island. In January 1950 Truman confirmed the "hands-off" policy and Taiwan-bound shipments stopped. Aid workers held no brief for Chiang or his cronies, but they refused to stand idle while the economy deteriorated. Valery de Beausset, J. G. White's lead engineer, scorned the State Department's predictions of collapse. "Suppose we act as if we really believe in what we hope and do what we started to do and not act so much like God?"<sup>13</sup> Using the supplies they had, the engineers and ECA officials began to lay the groundwork for a viable economy.

The Nationalists' reaction to defeat heartened ECA officials. On Taiwan, Chiang purged the ranks of the Kuomintang (KMT) party, reducing graft and factionalism and elevating younger leaders favored by the United States. K. C. Wu, a civilian reformer, became governor of Taiwan. Ch'en Ch'eng, Joseph Stilwell's favorite general, took the posts of premier and head of the central reform committee. Yen Chia-kan, a missionary-trained economist, became finance minister and head of the Committee on U.S. Aid (CUSA).<sup>14</sup> Yin Chung-jung, an engineer who had headed the Chinese

12. George H. Kerr, *Formosa Betrayed* (Boston, 1965), 248, 257-315; Tucker, *Taiwan, Hong Kong, and the United States*, 28; Lai Tse-Han, Ramon. H. Myers, Wei Wou, *A Tragic Beginning: The Taiwan Uprising of February 28, 1947* (Stanford, 1991), particularly chap. 3, reveals how the mainlanders' heavy-handed economic policies provoked the uprising.

13. Hsu Chen-kuo, "The Political Base of Changing Strategy Toward Private Enterprise in Taiwan, 1945-1955" (Ph.D. diss., Ohio State University, 1987), 134; Cleveland to Hoffman, "China Aid Program," 22 July 1949, RG 286, box 1. The debates on Taiwan's predicament are described in Ronald L. McGlothlen, *Controlling the Waves: Dean Acheson and U.S. Foreign Policy in Asia* (New York, 1993), 86-134; Acheson to Edgar, 30 March 1949, *FRUS, 1949* 9:305-6; "United States Policy Toward Formosa," Department of State *Bulletin* 22 (16 January 1950): 79-81; de Beausset diary, 15 February 1950, Val de Beausset Papers, Westcroft Farm, Grosse Ile, Michigan.

14. Bruce J. Dickson, "The Lessons of Defeat: The Reorganization of the Kuomintang on Taiwan, 1950-52," *China Quarterly* 133 (March 1993): 56-84. For biographies of Chinese officials see Chien-kuo Pang, "The State and Economic Transformation: The Taiwan Case" (Ph.D. diss., Brown University, 1988), 317.

procurement mission in New York during the war, led the key planning and resource allocation agencies, the Taiwan Production Board and the Central Trust.

The new leaders acted decisively to shore up the island's economy, enforcing controls on imports and foreign exchange. In a bid to raise agricultural yields, the government reduced farm rents and distributed land that had been confiscated from the Japanese. At the same time, it continued confiscations of manufacturing enterprises owned by Formosans. In one case, Chiang seized a factory after exiling the owner and threatening the general manager with arrest.<sup>15</sup>

Although versed in Anglo-American economics, none of the reformers advocated liberalization as an answer to Taiwan's problems. All agreed with the KMT's program of a "planned free economy" in which the state would direct economic activity while permitting a degree of "enterprise freedom." Ch'eng likened the program to the socialism of the British Labour party, while Yin drew analogies to Japanese development in the Meiji period. Both subscribed to Chiang's interpretation of the "Min-Sheng" principle: that restricting capital on behalf of the people's welfare was a primary function of the state.<sup>16</sup> Conflict between mainlanders and Formosan natives reinforced this ideology. State control meant control by mainlanders and the KMT, while "private" meant Formosan. Economic reforms coincided with a crackdown on Formosans believed to be sympathetic with Acheson's trusteeship plan.<sup>17</sup> By mid-1950 most of the economy was in government hands, and it was safe to allow private concerns some freedom in non-threatening sectors. This "liberalization," however, did not signal a new commitment to free enterprise, only a move from cruder to more sophisticated methods of state manipulation.

By contrast with their KMT counterparts, American officials addressed questions of development strategy in a more heterodox spirit. The ECA's authorizing legislation committed it to look first for solutions that employed private investment, but aid administrators refused to allow a technicality to

15. Thomas B. Gold, *State and Society in the Taiwan Miracle* (Armonk, NY, 1986), 65; K. C. Wu, "Your Money Has Built a Police State in Formosa," *Look*, 29 June 1954, 39-45.

16. Yin visited Japan at the height of the reverse course in 1950 and came to regard its mix of state guidance and export-oriented conglomerates as the model for Asian development. Hsu Chen-kuo, "The Political Base of Changing Strategy," 183-84, 230-36. *Min-Sheng*, the third of Sun Yat-sen's principles, is sometimes translated as "people's livelihood" and other times as "socialism." For Chiang's interpretation with respect to economic planning see Taiwan Provincial Government, Department of Information, *Taiwan: A Model Province of the Republic of China Based on the Three Principles of the People* (Taipei, June 1971), 56.

17. Kerr, *Formosa Betrayed*, 416-26; OIR, "Graphic Summary of the Formosa Situation," 21 August 1950, RG 59, State Department R&A Report No. 5320; Haggard, *Pathways*, 88. Each of the reforms increased the economic power of the mainlander-dominated state while reducing the power and wealth of potential rivals. Farm rent reduction, for instance, was followed by increases in taxes and the price of fertilizer supplied by a state monopoly. The income of Formosan landholders was thus simply transferred to the state.

delay the attainment of practical objectives.<sup>18</sup> The aid mission reinforced Taiwan's statist direction in four ways: by shoring up collapsing state enterprises, pioneering new methods of state control, strengthening the institutional base for planning, and co-opting groups—mainly the military—that opposed or disrupted change. Working within political and material constraints, ECA officials and J. G. White engineers restored state-owned factories to prewar production levels and collaborated with Chinese planners in creating the textile industry, one of the early triumphs of the Taiwan miracle.

Yin Chung-jung and J. G. White engineers Val de Beausset and Sidney L. Buffington together devised a program of "entrustment" under which the ECA furnished raw cotton directly to spinning mills. CUSA then purchased the finished yarn and sold it to weaving mills at fixed prices, likewise purchasing finished cloth and garments to be sold through government distribution networks. ECA officials liked the plan because at each step it generated "counterpart" funds, proceeds from the sale of U.S.-supplied goods in the form of local currency. These funds could be used to reduce the government deficit and hold down inflation. To maximize counterpart, they encouraged vertical integration and economies of scale. But the plan also served important KMT political objectives. It drew public and private manufacturers together under a program that allowed the state to fix prices, employment, profits, and production levels. Mills could be privately owned, but with the state as sole supplier and client, control remained with the KMT. Textile manufacturing catapulted ahead of Taiwan's other industries. Within two years, Yin and other KMT officials were using it as a model for how the state could incubate new industries by controlling imports and prices. The ECA had shown the KMT how to defy the laws of the market.<sup>19</sup>

Not satisfied to furnish commodities and tinker with industries, aid workers wanted a hand in setting government policy on budgets, imports, and exchange. Mission chief Raymond Moyer appealed through the embassy for a more flexible policy, but Acheson and Assistant Secretary of State Dean Rusk feared becoming implicated in Chiang's final failure. Congress meanwhile continued to approve larger sums of aid for Taiwan. On 5 June, Truman signed a bill providing \$94 million for the next fiscal year. Twenty days later, war erupted in Korea, and on the 27th, Truman ordered the Seventh Fleet to guard the Taiwan Straits. But the State Department still hesitated to let the ECA take a more active part in Taiwan's economic

18. *U.S. Statutes at Large* 64 (1950-51): 205.

19. Textiles remain Taiwan's most important industry, generating more jobs, exchange, and production value than any other enterprise. Thomas B. Gold, "Dependent Development in Taiwan" (Ph.D. diss., Harvard University, 1981), 97-106, provides a detailed account of the industry's origins. See also Hsu, "Political Base," 166; and Alan P. L. Liu, *Phoenix and the Lame Lion: Modernization in Taiwan and Mainland China, 1950-1980* (Stanford, 1987), 52-54, 123.

policymaking. In July, Moyer, with Cleveland's backing, asked to be allowed to set up a joint economic stabilization board, to build aid around long-term plans, and to set targets for taxes and spending. The military situation and the magnitude of the assistance demanded a more active role, he argued, and the Nationalists were receptive, even eager, for U.S. advice. Rusk refused. For now the program would remain unchanged, he explained, but the administration was examining the situation and might soon decide differently.<sup>20</sup>

ECA participation in industrial and budget planning did not become imperative until the Truman administration proposed a substantial program of military aid. Between December and February, as a balance of payments crisis emptied the Nationalist treasury, a Pentagon survey team found Chiang's armies in urgent need of \$500-million worth of supplies. The Korean War and the approval of NSC-68 made aid on this scale possible, and by early March 1951 the Joint Chiefs of Staff could imagine scenarios in which Nationalist troops would be used in raids on the mainland. As the JCS sent emergency aid and a military mission (MAAG) to Taiwan, ECA officials warned that these actions could tip Taiwan's economy over the edge. Huge budget deficits and drought-shrunken farm exports already threatened to destabilize the New Taiwan Dollar. To prevent a ruinous inflation the government had cashed its gold hoard, and while the JCS deliberated, the Bank of Taiwan was packing \$1.7 million in gold—the last of its reserves—aboard planes bound for New York. A sudden increase in military spending would send prices into a death spiral. On 19 March, Rusk ordered Griffin to proceed with plans for economic stabilization.<sup>21</sup>

ECA officials were ready to move ahead with the industrial program. Over the previous six months they had quietly expanded the list of U.S.-supplied commodities to include tinplate, iron, steel, sulphur, and bauxite, which arrived in crates and sacks emblazoned "Fuel for the Good Dragon." Moyer's Economic Stabilization Board (ESB) met for the first time on 19 March and although Rusk admonished the mission to "advise but not

20. Strong to Acheson, 21 January 1950, RG 59, 894A.00R/1-250; Moyer to Cleveland, 12 July 1950, RG 59, 894A.00R/7-2650; Rusk to Cleveland, 11 August 1950, RG 59, 894A.00R/8-1150. Rusk's position softened slightly after the National Security Council approved NSC-37/10, "Immediate United States Courses of Action with Respect to Formosa" (3 August 1950, *FRUS*, 1950 [Washington, 1976], 6:413-14), which ordered a military survey to determine the usefulness of the armies on Taiwan. Memorandum of conversation, "Policy Guidance for ECA Mission Taipei," 8 September 1950, RG 59, 894A.00R/9-850. Rusk allowed that while avoiding "very long range projects, ECA on Formosa need not keep looking over its shoulder" and could think about suggesting projects for approval.

21. Karl Rankin to Clubb, 24 January 1951, *FRUS*, 1951 (Washington, 1983), 7:1523-27; memorandum of conversation, Department of State-Joint Chiefs of Staff meeting, 6 February 1951, *ibid.*, 1566-68; JCS, "Courses of Action Relative to Communist China and Korea," 14 March 1951, *ibid.*, 1598-1605; Hsu, "Political Base," 146; Rusk to Griffin, 19 March 1951, *FRUS*, 1951 7:1596-97.

give direction to the Chinese," Americans did most of the talking at the first three weekly meetings. Yin, Yen, Ch'en, and other Chinese officials listened as an American adviser explained that over the past eight months Taiwan had been hemorrhaging dollars and gold at a monthly rate of \$2 million. In another two months, hyperinflation would set in unless the government implemented "rigorous" exchange controls. "These actions are drastic and necessary," he urged, "but they are dangerous."<sup>22</sup> On 9 April, the Executive Yuan implemented a dual exchange rate.

In the following months, the State Department urged the ECA to expand its role in directing Taiwan's recovery. Chester Morrill, a monetary policy expert dispatched to Taiwan by the Federal Reserve, consulted with Rusk and his deputy, Livingston Merchant, in May and found the department's position nearly the reverse of what it had been three months earlier. "It now appeared possible," Rusk explained, "that we might employ the Chinese forces where they could best serve in the world in the event of a general conflagration. In consequence, we were now raising our sights to somewhat longer-range programs." Morrill asked if the department still favored reducing the size of Chiang's army. No, Merchant replied. If Taiwan employed its full resources, it could develop a self-sustaining economy "and still maintain a military establishment no larger in proportion to [the] total population than were the United States and United Kingdom World War II establishments." Military Keynesianism had come to Taiwan. On 9 May, Rusk rescinded his order to refrain from giving directions. The mission should "exert its influence vigorously and firmly, in the Economic Stabilization Board and elsewhere."<sup>23</sup>

Over the next four months, the ECA placed advisers in virtually every branch of Taiwan's government and industry. MAAG closely supervised military spending. A visiting Senate mission noted that the ECA had "a hand, sometimes large, sometimes small, in the setting up of a national budget, revision of the tax structure to increase revenues, [and the] institution of a more austere import program," and that aid officials participated "in day-to-day decisions concerning such matters as banking and currency, individual applications for foreign exchange, and over-all national economic planning." Morrill worked with KMT officials to set up a banking structure more firmly under state control. Taiwan should avoid modeling its central bank on the United States's, he cautioned, since the Federal Reserve was too indecisive and susceptible to democratic pressures. The Bank of Taiwan,

22. OIR, "The Current Situation on Taiwan," 4 May 1951, RG 59, State Department R&A Report No. 5529; Yen Chia-kan to William Foster, 23 January 1951, Records of the U.S. Federal Reserve, Country Files, Taiwan—general; Rusk to Griffin, 19 March 1951, *FRUS*, 1951 7:1596–97; minutes of the second meeting of the Economic Stabilization Board, 22 March 1951, RG 59, 894A.131/4-1051; minutes of the third meeting of the Economic Stabilization Board, 28 March 1951, RG 59, 894A.131/4-1051.

23. Memorandum of conversation, "Projected Assignment of Mr. Morrill to Formosa," 14 May 1951, RG 59, 894A.10A/5-1451; Rusk to Griffin, 9 May 1951, *FRUS*, 1951 7:1664–65.

with the Fed's cooperation, became a pillar of the statist economy, chief financier to the army and its client firms.<sup>24</sup>

U.S. chargé Karl Rankin presented Chiang with an aide-memoire on 20 July demanding that U.S. officials be allowed to supervise Taiwan's budget. Chiang complied by forming a joint budget review committee, and by 7 August, Griffin could tell Congress that the Chinese "spend their full foreign exchange earnings now, we believe, pretty much under our guidance and direction."<sup>25</sup>

The state's broad economic powers augmented the effectiveness of the mission's advice. An aide to Senator Pat McCarran who visited Taiwan in August learned from Raymond Moyer that the ECA's decisions affected every corner of the economy. "Admittedly, implementation of these decisions is facilitated by the Government ownership or control of almost every significant economic activity: banks, railroads, electric power, large sugar plantations, major industrial installations, communications." Moyer explained that since "the government controls credit, imports, exports, and production, . . . once ECA has hurdled the barrier of government consent, it has a relatively clear course, devoid of the obstacles of independent labor or independent management to its goal."<sup>26</sup>

The ECA had more than one reason for supporting state monopolies. State corporations were nearly the sole source of government revenue, four-fifths of which went to the army. Through bond purchases, taxes, and requisitions, government enterprises met the army's daily food, clothing, and payroll requirements. It was this revenue base that made U.S. military aid to Taiwan a bargain. General William H. Chase, the chief military adviser, explained that "the cost of each soldier of the Chinese armed forces was about \$300 for maintenance, training, etc.," a figure that compared favorably with "an estimated \$5000 for each member of the United States armed forces." As Rankin later observed, "in strictly military and financial terms . . . the United States is getting a strategic bargain in its support of Free China." The mission placed a "management

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24. Senate Appropriations Committee, Special Subcommittee on Foreign Economic Cooperation, *United States Aid to Formosa*, 82d Cong., 1st sess., August 1951, 4-6. Morrill recommended a "European type" central bank that could steer investment into socially desirable industries. "One of the weaknesses of [U.S.] central banking in the past," he explained, "has been that the monetary authority has just gone along with economic changes instead of anticipating and formulating ideas on how they might be dealt with before they arise." Twenty-seventh meeting of the Economic Stabilization Board, 6 September 1951, RG 59, 894A.14/9-1551. The Bank of Taiwan did not make a single loan to a private firm until 1955, and until 1965 its lending to the private sector remained insignificant. Chi Huang, "The State and Foreign Capital: A Case Study of Taiwan" (Ph.D. diss., Indiana University, 1986), 123.

25. Acheson to Rankin, 22 June 1951, *FRUS*, 1951 7:1715-16. Rankin became ambassador in April 1953; U.S. Senate, Committee on Foreign Relations, *Mutual Security Act of 1951*, 82d Cong., 1st sess., 1951, 536.

26. Senate Appropriations Committee, *United States Aid to Formosa*, 6.

control advisor" in each of the principal monopolies and put J. G. White engineers at their disposal.<sup>27</sup>

These actions upset American businesses and violated the State Department's liberal developmentalist principles, but ECA saw no alternative. A regional director of the Standard Vacuum Oil Company advised the ECA to "get the government to sell the large number of industries it now owns. The situation is worse than it was in England at any time under the Labour government." Rankin sympathized. "In connection with state-owned or controlled industrial and commercial enterprises," he wrote the mission chief, "I hope that we can help the Chinese to avoid some of the pitfalls of uneconomic Socialism." But as far as the ECA was concerned, private enterprise was not an option. Domestic investors had vanished, and foreign capital was almost as scarce. Hong Kong speculators were unwilling to rely on mainland China's forbearance. In 1952 U.S. investment in Taiwan consisted of "several small export-import companies and an airline office." Those few investors who expressed an interest presented proposals that upset ECA's priorities. Reynolds Aluminum and Westinghouse tried to obtain U.S. and Chinese approval for a plant that would produce aluminum ingots for export, but Chinese economists objected that it would use scarce electric power. Instead, the ECA helped Taiwan build its own aluminum rolling mill and fabricating plant, both owned by the state.<sup>28</sup>

Under U.S. guidance, Taiwan employed a development strategy now known as "import substitution." Throughout the 1950s, external trade (chiefly sugar and other farm goods) remained small, never reaching above a third of the island's prewar levels. Japan remained the principal partner, but Tokyo's own import restrictions prevented it from absorbing more of Taiwan's produce. The island's efforts looked inward, developing domestic resources, markets, and manufacturing for home consumption. A barrier of import and exchange controls protected domestic firms from foreign competition and indirectly subsidized industry. The differential between the two exchange rates funneled 40 percent of the earnings from farm exports to manufacturers through artificially low prices for imported machinery and

27. Laura Hughes to Fred Bunting, "Activities of the China Mission in the Economic Field," 12 May 1952, *Records of the Office of Chinese Affairs, 1945-55*, microfilm (Wilmington, DE, 1989), reel 16; memorandum of conversation, "Conference with Maj. Gen. William H. Chase, Chief of Military Assistance Advisory Group, Formosa," 20 February 1952, *FRUS, 1952-1954* (Washington, 1985), 14:10; Karl M. Rankin, "Report on Foreign Economic Policy Discussions Between United States Officials in the Far East and Clarence B. Randall and Associates," 18 December 1956, *Declassified Documents Reference System, 1990*, 0443 (hereafter DDRS); Hughes to Bunting, "Activities of the China Mission in the Economic Field," 12 May 1952, *Records of the Office of Chinese Affairs, 1945-55*, reel 16; National Security Council, "U.S. Economic Assistance to Formosa," 28 May 1952, *FRUS, 1952-1954* 14:58.

28. L. B. Pearson to Department of State, 16 June 1952, *Records of the Office of Chinese Affairs, 1945-55*, reel 16; Rankin to Schenck, 14 January 1952, *ibid.*; OIR, "Private U.S. Investments As Sources of Friction in Selected Countries: The Far East," 31 December 1952, RG 59, State Department R&A Report No. 5985.2; Burton Crane, "Formosa Changing Form of Economy," *New York Times*, 8 February 1950.

raw materials. The United States mediated between this sheltered economy and the world market, making up the inevitable exchange shortfall and adding its own subsidies. To lighten its own burden, the United States tried to reduce Taiwan's reliance on imported goods.<sup>29</sup> Military advisers and aid officials worked closely to build an economy capable of supporting Taiwan's military establishment.

Anticipating reductions in military and economic assistance, the Truman administration encouraged the Economic Stabilization Board to draft long-range plans. As the Korean War stabilized in 1952, the Truman administration reconsidered the value of Chiang's army as an auxiliary to U.S. forces in the Far East. Despite aid and controls, Taiwan's economy remained perilously unstable, and Congress could not be expected to subsidize it forever. CIA deputy chief Allen Dulles and Paul Nitze, head of the Policy Planning Staff, urged that in the years remaining, aid should be used "to develop policies which will assure Formosa as an asset." This meant reducing the economic burden of Chiang's six-hundred-thousand-man army, which required the ECA to devote its resources to generating counterpart funds and supporting consumption and state enterprises. If the military burden could become smaller and more predictable, aid could subsidize imports of capital goods—machine tools, dynamos, fabricators—equipment that could be used to make Taiwan's economy support itself.<sup>30</sup>

The last shipments of military hardware were scheduled to arrive in 1956, and the ECA (now called MSA) began planning to terminate economic aid the same year. In August 1952 the mission consulted with the Economic Stabilization Board on preparations for the ending of aid. "An essential corollary of this effort," according to a State Department official, "is a shift in type of economic aid from saleable commodities to generate counterpart over to industrial and capital repair, expansion, and development." At MSA's request, the ESB presented a first draft of a four-year plan on 26 September, beginning a practice that has guided industrial growth on Taiwan ever since. A collage of earlier applications for grants and loans, the plan requested \$242 million in U.S. aid before 1957, when all aid (except military assistance) would end. The section on industry closely copied an industrial program prepared earlier by de Beausset, using his estimates and production targets. Under the plan, Taiwan would use import restrictions and exchange controls to shift foreign buying from commodities

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29. Ching-yuan Lin, *Industrialization in Taiwan, 1946-72: Trade and Import Substitution Policies for Developing Countries* (New York, 1973), 70-72; U.S. Department of Commerce, "Licensing and Exchange Controls, Taiwan," World Trade Information Service Operations Report No. 56-10 (Washington, January 1956); H. K. Kao, "Foreign Exchange and Trade Control in Free China," *Far Eastern Economic Review*, 13 January 1955; Igor Oganessoff, "Formosa Invasion Peril Spotlights U.S. Aid to Army, Economy," *Wall Street Journal*, 27 August 1958.

30. Memorandum of conversation, Department of State-JCS Meeting, 9 April 1952, *FRUS*, 1952-1954 14:39.

to capital machinery while continuing to protect textiles and other light manufacturing. Economists distinguish Taiwan's "indicative" plans from the "command" plans of the USSR, since Taiwan attained its goals with the help of incentives as well as penalties. But by manipulating investment, exchange, imports, prices, and wages, Taiwan seldom missed a target.<sup>31</sup> By strengthening and institutionalizing the planning function, the United States gave Taiwan a powerful tool for guiding development.

In announcing the plan, Chinese officials acknowledged that Taiwan had departed from the course of *laissez-faire* and private enterprise. On 31 December 1953, all of Taiwan's major dailies carried an article by Yin Chung-jung, "A Discussion on Industrial Policy for Taiwan," which declared that in the immediate future, Taiwan must face the near certainty of war with the mainland and the termination of U.S. aid. Both factors made necessary an intensive industrialization effort proceeding as quickly as possible and without wasting resources. "These two aims, however, cannot be achieved under a 'laissez faire' economy," Yin explained. "Their achievement must depend upon the active participation of the government in the economic activities of the island through deliberate plans and its supervision of their execution." The textile program offered a model, he argued, of how the government could guide investment, prices, supply, and demand to create industries from scratch. Private firms that worked "hand in hand with good government policy" would be rewarded; those that failed would be placed under "temporary control." The article excited little disagreement in the controlled press. "Mr. Yin's 'Discussion' on industrial policy, both in spirit and in substance . . . advocates controlled economy," Taiwan's *United Daily News* noted. Most writers approved. As one observed, "progress spear-headed by the government is bound to be more rapid than [progress] promoted by the people alone." The public discussion only hinted at divisions in the government over whether industry or the military should have first claim on resources and manpower.<sup>32</sup>

Strategic refinements that followed the election of Dwight D. Eisen-

31. Walter P. McConaughy to Allison, "Program Analysis: MSA Formosa," 22 August 1952, *Records of the Office of Chinese Affairs, 1945-55*, reel 16. Taiwan had six four-year plans between 1953 and 1975, a six-year plan (1976-81) and a ten-year plan (1980-89). Johnson, "Political Institutions and Economic Performance," 142. The first four-year plan remains secret in Taiwan but has been released in the Records of the Office of Chinese Affairs. De Beausset chose a four-year cycle to coincide with the term of J. G. White's contract. C. L. Terrell to MSA, "Economic Aid to China," 30 September 1952, *Records of the Office of Chinese Affairs, 1945-55*, reel 16; Hope to McConaughy, "Request for Clearance on Press Release Regarding Chinese Four-Year Plan," 3 December 1952, *Records of the Office of Chinese Affairs, 1945-55*, reel 16; interview with Val de Beausset, 31 May 1995; memorandum of conversation with Martin Wong, 9 December 1955, RG 59, Records of the Office of Chinese Affairs, 1954-56, lot 60D171, box 5; Gold, "Dependent Development," 250.

32. K. Y. Yin, "A Discussion of Industrial Policy for Taiwan," *Industry of Free China* 1 (May 1954): 1-14; "Road to Taiwan's Industrial Reconstruction," *ibid.*, 29-36.

hower enlarged the aid pool, allowing industrial growth to proceed without reducing Taiwan's military budget. During the campaign Eisenhower had criticized containment, arguing that Chiang should be "unleashed" to attack the mainland. On 2 January 1953, he followed through, announcing revised orders for the Seventh Fleet permitting Taiwanese offensive operations. The move was mainly bluff (Chiang secretly promised not to attack), but it meant a reprieve for Taiwan. Levels of military aid climbed—from \$24 million in 1953 to \$36 million in 1954 and \$37 million the following year—forcing economic aid to keep pace in order to forestall inflation. Talk of aid termination momentarily ceased, and the industrial program continued without cutbacks or competing demands from the military.<sup>33</sup>

Businessmen in Eisenhower's cabinet raised concerns about the statist direction of aid policy, but the administration remained pragmatic. Defense Secretary Charles E. Wilson, a former General Motors executive, complained in 1955 that by building government-run factories, the United States was "helping these countries to proceed down the road which led to state socialism or Communism." Undersecretary of State Herbert Hoover, Jr., agreed that "in many instances our assistance programs were actually subsidizing state socialism." The Soviet economic offensive in the Third World focused the National Security Council's attention on the issue in January 1956. Treasury Secretary George Humphrey argued that the Soviet initiative made it imperative that U.S. aid programs not be allowed to "create and maintain other government-controlled economies in the underdeveloped nations of Asia and Africa." But the president disagreed. "We did not need to fear a socialized state as something inimical to us in itself," Eisenhower observed. Sweden and Norway were socialist but also strong allies. Only socialized states tied to Moscow posed a danger. Vice President Richard M. Nixon pointed out that in most of Asia "there is no private enterprise which can be developed. . . . We cannot let these Asian nations go down the drain and be swallowed up by the Soviet Union while we are engaged in a campaign to support the ideals of free enterprise." Harold Stassen, director of the foreign aid program, suggested that the United States ought at least to appear to back private firms.<sup>34</sup>

In stressing the essential choice between a planned and a market economy, Humphrey and Wilson were simply repeating a widely accepted axiom of development theory. But other officials—from Eisenhower down—

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33. Karl Rankin to Walter P. McCaughy, 10 April 1953, *FRUS, 1952-1954* 14:184; memorandum of conversation, "Chinese Government Budgetary Problems and Interest in IBRD Loan," 21 September 1953, *FRUS: Secretary of State's Memoranda of Conversation, November 1952-December 1954 (Microfiche Supplement)* (Washington, 1992); memorandum of conversation with Martin Wong (secretary general, Council for U.S. Aid), 9 December 1955, RG 59, Records of the Office of Chinese Affairs, 1954-56, lot 60D171, box 5.

34. Minutes of the 266th meeting of the NSC, 15 November 1955, *FRUS, 1955-1957* (Washington, 1989), 10:29-30; minutes of the 273d meeting of the NSC, 18 January 1956, *ibid.*, 64-66.

saw the situational imperatives shaping Taiwan's political economy and were ready to discard theory if the circumstances justified it. Stassen, Rankin, and advisers close to the Taiwan aid mission would have preferred market-oriented solutions, but none seemed available. They complained that Taiwan's state enterprises were inefficient, riddled with nepotism, sinecures, and "mysterious" bookkeeping. But they recognized that Taiwan had few entrepreneurs and even fewer outside investors. Stassen had to admit that "private capital, both local and foreign, has not responded to the call." "Obviously it is desirable that private investment be encouraged" to lighten the aid burden, Rankin acknowledged, but even with U.S. guarantees, Taiwan's uncertain future kept investors away. "We are dealing with a problem that cannot wholly be solved by financial mechanisms," explained John J. McCloy, the governor of the World Bank. "Government capital can be directed, but private capital movements . . . can only be induced." U.S. officials in Taipei concurred. When Christian Herter, a visiting aid official, questioned the necessity for multiple exchange rates and state corporations, the embassy's economic officer pointed out the futility "of applying generalized free enterprise truisms to the peculiarities of the Chinese situation."<sup>35</sup> This kind of situational economics drew fire from Congress and critics within the administration, but aid officials continued to act on circumstances instead of theory.

Sensitive to American criticism, the Taiwanese took pains to appear at least to move toward liberalization. In 1952 aid workers had urged KMT officials to pay for the proposed final stage of land reform, the "Land to the Tiller" program, by giving landlords shares in public corporations. "Non-productive corporations would be at least partially removed from government ownership," a U.S. official explained. The firms "would presumably improve in productivity, while at the same time, the means would have been found for the re-purchase of land." Some analysts have since identified the program as a genuine move toward privatization; but as it was implemented in 1954, it looked more like a power grab. The state compelled landlords to surrender their property in return for overvalued shares in four public enterprises. Most shares immediately lost half their value. Shareholders enjoyed no proprietary privileges, and the firms continued under the same management with as much guidance from the state as ever. Aid officials

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35. Joseph Schumpeter and Max Weber are largely responsible for the market/planning dualism; see Chalmers Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975* (Stanford, 1982), 18; and Nathan Godfried, *Bridging the Gap between Rich and Poor: American Economic Development Policy toward the Arab East, 1942-1949* (New York, 1987), 12-13. Foreign Operations Administration (FOA), *Conclusions and Recommendations of the International Development Advisory Board* (Washington, 1953), 18; Karl M. Rankin, "Report on Foreign Economic Policy Discussions between United States Officials in the Far East and Clarence B. Randall and Associates," 18 December 1956, *DDRS, 1990, 0443*; FOA, *Conclusions*, 18; A. Guy Hope to Rankin, 14 January 1955, RG 59, Records of the Office of Chinese Affairs, 1954-56, lot 60D171, box 4.

noted that the shabby treatment of stockholders frightened potential investors more than ever.<sup>36</sup>

The aid mission may have strengthened the state's entrepreneurial role with its policy of incubating new "private" ventures. The mission encouraged Taiwanese planners to identify promising fields and to make investments even when no private companies offered to participate. Factories would be built with U.S. aid and then turned over to a hand-picked "entrepreneur" who would administer the company as a private concern. The mixture of state guidance and private ownership fit the political imperatives guiding U.S. policy: Privatization co-opted Formosans into the system, while Chiang's government kept control of resources and revenue. In 1955 the mission initiated a \$1.5-million project to manufacture plastic resins that were then being imported from a Japanese subsidiary of Monsanto. Despite congressional opposition in the United States, the project went ahead. J. G. White and Taiwanese planners both identified plastics as a desirable venture, and Yin Chung-jung took a personal interest in the proposal. Using the state's access to bank records, Yin identified Y. C. Wang as a suitable entrepreneur and "told" him to take over the plant when it was completed in 1957. The company went on to become the Formosa Plastics Group, a Fortune 500 company with subsidiaries in the United States. In Taiwan, establishing firms under state tutelage became standard practice as U.S. policies encouraged ever more complex and sophisticated linkages between corporations and the state.<sup>37</sup>

The two countries sometimes disagreed on economic policy, but the arguments usually surfaced in debates over military strategy. After their initial enthusiasm, Eisenhower's aides soon recognized that the United States could not support Chiang's oversized army indefinitely. The largest army in proportion to population in the world, it consumed 80 percent of Taiwan's budget, yet only a third of its soldiers were combat effective.<sup>38</sup> In

36. Troy L. Perkins to Mr. Johnson, "MSA Proposals for a Joint Commission for Industrial Development and a China Development Corporation," 18 July 1952, RG 59, 894A.00/7-1852; Nicholas H. Riegg, "The Role of Fiscal and Monetary Policies in Taiwan's Economic Development" (Ph.D. diss., University of Connecticut, 1978), 38; Igor Oganessoff, "A Tale of Two Lins: Land Reform Narrows Formosan Social Gap," *Wall Street Journal*, 15 April 1960. Of the four firms, only Taiwan Cement appreciated in value, and it only began to show a return after several years. Industry officials sought assurances that relations with government would remain as before. See the discussion on privatization in *Industry of Free China* 1 (1954); Joseph L. Brent, "Report on Foreign Economic Policy Discussions Between United States Officials in the Far East and Clarence B. Randall and Associates," December 1956, *DDRS*, 1990, 0444.

37. House Committee on Foreign Affairs, *Interim Report of the Subcommittee for Review of the Mutual Security Programs*, 86th Cong., 1st sess., 15 February 1959, 5; Alfred E. Moon to Stassen, "Secretary Hoover's Request for Information on the Proposed Plastics Plant for Formosa," 13 May 1955, and D. A. Fitzgerald to Stassen, "Polyvinyl Chloride Project in Formosa," 7 July 1955, Records of U.S. Foreign Assistance Agencies, Geographic Files of the Director, RG 469, box 26, Washington National Records Center; Wade, *Governing the Market*, 80.

38. Walter P. McConaughy to Mr. Allison, "Program Analysis: MSA Formosa," 22 August 1952, *Records of the Office of Chinese Affairs, 1945-55*, reel 16.

1956, MAAG encouraged Chiang to strike a more defensive posture, rely more on U.S.-supplied Matador missiles and Sabrejet fighters, and shrink the army. If military consumption could be reduced, aid officials could divert sufficient resources to capital formation to allow Taiwan to become self-supporting in a few years.<sup>39</sup> But Chiang stubbornly refused. Believing a reduction in military consumption would weaken mainlander control, the Bank of Taiwan, heads of state enterprises, and KMT officials joined ranks in upholding the pledge to return to the mainland, a mythic mission that justified the perpetual regimentation of the economy.<sup>40</sup> For the heads of state monopolies, the stakes were huge. The military was their source of credit and largest customer, buying 65 percent of the island's output of petroleum products and 40 percent of its cement.<sup>41</sup> U.S. officials argued, but they learned to design programs allowing the industrial program to continue without endangering the privileges of the military and its client firms.<sup>42</sup>

To accelerate the industrial program, the aid mission first had to give the military a stake in industrial development. Instead of diverting the military budget into capital formation, aid officials advised sacrificing consumer spending. The mission found the "standard of living on Taiwan, although miserably low by U.S. standards, is quite good by Asian standards." With Taiwan's 3.4-percent population growth, the State Department agreed, "a considerable portion of increased economic activity will have to be *prevented* from improving standards of living in order to help reduce imports" and government spending.<sup>43</sup> The mission advised keeping wages in check, resting its calculations partly on the assumption that the Formosan majority had little capacity for dissent.<sup>44</sup>

The mission also included the army in the industrial program by employing it to build infrastructure, committing a substantial portion of the aid

39. Rankin to Radford, 3 January 1956, RG 59, Records of the Office of Chinese Affairs, 1954-56, lot 60D171, box 18. The military hampered the industrial effort by running up budgetary deficits that siphoned off savings and investment through taxes and high interest rates. The military also had first claim on skilled technicians, electric power, petroleum, and cement.

40. Haggard, *Pathways*, 87; memorandum of conversation, Karl Arndt and Herbert Prochnow, "Discussion on Taiwan Economy in Taipei, October 10, 1955," RG 59, Records of the Office of Chinese Affairs, 1954-56, lot 60D171, box 12.

41. Operations Coordinating Board, "Report on Taiwan and the Government of the Republic of China," 16 April 1958, Eisenhower Papers, NSC Series, Policy Papers, Dwight D. Eisenhower Library, Abilene, Kansas.

42. NSC-5610, "Report by the Interdepartmental Committee on Certain U.S. Aid Programs," 3 August 1956, Eisenhower Papers, NSC Series, Policy Papers.

43. T. R. Bowden to Laura B. Hughes, 7 February 1956, RG 59, Records of the Office of Chinese Affairs, 1954-56, lot 60D171, box 12 (emphasis in original).

44. OIR, "Attitudes Toward Aid Programs." This assumption was proved wrong on 24 May 1957, when a mob sacked the U.S. embassy in Taipei after the acquittal (by a U.S. military court) of an American officer accused of murdering a Taiwanese man. The high living standards of U.S. servicemen partly accounted for the rioters' anger. Tucker, *Taiwan, Hong Kong, and the United States*, 90-92.

budget after 1956 to an East-West highway built by retired soldiers. To get Chiang to reduce his forces and recruit younger Formosan troops, the United States created the Vocational Assistance Committee for Retired Servicemen (VACRS) to employ overage soldiers in building the highway and developing mines, businesses, and timberlands along its route. VACRS enjoyed first claim on machinery imports and investment capital, privileges it continues to enjoy today. Now a conglomerate of some forty firms, VACRS is Taiwan's largest "private" business.<sup>45</sup> By ensuring the military and its client firms dominance over resources and attractive sectors, the mission co-opted the army into the industrialization drive.

Taiwan's economy moved rapidly ahead in the last years of the decade. With the help of generous applications of chemical fertilizer and DDT, farm exports tripled and nearly every available hectare was brought into production. Hydroelectric dams made Taiwan's power among the world's cheapest and most abundant. Manufacturing grew eight-fold from 1950 to 1959, flooding local markets with aluminum pans, textiles, and electrical parts.<sup>46</sup> The *Wall Street Journal* found Taipei "bustling and sprawling with the raw energy of an American frontier town."<sup>47</sup> But as U.S. aid passed the \$1-billion mark in mid-1958, aid officials knew import substitution had reached its limit. The inward-looking manufacturing sector remained at the mercy of the U.S. Congress, and export earnings—from sugar, pineapple, and other farm goods—suffered from Cuban and even U.S. competition.<sup>48</sup> Continued growth depended on finding new investment and sources of exchange.

U.S. advisers had long seen manufactured exports as a solution to Taiwan's critical shortage of foreign exchange. In 1952, de Beausset had urged manufacturers to exploit shortages created by the Korean War to corner markets in Southeast Asia. The opportunity drew more attention in 1954 when overproduction provoked a crisis in the textile industry. Mills were forced to close for more than a month owing to the saturation of the home market, a condition afflicting other industries as well. China gave officials in Washington and Taipei a second reason to push exports. In 1955, the People's Republic had reopened the Burma Road and launched a campaign to capture markets in Southeast Asia. KMT and State Department officials worried that trade might enlarge Communist China's influence, particularly

45. House Committee on Government Operations, *Foreign Aid and Construction Projects*, 85th Cong., 2d sess., 1958, 852; Republic of China, *China Yearbook, 1960-1961* (Taipei, 1960), 10; Robert H. Silin, *Leadership and Values: The Organization of Large-Scale Taiwanese Enterprises* (Cambridge, MA, 1976), 21. VACRS was originally called the Retser Program.

46. "Taiwan Electric Power Industry," *Far Eastern Economic Review*, 21 October 1954, 529; House Special Committee to Study the Foreign Aid Program, *Korea, Japan, Taiwan, and the Philippines: A Report on United States Foreign Assistance Programs*, 85th Cong., 1st sess., March 1957, 17.

47. Vermont Royster, "Island in the Sun: Formosa Grows Prosperous and Tries not to Look Back," *Wall Street Journal*, 26 March 1959.

48. H. K. Kao, "Foreign Exchange and Trade Control in Free China," *Far Eastern Economic Review*, 13 January 1955.

in the region's overseas Chinese communities. In December 1956, Chiang and Secretary of State John Foster Dulles had agreed on an export program to counteract this "cultural penetration." Nonetheless, import substitution had created powerful interests bent on preserving the system. Instead of exports, Finance Minister Hsu Pen-yuan and army officials proposed diverting resources into new import substituting ventures, like plastics and autos. But faced with increasing pressure from the United States, domestic manufacturers, and the KMT leadership, the opposition broke in April 1958. Hsu resigned, clearing the way for export-oriented reform.<sup>49</sup>

Between 1958 and 1961 the government imposed a series of reforms known as the Nineteen Points, replacing multiple exchange rates with a single rate; relaxing import controls and tariffs; offering rebates, tax incentives, credit, and subsidies to manufacturers producing for export; and allowing foreign firms to remit profits for the first time.<sup>50</sup> Neoclassical economists see this as Taiwan's turning point, its rejection of counterproductive, interventionist policies. But state-oriented analysts point to the selective nature of the reforms, which applied only to targeted sectors, industries like aluminum and textiles, which were ready for international competition.<sup>51</sup> Import substitution continued for most of the economy. Reform did not even mean an end to intervention in the export sectors, since government subsidies, credits, and rebates remained the key to success for private firms. Once again, the mechanisms of control simply became more sophisticated.

Taiwan's military success during the August 1958 straits crisis reinforced the shift toward an export-based strategy. When Communist forces began shelling Quemoy island on 23 August, Taiwanese Sabrejets took to the skies and inflicted heavy losses on the air force of the People's Republic. On 6 October the shelling stopped, and two weeks later Chiang and Secretary of State John Foster Dulles signed a joint communiqué renouncing the use of force to reconquer the mainland. The communiqué promised no reductions in China's armed forces, but the crisis demonstrated that Taiwan's defense rested on air supremacy, which in turn rested on earnings of foreign exchange. The Sabrejets required \$5–6 million worth of imported fuel and parts each year, an amount that could only be earned with manufactured

49. Val de Beausset to file, "Value of Aluminum Company to Taiwan," 19 February 1952, Records of U.S. Foreign Assistance Agencies, Mission to China, Organizations and Individuals, 1948–54, RG 469, box 2, National Archives; The Economist Intelligence Unit, *Quarterly Economic Review of China and Hong Kong* No. 9, March 1955, 8; George K. C. Yeh to Karl Rankin, "A Plan for Sino-American Cooperation to Combat Communist Penetration in Asia," 1 December 1956, *DDRS, 1994*, 1929; Stephan Haggard and Chien-Kuo Pang, "The Transition to Export-Led Growth in Taiwan," in *The Role of the State in Taiwan's Development*, ed. Joel Aberbach, David Dollar, and Kenneth Sokoloff (Armonk, NY, 1994), 73–74.

50. U.S. Department of Commerce, Bureau of Foreign Commerce, "Licensing and Exchange Controls, Taiwan," *World Trade Information Service Operations Report No. 59-12* (Washington, February 1959).

51. Wade, *Governing the Market*, 52–55; Haggard, *Pathways*, 92–93.

exports.<sup>52</sup> Two weeks after the communiqué, Taiwan implemented exchange rate reforms.

Export-orientation did not make things easier for private firms or outside investors. The government still controlled prices and interest rates, and without official sponsorship private firms remained vulnerable to sudden shifts. The most conspicuous victim was Tang Rong, a privately owned steel firm undergoing rapid expansion when it was caught overextended by a sudden rise in interest rates in 1960. The military had a strong interest in steel, and two years later the government stepped in to reorganize Tang Rong as a public enterprise.<sup>53</sup> But private firms that collaborated with the state enjoyed favored access to investment capital, as well as almost guaranteed profits and market share. Ta Tung Engineering, a manufacturer of electric fans, expanded with the help of U.S. aid and the Taiwanese government into the production of electrical meters, motors, and switches for export under licenses from Westinghouse and Toshiba. Lin Ting-sheng, the company president and a member of the KMT central committee, explained that "money is no problem. The problem is how to spend it wisely."<sup>54</sup> For both the United States and Taiwan, choices between public- and private-sector solutions were guided less by theory than by considerations of control, politics, and cost.

Continued restrictions, official and unofficial, discouraged foreign direct investment and encouraged arrangements favorable to Taiwanese companies. U.S. investment accelerated after the reforms, growing from just over \$2 million in 1959 to around \$50 million by 1965, but American businessmen still felt harassed. *Fortune* noted that Taiwan's "prevailing philosophy, inherited from Sun Yat-sen, if not exactly anti-capitalist, was in important respects not pro-capitalist."<sup>55</sup> A congressional delegation visited Taiwan in 1960 and found businessmen skeptical about reform, accusing the government of "extreme interference in the conduct of business, whether domestic or foreign." Public corporations competed with private ones, and officials persecuted foreign firms. The delegation found one unfortunate American whose plant had been shut by the Keelung city

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52. Harold Stassen to Struve Hansel, "Approval of FY1950-54 Mutual Defense Assistance Revised Material and Training Programs," 29 December 1954, RG 59, Records of the Office of Chinese Affairs, 1954-56, lot 60D171, box 5; Operations Coordinating Board, "Report on Taiwan and the Government of the Republic of China," 15 April 1959, Eisenhower Papers, NSC Series, Policy Papers.

53. Noble, "Between Competition and Cooperation," 133.

54. "Formosa: The Remarkable Message," *Fortune*, June 1959, 224; "Industries to be Visited by Herter Party," 13 September 1957, RG 469, Records of the U.S. Foreign Assistance Agencies, Mission to China, Industrial Development Division, Subject Files, 1956-61, box 14.

55. P. W. Colm and C. B. Bongard, "Taiwan: U.S. Policy Problems," 10 January 1966, *DDRS*, 1993, 2117; "Formosa: The Remarkable Message," *Fortune*, June 1959, 220, 226; Robert Keatley, "Prosperous Taiwan is on Way to Becoming Big Factory Center," *Wall Street Journal*, 2 August 1965, 1.

government and who, weeks later, had yet to discover why it was closed and who could reopen it.<sup>56</sup>

The economic ministry screened applicants for investment permits and employed a variety of devices to induce foreign firms to accept local partners (or partnership with a state enterprise) and transfer ownership to Taiwan after a set period. No fully-foreign-owned subsidiaries were allowed.<sup>57</sup> Faced with these restrictions, many foreign investors found it easier to allow Taiwanese firms to manufacture products under license, an arrangement by which U.S. and Japanese firms transferred technology and capital to a Taiwanese company in return for royalties. Japanese firms worked chiefly through licensing agreements, and between 1960 and 1965 a growing number of U.S. firms employed this option. It allowed Taiwan to retain domestic control of key industries and compelled foreign firms to share technology. Not until the erection in 1965 of the first export processing zone, a man-made platform in Kaohsiung Harbor that physically and symbolically segregated foreign firms from the domestic economy, did U.S. firms enjoy a degree of autonomy. Even then, a government Investment Commission kept a close eye on their operations.<sup>58</sup> Embassy officials were fully aware of the restrictions hampering U.S. investors, but there is no evidence that they made a concerted effort to change matters.

The aid mission could not undo what it had done. U.S. programs had given life to a plexus of government-corporate linkages too tangled even for AID officials to figure out. In the early 1960s, an AID official tried to discern the scale and complexity of links between the ministries, state enterprises, and private firms by interviewing managers and bureaucrats. His first visits provoked an official protest and he was ordered to stop.<sup>59</sup> Most American officials saw few reasons to quarrel with success. With its low inflation, high rate of capital formation, and solid support for defense, Taiwan stood apart from other clients. Undersecretary of State C. Douglas Dillon found its prospects for "rapid and sustained growth . . . quite exceptional."<sup>60</sup>

By the first years of the Kennedy administration, both governments were advertising Taiwan as a private enterprise success story. KMT officials presented it as a showcase of enlightened Nationalist rule and hinted that Taiwan's growing prosperity could incite rebellion on the mainland.<sup>61</sup> Kennedy, who had criticized Eisenhower's aid programs, touted Taiwan as an

56. Senate Committee on Interstate and Foreign Commerce, *Foreign Commerce Study*, 86th Cong., 2d sess., 1960, 7.

57. For the full list of restrictions on foreign investment see Chi Huang, "The State and Foreign Capital: A Case Study of Taiwan" (Ph.D. diss., Indiana University, 1986).

58. P. W. Colm and C. B. Bongard, "Taiwan: U.S. Policy Problems," 10 January 1966, *DDRS*, 1993, 2117; Haggard, *Pathways*, 198-99.

59. Allan B. Cole, "Political Roles of Taiwanese Entrepreneurs," *Asian Survey* 7 (September 1967): 645.

60. Douglas Dillon to Robert B. Anderson, 3 December 1959, RG 59, 894A.00/12-359.

61. Seymour Topping, "Taiwan Shifting Emphasis from War to Prosperity," *New York Times*, 21 December 1964.

exemplar of non-Communist development.<sup>62</sup> AID held up Taiwan's success as a shield against criticism. Release in 1958 of *The Ugly American*, a best-selling account of bungling aid officials, opened a series of congressional probes, funding cutbacks, and restrictions that only intensified during the Kennedy years. Senators Mike Mansfield (D-MT) and Jacob Javitz (R-NY) pushed for termination deadlines and a "private enterprise" approach to aid policy, positions ratified by the Clay Commission in 1963. That same year Congress created an Advisory Committee on Private Enterprise in Foreign Aid and instructed it to suggest a program of reforms by July 1965.<sup>63</sup> In January 1965 AID responded by announcing Taiwan's impending graduation and the commissioning of the Jacoby study.<sup>64</sup>

Jacoby's study defended AID at its most vulnerable points. While critical of procedural details, it congratulated AID for sticking to free-market fundamentals. "Both through its allocation of aid funds . . . and through its influence on Chinese policies, AID helped make private enterprise flower. It did not 'build socialism' in the Republic of China." Bell called the report "a milestone in the study of economic development."<sup>65</sup> At least temporarily, it mollified the critics. The advisory committee produced a report milder than that of the Clay Commission, but AID's prestige was only partly restored.<sup>66</sup> As the *New York Times* observed, "the 'graduation' of one client state . . . denotes virtually nothing about the progress of the other major clients or about the needs and American obligations in all the rest of the world."<sup>67</sup>

Taiwan did not pursue "etatisme" in spite of U.S. advice but partly because of it. The aid mission and Nationalist officials together invented institutions and patterns of government activity that some analysts today identify as ingredients of Taiwan's success. American engineers and aid officials carefully steered the Nationalist government around political obstacles that might have prevented or delayed industrialization, appeasing the military and improving the efficiency of state enterprises instead of trying to eliminate them. They chose solutions based not on fixed ideas but on circumstances and military necessity.

Aid officials saw the Nationalists' preference for statist solutions not as a cultural characteristic but as a reasonable response to political and economic circumstances: the absence of entrepreneurs, the needs of the military, the

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62. Kennedy to Chiang, 17 April 1961, in *President John F. Kennedy's Office Files, 1961-1963*, part 5, *Countries File*, ed. Paul Kesaris and Robert E. Lester (Bethesda, MD, 1989), microfilm, reel 4; Rostow to Kennedy, 31 July 1961, *ibid.*

63. *Congressional Record*, 88th Cong., 2d sess., 1963, 110, pt. 9:11906.

64. Felix Belair, Jr., "U.S. to Publicize Effects of Aid on Boom in Taiwan," *New York Times*, 13 January 1965.

65. Jacoby, *U.S. Aid to Taiwan*, 245, vi.

66. Advisory Committee on Private Enterprise in Foreign Aid, *Foreign Aid through Private Initiative* (Washington, July 1965).

67. Max Frankel, "U.S. Economic Aid to Taiwan Ended; 'Graduation' Hailed," *New York Times*, 1 July 1965.

shortage of export revenue. Instead of waiting for the cascades of capitalist development to reach Taiwan, the aid mission made its own waves. U.S. officials only later came to regard such tactics as counterproductive, and not because of their own experience, but because of pressure from Congress to adopt strategies that would create the proper climate for U.S. direct investment abroad. After the mid-1960s, in a vain bid to appease its critics, AID justified its massive interventions in foreign markets in the name of preventing government intervention in foreign markets. But by then Taiwan had already graduated.

By dealing pragmatically with local situations and weighing tradeoffs between strategic, political, and developmentalist goals, U.S. officials counteracted the universalizing tendencies of development theory. The United States, at least in aid's early years, supported the growth of political economies as distinct from each other as they were from putative models.<sup>68</sup> In many ways, the Cold War concealed the diversity in philosophy and organization among capitalist economies that is now apparent, and some observers have already predicted that these differences will lead to a crisis in the world trade order or even a new East-West confrontation. In any event, debates on U.S. trade and industrial policy will likely focus on problems the China Aid Mission was familiar with: issues of political economy, the proper relations between state and market, and how other countries have organized themselves in the struggle for relative efficiency.

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68. For example, Taiwan's "graduating class" included South Korea, Iran, and Brazil.