

**USAID Development
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Principles from East Asia: The Case of Taiwan
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Summary

Taiwan is considered a USAID success story. Much of this success can be attributed to specific strategies and principles. During its engagement with Taiwan, USAID:

- successfully engaged the endorsement, commitment, and support of high level Taiwanese officials and U.S. government policy makers.
- successfully engaged the support and cooperation of like-minded local experts and other allies in the recipient government.
- trained and maintained contact with reform-oriented local technical experts, especially when official policy was not on a growth track. Using this approach, USAID established a relationship with future leaders which contributed to successful policy implementation in 1960.
- in general, took steps which strengthened the position of allies within the recipient government.
- focused primarily on promoting a pro-growth policy environment and a free-market economy.
- established an overall strategy focusing on key goals which included export-led growth and the creation of a viable private sector.
- in consultation with like-minded officials in the recipient government, established a reasonable and detailed list of reforms, a time line for implementation, and measures of success (i.e. the “19 Points” Proposal).
- clearly and credibly articulated that aid will be withdrawn if conditions were not strictly met or measurable progress not made. The United States Government was prepared to withdraw aid if necessary.
- established semi-autonomous, external institutions for the purpose of administering aid. Members of these bodies included United States officials. This was especially important given that the private sector was small and that Taiwan had little experience with private sector development.

I. Introduction

USAID's work played a central role in propelling Taiwan towards strong, sustained, and equitable economic growth that benefited broad segments of the population. Indeed, between 1952 and 1980 Taiwan reported an average annual growth rate of 9.2 percent, and between 1981 and 1995 an average annual growth rate of 7.5 percent.

From 1951 through 1965 the U.S. invested \$1.5 billion in Taiwan's economy with aid funding representing nearly half of public investment over the course of U.S. engagement.¹ Most of these funds were aimed at creating a domestic infrastructure conducive to private investment and were channeled toward utilities, transportation and agro-industries. Aid funding was also used to establish the China Development Corporation, the Industrial Development and Investment Center, the Joint Commission on Rural Reconstruction, the China Council for U.S. Aid, and several export processing zones, all of which were geared toward promoting exports, private investment and growth.

Importantly, since 1960 disbursement of funds was conditioned upon the adoption of nineteen specific private sector-led, export-oriented policy reforms and an overall improvement in the policy environment. These efforts enabled unprecedented economic growth. Overall, Taiwan's GNP increased from \$900 million in the early 1950's to \$2.4 billion by 1965, a magnitude some believe could not have been attained until 1995 were it not for U.S. provided aid and policy recommendations. Taiwan's impressive economic performance and drive toward industrialization are, in large part, attributed to USAID and ECA investment and to the successful implementation of U.S. prescribed economic policy reforms.²

According to Pillsbury (1999), the underlying reason for U.S. success in Taiwan stems from: (1) active involvement of high level U.S. officials; (2) support of at least some high level officials in the recipient government; (3) the consistent support of western-trained local technical experts in key positions; (4) the implementation of specific, market-oriented reforms which were developed by both the recipient and donor; (5) the development of semi-autonomous institutions designed for the purpose of administering aid; and (6) strengthening the position of allies in the recipient government and ensuring lasting success by making the dispersal of aid contingent on implementation of reforms and positive results.

This paper more closely examines USAID and ECA involvement in Taiwan, why Taiwan was a success story, and the degree to which policy reforms coincide with the current views on development.

¹ Approximately 50 percent of aid was allocated for defense support, 25 percent was PL 480 agricultural surplus, and 12 percent was technical assistance, development loans, and grants (Pillsbury (1999)).

² ECA, or the Economic Cooperation Administration, was the predecessor of USAID.

II. U.S. Involvement in Taiwan

From 1951 through 1965 the United States provided Taiwan with both policy advice and investment.³ Throughout the 1950s Taiwan readily accepted U.S. investment but, due to political opposition, was only partly receptive to policy prescriptions. However, Taiwan did implement some reform during the 1950's. During this time the government managed to bring inflation under control, balanced the budget, attempted to reform the tax system, reformed state-owned enterprises to a degree, and made some effort to encourage the production of manufactured exports. Key reforms such as comprehensive currency devaluation, privatization of the state bank, privatization of state owned enterprises, aggressive promotion of exports, and liberalization of foreign investment and trade were resisted.

Though Taiwan's approach to policy reform during the 1950s was half-hearted at best, the measures taken were a step in the right direction and supported economic growth to some degree. However, Taiwan was unable to reach its full potential and remained an agricultural economy with a small private sector and only two primary exports; sugar and rice.

In 1960 the U.S. took a more assertive approach and engaged Taiwan in a very aggressive policy dialog. The U.S. government offered Taiwan a \$45 million grant, followed by \$10 million two months later, with the condition that it undertake a comprehensive reform program focusing on export-promotion and private sector development. The strategy worked. Taiwan accepted the package and undertook an export drive as well as measures to aggressively and credibly expand the private sector. Taiwan enacted land reform, moved away from import substitution, used various tools to encourage private investment and savings, lessened reliance on state owned enterprises, and implemented various other reforms. The results were dramatic. The savings rate increased to an unprecedented 35 percent, freeing up funds for public investment and private lending, government expenditure was reduced to under 20 percent of GNP, and by 1961 private capital started flowing into the country. The economy grew at an astounding rate and quickly became private sector driven, export oriented, and industrialized. In 1952, agriculture was the largest sector of the economy, comprising 32.2 percent of GDP while industry comprised only 16.7 percent. By 1961 agriculture's share fell to just 25 percent and industry rose to 23.7 percent, and by 1962 agriculture was no longer the largest share of the economy. Taiwan's industrial era was underway.

Much of the growth that occurred from the early 1960s onward is a direct result of market-oriented reforms and can be attributed to a growing private sector and strong export performance which many argue would not have been possible without U.S. involvement. By the time USAID involvement ceased in 1965, both industry and the private sector were vibrant and well-established.

³ The IMF was the only other external development organization to be involved in Taiwan during the 1950's and limited its involvement to offering advice. In 1955 the IMF suggested that Taiwan allow exporters to use export earnings for the purpose of buying imported goods. Taiwan responded positively to this advice.

III. Why USAID Succeeded in Taiwan

In addition to offering appropriate policy prescriptions and engaging in aggressive policy dialog, USAID was successful in Taiwan because key U.S. and Taiwanese government officials were committed to market-reform and because aid was effectively disbursed.

Several high level Taiwanese officials were receptive to policy advice as were lower-level, western-trained economists and other technocrats in the government, while the military and some elements in the government were strongly opposed to reform. Recently declassified documents reveal that a great deal of behind the scenes preparation and dialog took place and that top Taiwanese and U.S. officials were actively engaged in formulating a coherent plan for policy reform. Additionally, many officials in the United States, including President Eisenhower, were highly supportive of efforts to assist Taiwan and were personally interested in launching a new development program.

Perhaps the greatest support came from Taiwan's Minister of Economic Affairs, K. Y. Yin. Though not originally a market reformer, in the mid-1950s Yin had come to believe that market-oriented policies would offer the surest path to growth and development, and understood the importance of rapid industrialization, trade liberalization and devaluation. In 1958 Minister Yin came to power and in cooperation with the ECA, USAID's predecessor agency, developed a confidential "19 Point" Proposal of reforms (see Appendix).⁴ The "19 Point" Proposal stressed rapid, comprehensive, and specific actions, and supported the development of an export industry and private sector. It also focused on continued macroeconomic stabilization and microeconomic adjustment. Specifically, this proposal aimed at improved trade capacity, greater savings and investment, development of a capital market, privatization, raising electricity prices to market rates, limiting military budgets, reforming the tax system and tax administration, establishing a central bank, liberalizing imports, and unifying the exchange rate. Indeed, with Minister Yin's urging, acceptance of the "19 Points" became the primary condition the U.S. imposed before disbursing aid.⁵

It has been argued that another reason for USAID's success in Taiwan was effective aid administration. Given the fact that during the 1950's and early 1960's Taiwan had a very small private sector and little experience in developing private industry, it was determined that disbursing aid effectively was an especially important component for a successful development program. This was all the more important given the magnitude of aid which, at one point, accounted for almost 10 percent of Taiwan's GNP and half of all investment. In order to appropriately channel funds, Taiwan agreed to the creation of several semi-autonomous, external institutions which would be used to disburse funds. These institutions, specifically the China Development Corporation and the Industrial Development and Investment Center, were funded by the United States and staffed by

⁴ USAID initially proposed ten points, but at Minister Yin's urging nine additional points were added (Pillsbury (1999)).

⁵ It is noteworthy that in order to strengthen his position and ensure the implementation of comprehensive reform, Minister Yin was especially adamant that military expenditure (point 14) be more closely examined as a pre-condition for aid (Williamson (1999)).

U.S. officials. Additionally, at U.S. urging, Taiwan created several export processing zones which encouraged private capital flows and helped expand the private sector. These were deemed so successful that additional export zones soon followed.

IV. Taiwan and the ‘Washington Consensus’

Conditionality, support from both U.S. and Taiwanese officials, the creation of effective aid administering institutions, and export processing zones all contributed to the success of USAID’s efforts in Taiwan. But it is also important to consider the role of policy and whether advice offered at the time was indeed appropriate.

In the 1980’s, John Williamson of the Institute for International Economics first articulated what has become known as the Washington Consensus.⁶ The Washington Consensus is comprised of ten broad policy reforms and principles on which there is some agreement among experts (see appendix). It is argued that, when properly implemented, these reforms create an environment conducive for economic growth and development. Though Taiwan’s reform efforts pre-date Williamson’s work, it is important to note that to a large degree the “19 Points” coincide with the ‘Washington Consensus’, at least partly addressing each of the Consensus reforms except for property rights (Consensus point 10).

⁶ For details see Williamson (1990, 1999 and 2002)

Appendix

The “19 Points” Proposal⁷

- (1) Tax incentives to increase savings.
- (2) Establish a securities exchange.
- (3) Liberalize controls on private investment.
- (4) Privatize several government enterprises.
- (5) Review further liberalization of private investment.
- (6) Submit legislation to expedite private project approval.
- (7) Improve efficiency of public enterprises.
- (8) Establish a commission to reform public utility rates.
- (9) Reform tax administration.
- (10) Submit a new tax law.
- (11) Establish a performance budget.
- (12) Remove hidden subsidies to government enterprises.
- (13) Remove non-salary subsidies to government employees.
- (14) Closer scrutiny of defense expenditure.
- (15) Create a central bank to control interest rates and credit separate from the Bank of Taiwan.
- (16) Expand the banking supervision system.
- (17) Ensure banks follow their charters.
- (18) Establish a unitary exchange rate of foreign exchange.
- (19) Promote exports by providing incentives, simplifying procedures, and broadening overseas commercial contacts.

The ‘Washington Consensus’⁸

Generally, the Washington Consensus is comprised of the following ten reforms:

- (1) Fiscal Discipline.
- (2) Reordering Public Expenditure Priorities.
- (3) Tax Reform.
- (4) Liberalizing Interest Rates.
- (5) A Competitive Exchange Rate.
- (6) Trade Liberalization.
- (7) Liberalization of inward Foreign Direct Investment.
- (8) Privatization.
- (9) Deregulation.
- (10) Property Rights.

⁷ From Pillsbury (1999).

⁸ From Williamson (2002).

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