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## Lessons from Taiwan for Post-Communist Transition: Another Look

East Asia's stunning economic growth makes it an alluring source of inspiration for economic reforms in the post-communist countries of Eastern Europe and the former Soviet Union (hereafter denoted as EEFSU). Clark and Lam are recent additions to the long list of analysts who have suggested that the reform strategies of the EEFSU should be based on the "lessons" of East Asia, in their case the lessons of Taiwan.<sup>1</sup> According to Clark and Lam, Taiwan began its period of rapid growth in the 1950s with "a state-dominated economy, a highly distorted price and market system, and a government that was suspicious of and somewhat hostile toward the private sector" (p. 113). In essence, "Taiwan in the 1950s was very similar to Eastern Europe and the Commonwealth of Independent States (CIS) after the collapse of communism in terms of its system of real property" (p. 115).

The telling point, according to Clark and Lam is that "Taiwan, in fact, ignored the advice of Western advisors who advocated the privatization of state enterprises. With the slight exception of the state corporations that were used to compensate landlords during the land reform of the early 1950s, privatization of state corporations began only in

1989, forty years after the Nationalists arrived in Taiwan" (p. 111). The key to Taiwan's dynamism was not privatization, but rather the growth of the new private sector. The private sector rose up alongside an extensive state sector, so that "a large state sector there did little to inhibit the development of the island's dynamic capitalism" (p. 116).

The main policy implication, according to Clark and Lam, is that EEFSU should *delay* privatization. According to the authors, privatization has been shown by Taiwan's experience to be unnecessary in the early stages of development. Moreover, the authors surmise that privatization may exacerbate income inequality and undermine the provision of social functions. In the meantime, the further growth of the state sector should be resisted, while market institutions are gradually developed. Their summary slogan is "Rapid Marketization through institution building, but Slow Privatization!" (p. 119)

Unfortunately, Clark and Lam, like many predecessors, fall prey to a basic fallacy: the presumption that the economic structures in East Asia and EEFSU are sufficiently similar to translate the institutional pathways of East Asia to the Eastern Eu-

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ropean or post-Soviet context. While East Asia has much to teach the EEFSU in very general terms — about the value of export-led growth, private ownership, commitments to education, macroeconomic stability — the specific institutional strategies of the two regions must be different, given the differences in economic history, factor endowments, and stages of economic development, as Sachs and Woo have stressed.<sup>2</sup> There are some elementary and powerful reasons why privatization is necessary in the EEFSU, even if it played a marginal role in the early stages of Taiwan's economic takeoff.

### A Comparison of Initial Conditions

Clark and Lam seek to draw lessons from Taiwan's economy of the 1950s and 1960s for EEFSU's economy in the 1990s. Such comparisons should start by recognizing the fundamentally different characteristics of the two settings. As we show in Table 1, Taiwan began its economic takeoff as a low-income, rural, agricultural economy, with 56.1 percent of the employment in the primary (agricultural) sector, and only 16.9 percent of the employment in the secondary sector (mining, manufacturing, construction, utilities). By contrast, Eastern Europe and the Soviet Union began the transition to the market as middle-income, urban, industrial economies. The level of economic development was much higher than in Taiwan, and the proportion of the employment in agriculture was much less than the proportion in industry. Note that the People's Republic of China in 1978, at the start of Deng Xiaoping's market reforms, was much closer in structure to Taiwan in the 1950s than was EEFSU.

Clark and Lam argue that Taiwan was a heavily state-owned economy, but this is an optical illusion resulting from their focus on the industrial sector, which was a very small part of the overall economy. They note that "Government-owned enterprises accounted for 57 percent of the island's industrial production in 1952," but they fail to note that since

Taiwan was still an agricultural economy, the industrial production was merely some 20 percent of GDP in 1952.<sup>3</sup> Thus, state-owned industry accounted for only some 11.4 percent of GDP. The small share of the state-owned sector is even more marked in terms of employment, as we see in Table 2. The public sector accounted for only 12.7 percent of the total employment, while the private sector (including peasant agriculture) accounted for some 87.3 percent of the employment.

Consider the vast difference in conditions in EEFSU at the start of the 1990s. The industrial economy accounted for between 40 percent and 50 percent of GDP, and virtually all of it was state owned. More importantly, employment in the state sector ranged between some 70 percent of the total employment (in Poland) to around 99 percent of the total in the former Soviet Union! Thus, while around 90 percent of Taiwanese employment was in the private sector, around 90 percent of EEFSU employment, on average, was in the state sector at the start of the transition.

### Implications of the Differing Initial Conditions

Clark and Lam think they recognize "state domination" when they see it in Taiwan in the 1950s, but compared with EEFSU, the postwar Taiwanese economy was overwhelmingly private in ownership and operation. This is emphatically true of the overall economy, but even the industrial sector had a significant share of private ownership, around 40 percent. Though state enterprises played a large role in the industrial sector in 1952, the simple fact is that Taiwan was still a poor, agrarian economy, with the peasantry still constituting the bulk of the labor force.

This matters a great deal, since it was the inter-sectoral mobility from agriculture to industry that provided the bulk of new workers in the small, labor-intensive manufactures that blossomed in Taiwan upon the start of outward-oriented growth at

Table 1: Basic Indicators of Development

	China			Taiwan*			Russia			Poland		
<b>A. Per Capita GNP US\$ (current value)</b>												
Year	1980	1984	1993	1952	1965	1993	1990	1991	1992	1982	1989	1992
	280	310	490	196	217	10,852	4,160	3,650	2,830	1,490	1,990	1,970
<b>B. Rural Share of Population (percent)</b>												
Year	1952	1978	1993	1961		1981	1973	1985	1992	1973	1989	1992
Share	87.5	82.1	71.9	70		52	35.2	28.1	25.2	45.8	37.9	36.6
<b>C. Employment Share by Sector (percent)</b>												
Year	1978	1984	1993	1952	1965	1993	1980	1985	1992	1989	1990	1991
Primary	70.5	64.0	56.4	56.1	46.5	11.5	15.0	14.0	14.4	25.7	26.2	26.7
Secondary	17.4	20.0	22.4	16.9	22.3	39.1	42.1	42.0	40.6	37.5	36.5	35.4
Tertiary	12.1	16.0	21.2	27.0	31.2	49.4	42.9	44.0	45.1	36.8	37.3	38.0
<b>D. GDP/GNP Share by Sector (percent)</b>												
Year	1978	1984	1993	1952	1965	1993	1985	1990	1993	1985	1990	1993
Primary	28.4	33.1	21.2	33.2	23.6	3.5	11.9	16.6	8.8	14.5	8.9	6.3
Secondary	48.6	44.8	51.8	19.7	32.2	40.6	50.0	47.6	48.1	51.0	57.2	38.6
Tertiary	23.0	22.0	27.0	48.1	46.2	55.9	38.1	35.8	43.1	34.4	33.9	55.1

\* Taiwan rural share of population equals (1-urban population share), where urban population includes only population in cities whose population exceed 100,000.

Source: 1994 Statistical Yearbook of China; <sup>4</sup> 1994 Taiwan Statistical Data Book; <sup>5</sup> World Bank Statistical Handbook, States of the Former Soviet Union 1993 and 1994; <sup>6</sup> Sachs 1995, Table 2 for 1985 Russia's GDP share data; USSR Facts & Figures Annual, vol. 1, vol. 14 & vol. 15; <sup>7</sup> The Europa World Yearbook 1995; <sup>8</sup> World Tables 1995; <sup>9</sup> World Bank, Trends in Developing Economies 1995; <sup>10</sup> Cheng, 1993. <sup>11</sup> (See endnotes 3-11.)

the end of the 1950s. The agricultural hinterland offered a highly elastic supply of low-wage, literate labor to the newly developing private firms. There is really no mystery, therefore, regarding the main point made by Clark and Lam that non-state firms were able to grow up alongside the state-owned sector. The state sector had neither the dominant weight in employment nor in capital and land markets that would have caused the state sector to stifle the development of the private sector. Nor was the state sector so large by itself that it threatened to undermine public finances in Taiwan. Clark and Lam

underscore the inefficiency of the Taiwanese state sector, noting that many state enterprises are "poorly run and inefficient" (p. 118). The good news is that this inefficiency did not destabilize the rest of the economy, mainly because the state sector was modest in proportion to the overall economy.

Now consider the conditions in EEFSU. In this case, there is no agricultural hinterland that can be the source of growth for the new non-state sector. In fact, at the start of transition, there is virtually no non-state sector whatsoever that can be a source of workers, capital, and land for the new non-state

Table 2: Distribution of Employment by Ownership (percent)

Year	China			Taiwan*			Russia			Poland*		
	1978	1984	1993	1952	1965	1993	1980	1987	1991	1970	1980	1989
State Sector	18.6	17.9	18.1	12.7	14.6	11.8	98.9	98.8	92.4	68.0	73.4	70.3
Non-state Sector	81.4	82.1	81.9	87.3	85.4	88.2	1.1	1.2	7.6	32.0	26.6	29.7

Notes on state and non-state sectors:

- For Taiwan and Poland, state sector refers to public sector or government sector plus public enterprises; non-state sector refers to private sector.
- For China, state sector means state-owned units, while non-state sector comprises of collectively owned units, joint-management economic units, stock-ownership economic units, joint ventures, private enterprises, individuals, and others.
- For Russia, state sector means state sector, leased enterprises, economic associations, social organizations, collective farms; and non-state sector comprises of joint-stock companies, joint ventures, cooperatives, individual labor, private subsidiary agriculture and private agriculture.

Source: 1994 Statistical Yearbook of China; Yearbook of Manpower Survey Statistics Taiwan Area, Republic of China 1993; <sup>12</sup> World Bank, Statistical Handbook 1994, States of Former Soviet Union; Central Statistical Office, Poland 1990 Statistical Data. <sup>13</sup> (See endnotes 4, 6, 12, and 13).

sector. If the new entrepreneurial non-state sector was to develop, it had to come, almost by definition, from a shrinkage of the existing state sector. In pure resource terms, this was feasible, since the preexisting state sector was vastly overmanned and inefficient, and therefore capable of freeing up considerable amounts of capital, resources, and labor.

In political-economic terms, however, the situation in the EEFSU was vastly more complicated than in Taiwan. Employment in state-owned industry in the EEFSU was highly subsidized before the start of the transition process. Enterprises received direct subsidies from the budget, cheap credits from state banks, raw-material inputs far below world prices, subsidized imports, and other non-market provision of resources with large implicit subsidization. The so-called soft-budget constraint on the enterprises guaranteed that they could honor pledges to workers of guaranteed employment and access to a myriad of social services. The state subsidies for industry were financed in a variety of ways, including the depletion of natural resources, despoilation of the environment, borrowing from abroad, and the exhaustion of foreign-exchange reserves. As the limits were reached on these forms of financing, gov-

ernments turned to the inflation tax as a last resort, sending inflation rates to triple-digit or quadruple-digit annual rates throughout the region.

As long as the large implicit and explicit subsidies remained in place, workers could not be coaxed to leave protected and subsidized state jobs for the vagaries of the private sector, even when the social product in the private sector was much above that of the state sector.<sup>14</sup> Thus, in order to induce the rise of the new private sector — as well as to stabilize the macro-economy — it was necessary to cut subsidies sharply and to introduce market competition for the enterprises. All this was done with the knowledge that there would have to be a significant downsizing of employment and production at the existing industrial enterprises, with all of the attendant political uncertainties and opposition that such downsizing would entail.

Moreover, it was recognized from the start that subsidy cuts and market competition would not be enough to discipline the enterprises. They desperately needed new management, both depoliticized and more attuned to market forces. While Taiwan could accept some degree of inefficiency in its state enterprises for two or three decades, EEFSU could

not, for several reasons. First, the state-owned enterprises accounted for a vastly greater share of the total economy, so that continued inefficiency would have much more consequential adverse effects.

Second, as soon as the heavy repression of the communist state was lifted at the end of the 1980s, workers, managers, local officials, and the central bureaucracy began to strip the state enterprises of assets and income. Salaries and wages soared, sending the enterprises into the red. Similarly, state managers quickly learned to set up private companies as conduits for the enterprise profits, in effect privatizing the enterprise income while socializing the bad debts.<sup>15</sup> While Taiwan could exercise state control over a few dozen large state enterprises, the post-communist governments of EEFSU had no possibility whatsoever to exercise long-term administrative, economic, and political control over workers and managers in literally thousands of large-scale enterprises within each economy. Poland began the transition with an estimated 8,000 large enterprises, and Russia counted around 25,000 large state-owned firms.<sup>16</sup>

### Early Results of Transition in EEFSU

These arguments might appear purely hypothetical were it not for the first five years of market reforms in the region. We have been able to garner several lessons in that period.<sup>17</sup>

- The heavy industrial enterprises were forced to retrench, as all EEFSU economies experienced a sharp downturn in industrial production at the start of transition. This sharp down-

turn occurred in every kind of reform program: radical, gradual, and mixed.

- Countries that undertook faster market reforms, e.g., the Czech Republic, Estonia, Poland, and Slovenia, achieved a faster restoration of economic growth.
- Rapid privatization has proved to be administratively and politically feasible, with the voucher scheme in the Czech Republic the clearest case of rapid privatization.
- Countries that failed to achieve stabilization, such as Russia, imposed much heavier social costs upon the population than did countries undertaking decisive stabilization programs.
- Much of the new growth in the reforming countries has come from new small- and medium-sized (SMEs) private firms, reminiscent of the growth experience in Taiwan. Nonetheless, the growth of the SME sector has depended on the rapid downsizing of the large state-owned enterprise sector.

We can say that the East Asian experience, including Taiwan's, contains several important lessons for EEFSU, though not the lesson on privatization emphasized by Clark and Lam. While EEFSU should indeed privatize and downsize the state sector, it should also heed the real lessons of East Asia with regard to: the crucial role of openness and export orientation of the economy; the importance of small- and medium-sized enterprises for entrepreneurial dynamism; the need for macroeconomic stability, based on prudent fiscal and monetary policies; a tax system that promotes savings and investment; and a long-term emphasis on the development of human skills.

### Notes

1. Cal Clark and Danny Kin-Kong Lam, "Taiwan's Experience with Privatization and Its Implications for the Former Soviet Bloc," *Business & the Contemporary World* 7, no. 1 (1995): 107-23. Other analysts who take a position



- similar to that of Clark and Lam include, for example, J. McMillan and B. Naughton, "How to Reform a Planned Economy: Lessons from China," *Oxford Review of Economic Policy* 8, no. 1 (Spring 1992): 130-43.
2. Sachs and Woo, "Structural Factors in the Economic Reforms of China, Eastern Europe, and the Former Soviet Union," *Economic Policy* 18 (April 1994): 101; and Jeffrey, D. Sachs, "Reforms in Eastern Europe and the former Soviet Union in Light of the East Asian Experience." Presented at the NBER-TCER-CEPR Conference on Transition from Socialist Economies, January 6-7, 1995, Tokyo, Japan.
  3. Even this official estimate of the share of industry in GDP probably overstates the actual share, since price controls on agriculture and undercounting of small, non-industrial enterprises in the primary and tertiary sectors would tend towards an *overestimate* of the share of the industrial sector in the total economy. See J. McMillan and B. Naughton, "How to Reform a Planned Economy: Lessons from China," *Oxford Review of Economic Policy* 8, no. 1 (Spring 1992): 130-43.
  4. State Statistical Bureau, People's Republic of China, *Statistical Yearbook of China*, 1992, 1993 and 1994.
  5. Council for Economic Planning and Development, Republic of China, *Taiwan Statistical Data Book*, 1994 and 1995.
  6. World Bank, *Statistical Handbook, States of the Former Soviet Union*, 1993 and 1994.
  7. Alan P. Pollard, *USSR Facts & Figures Annual 15*, Academic International Press, 1991; Pollard, *USSR Facts & Figures Annual 14*, Academic International Press, 1990; Pollard, *USSR Facts & Figures Annual 1*, Academic International Press, 1977.
  8. Europa Publication Limited, *The Europa World Year Book 1995* (London, England: Europa Publication, 1995).
  9. World Bank, *The World Bank World Tables 1995* (Baltimore, MD: The Johns Hopkins University Press, 1995).
  10. World Bank, *Trends in Developing Economies 1995* (Washington, DC: The World Bank, 1995).
  11. Tun-jen Cheng, "Taiwan in Democratic Transition," *Driven by Growth* (New York: M.E. Sharpe, 1993), 200.
  12. Director-General of Budget, Accounting and Statistics, Executive Yuan, Republic of China, *Yearbook of Manpower Survey Statistics Taiwan Area, Republic of China 1993*, 1993.
  13. Central Statistical Office, *Poland 1990 Statistical Data* (Warszawa, Poland: Central Statistical Office, 1990), 26.
  14. By contrast, peasants in Taiwan were not heavily subsidized. They were eager to find jobs in the emerging private industrial sector, even at extremely low wages and difficult working conditions.
  15. In a standard ploy, the state manager would set up a private shell company, which would lease the enterprise assets at a de minimus price.
  16. M. Boycko, A. Shleifer, and R. Vishny, *Privatizing Russia* (Cambridge, MA: The MIT Press, 1995): 71.
  17. For further details see L. Balcerowicz, and A. Gelb, "Macropolicies in Transition to the Market Economy: A Three-Year Perspective," *Proceedings of the Annual Conference on Development Economics 1994*, Washington, DC, World Bank, 1995, 21-56; J. Sachs and A. Warner, "Economic Reform and the Process of Global Integration," *Brookings Papers on Economic Activities*, no. 1, 1995, 1-118; and Sachs, "Reforms in Eastern Europe and the Former Soviet Union."